

NEW YORK STOCK EXCHANGE, INC.

EXCHANGE HEARING PANEL DECISION 03-71

April 22, 2003

U.S. BANCORP PIPER JAFFRAY INC.
MEMBER ORGANIZATION

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Violated Exchange Rules 476(a)(6) and 401 by engaging in acts that created or maintained inappropriate influence by the investment banking department over research analysts, therefore imposing conflicts of interest on its research analysts, by failing to manage these conflicts in an adequate or appropriate manner, by threatening to drop research coverage if the Firm was not selected as a lead manager in an investment banking transaction, by issuing certain research reports that did not provide a sound basis for evaluating companies, by making payments for research to other broker-dealers for research coverage and by failing to disclose or cause to be disclosed such payments in offering documents or elsewhere, by receiving payments for research without disclosure; violated Exchange Rule 472 by issuing certain research reports that contained opinions for which there was no reasonable basis and by making payments to other broker-dealers for research, by failing to disclose or cause to be disclosed such payments in offering documents or elsewhere, and by receiving payments for research in conjunction with underwriting transactions without disclosing receipt of such payments; and violated Exchange Rule 342 by failing to establish and maintain adequate policies, systems, and procedures for supervision and control of its research and investment banking departments – Consent to censure, a total payment of \$32,500,000 and an undertaking.

Appearances:

For the Division of Enforcement
David P. Doherty, Esq.
Robert A. Marchman, Esq.
Linda S. Riefberg, Esq.
Jeanne R. Elmadany, Esq.
Suzanne R. Elovic, Esq.
Samantha Hankins, Esq.
James E. Shipley, Jr., Esq.

For the Respondent
Phillip Goldberg, Esq.
James Chosy, Esq.

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An Exchange Hearing Panel met to consider a Stipulation and Consent¹ entered into between the Exchange's Division of Enforcement and U.S. Bancorp Piper Jaffray Inc. ("Piper Jaffray" or the

¹ This document is a "Stipulation and Consent" as the term is used in Exchange Rule 476(g), which authorizes an Exchange Hearing Panel to accept findings of fact to which the parties consented without the presentation of evidence or testimony.

“Firm”), a member organization of the Exchange. Without admitting or denying the allegations in the Stipulation and Consent the Firm consents to findings by the Hearing Panel that the Firm:

- I. Violated Exchange Rule 476(a)(6) by engaging in conduct inconsistent with just and equitable principles of trade by:
 - A. Engaging in acts and practices that created or maintained inappropriate influence by the Investment Banking Department over research analysts, therefore imposing conflicts of interest on its research analysts, and failing to manage these conflicts in an adequate or appropriate manner;
 - B. Threatening to drop research coverage if the firm was not selected as a lead manager in an investment banking transaction, as described below;
 - C. Issuing research reports on Esperion Therapeutics, Inc., and Triton Network Systems that did not provide a sound basis for evaluating facts regarding those companies’ business prospects, contained exaggerated or unwarranted claims about those companies, and/or contained opinions for which there was no reasonable basis;
 - D. Making payments for research to other broker-dealers not involved in an underwriting transaction when the firm knew that these payments were made, at least in part, for research coverage, and by failing to disclose or cause to be disclosed in offering documents or elsewhere the fact of such payments; and
 - E. Receiving payments for research from other broker-dealers in conjunction with underwriting transactions without disclosing receipt of such payments, in violation of Section 17(b) of the Securities Act of 1933.
- II. Violated Exchange Rule 401 by failing to adhere to the principles of good business practice in the conduct of its business affairs by:
 - A. Engaging in acts and practices that created or maintained inappropriate influence by the Investment Banking Department over research analysts, therefore imposing conflicts of interest on its research analysts, and failing to manage these conflicts in an adequate or appropriate manner;
 - B. Threatening to drop research coverage if the firm was not selected as a lead manager in an investment banking transaction, as described below;
 - C. Issuing research reports on Esperion Therapeutics, Inc., and Triton Network Systems that did not provide a sound basis for evaluating facts regarding those companies’ business prospects, contained exaggerated or unwarranted claims about those companies, and/or contained opinions for which there was no reasonable basis;

