STATE OF ILLINOIS
SECRETARY OF STATE
SECURITIES DEPARTMENT

IN THE MATTER OF: JANNEY MONTGOMERY SCOTT L.L.C.	)	**FILE NO. 0400652**

CORRECTED NOTICE OF HEARING

TO THE RESPONDENT: Janney Montgomery Scott L.L.C.
(B/D #: 463)
1801 Market Street
Philadelphia, Pennsylvania 19103-1675

You are hereby notified that pursuant to Section 11.F of the Illinois Securities Law of 1953 [815 ILCS 5} (the "Act") and 14 Ill. Adm. Code 130, Subpart K, a public hearing will be held at 69 West Washington Street, Suite 1220, Chicago, Illinois 60602, on the 19th day of January, 2005, at the hour of 10:00 a.m., or as soon as possible thereafter, before James G. Athas, Esq. or such other duly designated Hearing Officer of the Secretary of State.

Said hearing will be held to determine whether an Order shall be entered revoking Janney Montgomery Scott L.L.C.'s (the "Respondent") registration as a dealer in the State of Illinois and/or granting such other relief as may be authorized under the Act including but not limited to the imposition of a monetary fine in the maximum amount pursuant to Section 11.E(4) of the Act, payable within ten (10) business days of the entry of the Order.

The grounds for such proposed action are as follows:

1. That at all relevant times, the Respondent was registered with the Secretary of State as a dealer in the State of Illinois pursuant to Section 8 of the Act.

2. That on August 25, 2004, the United States Securities and Exchange Commission (SEC) entered an Order Instituting ADMINISTRATIVE

AND CEASE AND DESIST PROCEEDINGS, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER (Order) in administrative Proceeding File No. 3-11604 against the Respondent which imposed the following sanctions:

a. Cease and desist from committing or causing any violations and any future violations of Section 17(b) of the Securities Act and Section 17(a) of the Exchange Act and Rule 17a-4 promulgated thereunder;

b. Censure; and

c. Pay a civil money penalty in the amount of $875,000.

3. That the Order found:

a. Respondent is a broker-dealer registered with the Commission pursuant to Section 15(b) of the Exchange Act and is a member of NASD, Inc. and the New York Stock Exchange, Inc. Its' principal place of business is in Philadelphia, Pennsylvania.

b. During 1999 and 2000, the Respondent received three payments in consideration for publishing research on three public companies. The Respondent did not disclose those payments in its research reports. The firm's failure to disclose these payments were in violation of Section 17(b) of the Securities Act.

In addition, from July 1999 through June 2001, the Respondent failed to preserve business-related internal electronic mail communications that it was required to maintain pursuant to Section 17(a) of the Exchange Act and Rule 17a-4 thereunder.

c. During the period 1999 through at least 2003, broker-dealer that were underwriting public offerings sometimes paid other broker-dealers to issue research on or "cover" their issuer clients. These arrangements were made with regard to both initial public offerings ("IPOs") and secondary offerings. In some situations, the issuers directed the lead underwriters to make the payments, and in others, the lead underwriters selected the firms that received the payments. Some firms issuing the research actively solicited the payment.

In certain instances, the payments were made to firms that were not participating in the underwriting, and therefore not earning investment banking fees from the issuer on the particular offering.

In other instances, firms that were underwriting small portions of the offering received additional payments in consideration for publishing research. These payments often were significantly larger than the underwriting fee the firm received.

Section 17(b) of the Securities Act requires that any person who receives consideration, directly or indirectly, from an issuer, underwriter, or dealer for issuing research must fully disclose the receipt of the payment (whether past or prospective) and the amount. However, the broker-dealers that received these payments failed to disclose in their research reports that they received payment for publishing research.

d. The Respondent **Did Not Disclose Its Receipt of Payments In Consideration for Publishing Research**

On three occasions during 1999 and 2000, the Respondent received payments from other investment banking firms for research coverage of those firms' investment banking clients (the "issuers"). These payments ranged in amounts from $23, 800 to $50,000. The Respondent published research regarding these issuers without disclosing in the reports the receipt of the consideration and the amount received. The Respondent had previously been covering the issuers prior to becoming aware that it would receive the payments.

For example, on May 31, 2000, the Respondent was paid $23,800 by the lead underwriter for issuing research on Whitehall Jewellers, Inc. ("Whitehall") in connection with a February 29, 2000 secondary offering. An internal memorandum of the Respondent stated the "entire check was specifically for research coverage." The Respondent issued research reports on Whitehall on May 4 and 24, 2000. Although the Respondent was aware at the time that it issued the reports that it would be paid for issuing the research, the research reports did not disclose the $23,800 payment.

In another instance, on June 13, 2000, the Respondent received a $25,299 payment from an investment bank in consideration for research in connection with a March 21, 2000 securities offering for Diamond Technology Partners, Inc. ("Diamond Technology"). An internal memorandum of the Respondent stated the "payment {the Respondent} received was specifically for research coverage." The respondent issued a research report on Diamond

Technology on April 25, 2000. Although the Respondent was aware at the time that it issued the report that it would be paid for issuing the research, it did not disclose in the report the $25,299 payment.