- D. Making payments for research to other broker-dealers not involved in an underwriting transaction when the firm knew that these payments were made, at least in part, for research coverage, and by failing to disclose or cause to be disclosed in offering documents or elsewhere the fact of such payments; and
 - E. Receiving payments for research from other broker-dealers in conjunction with underwriting transactions without disclosing receipt of such payments, in violation of Section 17(b) of the Securities Act of 1933.
- III. Violated Exchange Rule 472 relating to communications with the public by:
- A. Issuing research reports on Esperion Therapeutics, Inc., and Triton Network Systems that did not provide a sound basis for evaluating facts regarding those companies' business prospects, contained exaggerated or unwarranted claims about those companies, and/or contained opinions for which there was no reasonable basis;
 - B. Making payments for research to other broker-dealers not involved in an underwriting transaction when the firm knew that these payments were made, at least in part, for research coverage, and by failing to disclose or cause to be disclosed in offering documents or elsewhere the fact of such payments; and
 - C. Receiving payments for research from other broker-dealers in conjunction with underwriting transactions without disclosing receipt of such payments, in violation of Section 17(b) of the Securities Act of 1933.
- IV. Violated Exchange Rule 342 by failing to establish and maintain adequate policies, systems, and procedures for supervision and control of the Research and Investment Banking Departments reasonably designed to detect and prevent the foregoing investment banking influences and conflicts of interest, including a separate system of follow-up and review to assure compliance with applicable Exchange Rules and federal securities laws.

For the sole purpose of settling this disciplinary proceeding, prior to hearing, without adjudication of any issues of law or fact, and without admitting or denying allegations, facts, conclusions or findings referred to herein, the Firm consents to findings by the Hearing Panel, the substance of which is as follows:

Background and Jurisdiction

1. Piper Jaffray is a broker dealer with its principal place of business in Minneapolis, Minnesota. The firm engages in a full-service securities business, including retail and institutional sales, investment banking services, trading, and research.

2. Piper Jaffray is registered with the Securities and Exchange Commission, is a member of the Exchange and NASD Inc. (“NASD”), and is licensed to conduct its securities business on a nationwide basis.
3. This action concerns the years 1999, 2000, and 2001 (the “relevant period”). During that time, Piper Jaffray engaged in both research and investment banking (“IB”) activities.
4. At various times during the relevant period, Piper Jaffray placed undue emphasis on utilizing its research analysts to maximize its opportunities to obtain investment banking revenues from companies in the technology, telecommunications, and biotechnology industry sectors. Such emphasis on obtaining investment banking revenue created conflicts of interest for the research analysts that in two instances resulted in the issuance of research reports that violated Exchange Rule 472. Piper Jaffray failed adequately to monitor and supervise the conflicts of interest inherent in seeking investment banking opportunities from companies covered by Piper Jaffray research analysts. Piper Jaffray’s violative conduct, described herein, was caused by a flawed organizational structure, combined with inadequate supervision of the conflicts of interest.
5. Piper Jaffray grouped its research analysts by industry sector and those analysts worked as a team with the firm’s investment bankers, who focused on the same industry sector. The majority of research analysts’ compensation was paid in the form of a bonus, which for some analysts was directly tied to revenues from investment banking transactions of companies in their industry sector. In other cases, the analyst’s contribution to investment banking revenue, and investment banker input into analysts’ evaluations played a significant part in determining the analysts’ bonuses. In certain cases, investment bankers commented in reviews that research analysts needed to become lead analysts, a reference to using their professional opinions and reports to assist the firm in obtaining the top role in investment banking transactions. As a result of these influences, certain Piper Jaffray research analysts indirectly were motivated to obtain, retain and increase investment banking revenue.
6. In certain instances, Piper Jaffray also provided draft research reports to potential investment banking clients during sales pitches, and this implicit promise of favorable research was an important aspect of Piper Jaffray’s attempts to gain the companies’ investment banking business. In other instances, after determining to issue research, Piper Jaffray provided company executives with draft reports, including the proposed rating and target price, and solicited comments on the report from those company executives.
7. Piper Jaffray failed to disclose that it received compensation from the proceeds of underwriting for, among other services, providing research. It also paid proceeds of certain underwritings to other broker dealer firms to issue research on companies whose offerings it underwrote and did not ensure that such payments were disclosed.

8. Finally, in one instance, Piper Jaffray engaged in improper behavior by threatening to drop research coverage on a company if Piper Jaffray did not receive a certain role in the company's offering of securities.

Piper Jaffray's Structure and Procedures Encouraged Research Analysts to Contribute to Investment Banking Revenue, Thus Creating Conflicts of Interest

Overview of Piper Jaffray and the Financial Contribution of its Equity Capital Markets Division

9. U.S. Bancorp Piper Jaffray Inc. was founded in 1895.² The firm is headquartered in Minneapolis, Minnesota, and has approximately 3,100 employees, including approximately 875 financial advisers, more than 80 investment bankers, and approximately 70 research analysts. Piper Jaffray has operations in 124 offices in 25 states throughout the country.
10. During the relevant period, Piper Jaffray's business included retail brokerage, known as Private Advisory Services; fixed income underwriting, sales and trading (known as Fixed Income Capital Markets); and equities investment banking, syndicate, research, and institutional sales and trading (known as Equity Capital Markets or "ECM"). Thus, equity research and investment banking were in the same business line and, ultimately, reported to the same individual.
11. In 1998, Piper Jaffray generated equity investment banking revenue of approximately \$79,500,000. That increased by 100 percent to approximately \$159,000,000 in 1999. In 2000, revenue from equity investment banking grew to approximately \$269,200,000, a 69 percent increase over 1999. In 2001, Piper Jaffray's revenue from equity investment banking was approximately \$153,000,000. From 1999 through 2001, revenue from equity investment banking represented a significant portion of the firm's revenue, accounting for between 19 – 26 percent of the firm's total revenue.

Piper Jaffray Aligned Research Analysts With the Firm's Investment Bankers

Piper Jaffray Developed and Implemented Specific Plans
to Have Research Analysts Work With Investment Bankers
in an Effort to Obtain Investment Banking Business

12. During the relevant period, many companies, particularly those in the technology area, issued stock through public offerings, and there was intense competition among investment banking firms to obtain this business. In order to maximize its chances to participate in these offerings, Piper Jaffray made a concerted effort to include its research analysts in its solicitation of this business. This effort included developing and implementing specific marketing plans, which provided for research analyst involvement in the investment banking process.

² U.S. Bancorp acquired Piper Jaffray Inc., as a subsidiary in 1998.

Move to the Left Strategy

13. In May 2000, Piper Jaffray's ECM Operating Committee amended its procedures and strategies in a specific effort to gain lead manager status in more offerings. The Lead Manager is the firm typically listed on the left side of the offering prospectus. Thus, Piper Jaffray implemented a plan referred to as the "Move to the Left Strategy." The ECM Operating Committee noted its strong commitment to a "multi-pronged strategy" to obtain lead-manager status on offerings. In instructions to ECM employees, the ECM Operating Committee stated that the firm "must begin to wage a war in earnest for lead-manager status." That plan instituted a "line in the sand" policy: The firm would not accept a syndicate position in any deal unless the firm was placed in the major bracket for the underwriting.
14. The Research Department played an important role in the firm's Move to the Left Strategy. Specifically, to develop a "lead manager mentality," the firm developed a "lead manager Red Zone training program." That program called for the senior bankers, senior research analysts, and Capital Markets personnel to "go through this special training seminar [focused] on pitching for the lead on public equity transactions."

Lead Manager Protocol

15. In August 2000, the head of ECM's syndicate department prepared another specific effort to gain additional lead managed offerings. In setting out his new "Lead Manager Protocol" to all ECM employees, the head of the syndicate department stressed that the "formal protocol of responsibilities ... will allow all of us—Investment Banking, Research, Sales, Trading and Capital Markets—to share responsibility for the success of each and every lead-managed offering."
16. The Lead Manager Protocol, issued in August 2000, called for:
 - the lead banker and lead research analyst to make a presentation to the firm's Pre-Commitment Committee before any company would be considered for an underwriting;
 - the research analyst to participate in a "get-to-know-you" session with prospective investment banking clients as part of a "Day at Piper" session;
 - the lead banker and senior analyst to re-present the prospective company client to the Commitment Committee. The lead banker and "senior analyst must demonstrate continued due diligence effort and must provide renewed commitment to the transaction";

- research and sales to “set up a roadshow schedule to ensure a targeted and efficient roadshow...[and] focus on ascertaining the right accounts to see and why these are the right accounts;”
 - senior analysts to “provide aggressive pre-meeting preparation and post-meeting follow-up to each 1-on-1 appointment;”
 - senior analysts to be “available during critical parts of roadshow and pricing”; and
 - the senior analyst to “coordinate with Capital Markets to sort out the aftermarket intentions of each account.”
17. The Lead Manager Protocol described a primary function of a research analyst in communicating regarding the progress of the transaction once the firm had obtained a lead management role in an IPO when it stated: “Senior analyst will coordinate with Capital Markets to communicate a consistent message regarding the progress of the transaction, acting as a supporter of Capital Markets’ message and not as an independent filter The goal of the [s]enior analyst is to reinforce reasonable and exceedable expectations.”