By failing to disclose in these research reports that it had received payment for issuing that research, the Respondent violated Section 17(b) of the Securities Act.

e. **The Respondent Failed to Maintain Electronic Mail Communications.**

From July 1999 through June 2001, The Respondent's employees used e-mail to conduct The Respondent's business as a broker, dealer and member of an exchange. During that period, The Respondent failed to preserve copies of business-related e-mail as required under Section 17(a)(1) of the Exchange Act and Rule 17a-4 thereunder. Although The Respondent retained "external" e-mail (e-mail that was sent to someone outside the firm), it did not preserve all of its "internal" e-mail (e-mail that was sent only between employees of the firm) that related to its business. As a result, the Commission did not have access to that e-mail in connection with the investigation that resulted in this proceeding.

f. **The Respondent Violated Section 17(b) of the Securities Act.**

Section 17(b) of the Securities Act provides: It shall be unlawful for any person, by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, to publish, give publicity to, or circulate any notice, circular, advertisement, newspaper, article, letter, investment service, or communication which, though not purporting to offer a security for sale, describes such security for a consideration received or to be received, directly or indirectly , from an issuer, underwriter, or dealer, without fully disclosing the receipt, whether past or prospective, of such consideration and the amount thereof.

15 U.S.C § 77q(b).

In order to violate Section 17(b), a person must "(1) publish or otherwise circulate (using a means of interstate commerce), (2) a notice or type of communication (which describes a security), (3) for consideration received (past, currently, or prospectively,

directly or indirectly), (4) without full disclosure of the consideration received and the amount." *SEC v. Gorsek*, 222 F. Supp. 2d 1099, 1105 (C.D. Ill. 2001). Courts have held that Section 17(b) does not require a showing of scienter. *SEC v. Liberty Capital Group, Inc.* 75 F. Supp. 2d 1160, 1163 (W.D. Wash. 1999); *SEC v. Huttoe*, 1998 WL 34078092 (D.D.C Sept. 14, 1998).

The Respondent published and circulated communications in the form of research reports that described certain securities for consideration received, but did not disclose the receipt or amount of these payments. As a result, investors did not receive information relating to the objectivity of the research.

g. **The Respondent Violated Section 17(a)(1) of the Exchange Act and Rule 17a-4 Thereunder.**

Section17(a)(1) of the Exchange Act provides that each member of a national securities exchange, broker, or dealer "shall make and keep for prescribed periods such records, furnish copies thereof, and make and disseminate such reports as the Commission, by rule, prescribes as necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of this title."

The Commission has emphasized the importance of the records required by the rules as "the basic source documents" of a broker-dealer. *Statement Regarding the Maintenance of Current Books and Records by Brokers and Dealers*, 4 SEC Docket 195 (April 6, 1974). The record keeping rules are "a keystone of the surveillance of broker and dealers by [Commission] staff and by the securities industry's self-regulatory bodies." *Edward J. Mawod & Co.*, 46 S.E.C. 865, 873 n.39 (1977) citation omitted), *aff'd sub nom Mawod & Co. V. SEC*, 591 F.2d 588 (10th Cir. 1979).

Pursuant to its authority under Section 17(a)(1) of the Exchange Act, the Commission promulgated Rule 17a-4. Rule 17a-4(b)(4) in turn requires each broker-dealer to "preserve for a period of not less than 3 years, the first two years in an accessible place....[o]riginals of all communications received and copies of all communications sent by such member, broker or dealer (including inter-office memoranda and communications) relating to this business as such." Rule 17a-4 is not limited to physical documents. The Commission has stated that internal electronic

mail communications relating to a broker-dealer's "business as such" fall within the purview of Rule 17a-4 and that, for the purposes of Rule 17a-4, "the content of the electronic communication is determinative" as to whether that communication is required to be retained and accessible. *Reporting Requirements for Brokers or Dealers under the Securities Exchange Act of 1934*, Rel. No. 34-38245 (Feb. 5, 1997).

From July 1999 through June 2001, The Respondent failed to preserve business-related internal e-mail for three years in violation of Section 17(a)(1) of the Exchange Act and Rule 17a-4 thereunder.

h. Based on the foregoing and The Respondent's Offer of Settlement, the Commission finds that with respect to payments received for the issuance of research, The Respondent willfully violated Section 17(b) of the Securities Act by publishing communications that described securities for consideration received, directly from an underwriter, without disclosing the receipt of such consideration and the amount thereof.

Based on the foregoing and The Respondent's Offer of Settlement, the Commission finds that with respect to electronic mail communications during the relevant period, The Respondent willfully violated Section 17(a) of the Exchange Act and Rule 17a-4 promulgated thereunder by failing to preserve business-related internal electronic mail communications for three years.

4. That Section 8.E(1)(k) of the Act provides, inter alia, that the registration of a dealer may be revoked if the Secretary of State finds that such dealer has any order entered against it after notice and opportunity for a hearing by the United States Securities and Exchange Commission arising from any fraudulent or deceptive act or a practice in violation of any statute, rule, or regulation administered or promulgated by the agency.

5. That the Respondent had notice and opportunity to contest the issues in controversy, but chose to resolve the matter with the SEC.

6. That by virtue of the foregoing, the Respondent's registration as a dealer in the State of Illinois is subject to revocation pursuant to Section 8.E(1)(k) of the Act.

You are further notified that you are required pursuant to Section 130.1104 of the Rules and Regulations (14 Ill. Adm. Code 130) (the "Rules"), to file and answer to the allegations outlined above within thirty (30) days of the receipt of this notice. A failure to file an answer within the prescribed time shall be construed as an admission of the allegations contained in the Notice of Hearing.

Furthermore, you may be represented by legal counsel, may present evidence, may cross-examine witness and otherwise participate. A failure to so appear shall constitute default, unless any Respondent has upon due notice moved for and obtained a continuance.

A copy of the Rules, promulgated under the Act and pertaining to hearings held by the office of the Secretary of State, Securities Department, is included with this Notice.

Delivery of Notice to the designated representative of any Respondent constitutes service upon such Respondent.

DATED: This 1st day of December 2004.

JESSE WHITE
Secretary of State
State of Illinois

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