**Research Analysts “Pitched” for Investment Banking Deals and
Advocated for the Issuer at Roadshows**

18. Piper Jaffray’s procedures allowed for the close alignment of research analysts with investment bankers in the same industry sector. ECM marketed to potential clients its research coverage, market making and institutional sales as part of the firm’s efforts to obtain investment banking business. Piper Jaffray used the slogan, “One Team, One Business” in its marketing materials with prospective investment banking clients. Internally, the company had “transaction teams” that included investment bankers and research analysts.
19. The emphasis on securing investment banking business through pitches and then selling the securities through roadshows gave rise to conflicts of interest for the research analysts. In some instances, the research analyst became a prime contact person for the company with respect to soliciting investment banking business. For example, on May 10, 1999, a research analyst wrote to an officer of E-Machines, a potential investment banking client: “This is my final appeal to be a part of the underwriting team. This is your deal and you control the strings. All we are looking for is ten percent of the economics to participate in the underwriting. This itself should be indicative of my sincere interest in your story ... In the final analysis, it is less important to have bulge bracket firm as a hood ornament than it is to have a quality analyst who will provide you with the support and coverage your company needs.”

Research Analysts' Participation in Pitch Meetings Was Important in Obtaining Investment Banking Mandates

20. Before Piper Jaffray made its “pitches” to an issuer for investment banking business, the investment banker, teamed with a research analyst for the appropriate sector, would make a presentation to Piper Jaffray’s Pre-Commitment Committee. This presentation included a recommendation and analysis detailing why the firm should pursue an investment banking relationship with the issuer. After Piper Jaffray determined to compete for a company’s investment banking business, particularly in the case of an initial public offering (“IPO”), the research analyst’s role was influential in obtaining that business.
21. One aspect of a research analyst’s function was to play a key role in the process to “pitch” Piper Jaffray to the prospective client. In certain instances, a research analyst’s role at a pitch meeting with an issuer was to assist investment banking personnel in convincing the issuer that Piper Jaffray should be chosen as the lead managing underwriter for the offering. A research analyst’s presence suggested that the Research Department would work hand-in-hand with the investment bankers to provide service and support for the issuer. Research analysts routinely appeared with investment bankers at pitch meetings designed to help sell Piper Jaffray to the potential client and provided information relating to their research in pitchbooks given to prospective client companies.

In Certain Instances, Pitchbooks Provided to Potential Investment Banking Clients Contained Mock Research Reports Impliedly Promising Favorable Research

22. When investment bankers and research analysts presented “pitches” to prospective investment banking clients, Piper Jaffray typically gave the prospective client a pitchbook explaining the proposed services to be provided by the firm. These pitchbooks detailed, in a most favorable manner, why Piper Jaffray should be selected to underwrite the offering. In addition to providing information about how Piper Jaffray would conduct the underwriting, the pitchbooks routinely included a roadmap of the amount and type of research coverage that Piper Jaffray would provide to support the company if it obtained the investment banking business. In certain instances, Piper Jaffray included a “mock” research report for the companies, containing a valuation analysis and “mock” rating such as “buy,” impliedly promising to the issuer that the research analyst would issue a favorable research report if it selected Piper Jaffray for the investment banking business. In some instances, Piper Jaffray’s mock research reports also included a favorable “mock” target price for the issuer’s stock.
23. For example, in August 2000, Piper Jaffray made a pitch to be the lead underwriter for an offering by TheraSense, a medical technology issuer. In preparing for the pitch, a research analyst prepared a mock research report about the issuer and presented that mock report at the pitch meeting. The mock research report noted in

several places a proposed rating of “Strong Buy.” The mock report contained very positive news about the company, claiming that its initial sales of the product were “nothing short of breathtaking.” In part, as a result of that pitch, the company awarded Piper Jaffray the role of lead managing underwriter, which generated underwriting fees of \$3,785,512 for the firm when the offering went effective in October 2001. Piper Jaffray initiated coverage of the issuer with a “Strong Buy” recommendation shortly after the offering went effective.

24. Finally, after Piper Jaffray was awarded an investment banking mandate, another key function for a research analyst was to provide meaningful support to the firm’s institutional investor clients to ensure that an underwriting was successful. Investment bankers, research analysts and company representatives generally traveled to the offices of institutional investor clients, to meet with them and describe the offering and determine their interest in purchasing the stock. At times, research analysts attended and provided significant assistance at these “roadshow” meetings.

***Piper Jaffray Tied Research Analysts’ Compensation to
Investment Banking Revenue***

25. During the relevant period, Piper Jaffray compensated research analysts, in part, based on the amount of investment banking revenue generated within their respective industry sector. This practice created a conflict of interest for research analysts, since analysts were compensated, in part, on issuing objective research and on the firm’s success in obtaining investment banking business.
26. Specifically, Piper Jaffray paid certain analysts a percentage of investment banking revenue and institutional commissions generated by companies in their industry sector. The firm entered into written agreements with at least 16 research analysts to pay them a defined percentage of the revenue generated by the companies they covered. This included revenue from net underwriting profits, institutional sales commissions, trading commissions, equity and debt management fees, mergers and acquisition advisory fees, equity and debt private placement fees, research checks, and syndicate trading profits. The defined percentage set forth in these written agreements ranged from a guaranteed 7 to 15 percent of the revenues generated by the companies in their industry sector.
27. Compensation for other research analysts was comprised of base salary plus a bonus. Investment banking revenue was a significant factor in determining the bonus. The bonus was based, in part, on investment banking revenue received from companies in the specific industry sector that each analyst covered, and the level of contribution the research analyst made in the effort to obtain the investment banking business. The bonus usually formed the majority of a research analyst’s total compensation. In 1999 and 2000, for example, more than 85 percent of a typical research analysts’ compensation came from the bonus, while in 2001 approximately 77 percent of a typical research analyst’s compensation was in the form of a bonus. During that time,

research analysts' salaries generally ranged from \$60,000 to \$250,000, while the discretionary bonus ranged from \$75,000 to \$4,000,000.

28. In determining the amount of discretionary bonuses, supervisors in the research department considered, among other things, a research analyst's contributions to the firm's success in obtaining investment banking revenues. Performance evaluations of the research analysts demonstrate this consideration. Research analysts received periodic reports detailing the year-to-date revenues generated by their covered companies. At times, senior investment bankers provided these reports to the research analysts, as well as to investment banking employees, and listed the projected investment banking revenue goals for the covered companies. One supervisor noted in a performance evaluation that a certain analyst should work on becoming a "lead managing analyst." That expression was a reference to the lead managing underwriter position that Piper Jaffray sought in offerings because it resulted in the greatest amount of control and revenue. Thus, the supervisor's expression acknowledged the role that an analyst could play at Piper Jaffray in obtaining investment banking business. For example, one senior analyst received a salary of \$160,000 and a bonus of over \$3.8 million. In another example, an analyst received a salary of \$130,000 and a bonus of over \$3 million. In both of these instances, the bonus determination included consideration of investment banking and trading revenues for companies in the industry sector covered by the analyst.
29. The fact that research analysts contributed to the firm's efforts to obtain investment banking revenue is also evident from the personal goals set by certain research analysts. Some analysts, in setting forth their goals, stated specific investment banking revenue goals and listed the ongoing support of investment banking and sales as important to their continued success.

***Investment Bankers Evaluated Research Analysts' Performance
and Influenced Their Bonus Compensation***

30. In 2000 and 2001, investment bankers who worked on investment banking business with research analysts participated in the annual performance evaluations of those research analysts. Specifically, in certain instances, investment bankers completed and provided to the Director of Research a "Banker Peer Review" on certain research analysts. Investment bankers evaluated research analysts using specific criteria, including:
- "proactively generates and shares valuable M&A/strategic ideas;"
 - "prepares for pitches and contributes to preparation of pitchbook;"
 - "effective in pitches; [and] takes the aftermarket commitment seriously."
31. Thus, investment bankers provided significant input in the performance evaluation of research analysts which, in turn, influenced the bonus compensation of those research analysts. For example, an investment banker noted in his banker peer review that a

- particular analyst: “needs to be proactive in pursuing fee-generating companies for his coverage list. He is very focused on big cap names that do not pay.”
32. This review process indicated to research analysts that, in part, their role was to assist the investment bankers and the firm’s investment banking clients.

***Piper Jaffray Lacked Procedures and
Did Not Adequately Monitor Research Analysts’ Sharing of
Draft Research Reports With Issuers***

33. In certain cases, prior to the dissemination of research reports, Piper Jaffray research analysts provided copies of their draft reports to an issuer’s executives, and solicited comments and suggestions for such reports. Providing draft research reports to an issuer’s executives could potentially compromise a research analysts’ independence in that the investment banking clients may pressure the analyst to make inappropriate changes to the draft report.
34. Certain draft research reports provided to an issuer included not only the factual portions of a draft report, but also the analyst’s valuation, rating and suggested target price. In some cases, company executives were given electronic copies of the research report, and returned to the firm a “red-lined” version of the report with their comments and edits. For example, on September 27, 2001, a Piper Jaffray research analyst sent a representative of Genta, Inc. an e-mail containing a draft report with a rating. This e-mail stated, “ Hope you are doing better. Here is a draft of our initiation note. Please review it and send me any comments you may have. Thanks...” On October 2, 2001, Genta responded to the e-mail with extensive comments on the note.
35. In other instances, Piper Jaffray investment bankers suggested to issuer clients that research reports initiating coverage would be subject to approval by the issuer. For example, on January 11, 2001, a Piper Jaffray investment banker wrote to executives at Metromedia Fiber Network, Inc. (“Metromedia”), an investment banking client, thanking them for their meeting with a Piper Jaffray senior research analyst. The banker wrote: “<the analyst> has decided to initiate coverage with a Strong Buy, our firm’s highest recommendation. * * *his research associate * * *will be calling you later today to request help in finalizing the report. *Nothing will be published without your prior approval.*” (Emphasis added).
36. On January 26, 2001, Piper Jaffray initiated coverage of Metromedia with a “strong buy” and a \$27 price target. And, on November 22, 2000, a Piper Jaffray senior investment banker wrote to executives of Qwest thanking them for an in-person meeting. The banker wrote: “We expect to initiate research coverage within the next few weeks and will submit a draft of such report for your review and approval prior to publication.”

37. Notwithstanding the potential that research analysts could be subjected to pressure by issuers, Piper Jaffray failed to have adequate procedures or controls to monitor such communications.

***Piper Jaffray Lacked Procedures and Controls Sufficient To Monitor
The Influence of Investment Banking on Research Analysts***

38. In view of the interaction between research analysts and investment banking described above, Piper Jaffray lacked adequate systems or procedures to supervise the influence that investment banking opportunities had on research personnel. For example, on January 17, 2001, a Piper Jaffray senior research analyst wrote an e-mail to a junior analyst seeking input as to whether he should maintain a “buy” rating on Natural Microsystems, Inc. (“NMSS”). Piper Jaffray had downgraded NMSS from “strong buy” in December 2000 based on the company’s announcement that it would likely miss its earnings projections for the year. Upon the company’s announcement in January 2001 that it had, in fact, not met its projections for 2000, the senior analyst again evaluated the company’s rating. In response to the senior analyst’s request for input, the junior analyst responded that, in his opinion, the company should stay a “buy” “taking into consideration banking relationship,” but that absent such considerations he would rate the stock a neutral.
39. On January 18, 2001, Piper Jaffray issued a research report that maintained the previously lowered “buy” rating.³ The report included a lower price target than that published previously, cautionary statements about NMSS’s short term prospects and a predicted “struggle” for the company’s shares during the first half of 2001. In the same research report, Piper Jaffray lowered its revenue estimates by almost one half and reduced the earnings per share to show a loss in fiscal year 2001. At that time, Piper Jaffray defined a “buy” rating as: “Expect positive price appreciation over next 12 months; Solid long term company fundamentals; attractive long-term valuation, though shares may be extended based on near-term parameters.” Piper Jaffray subsequently lowered its rating to “neutral” on April 12, 2001.
40. Moreover, Piper Jaffray rarely issued a sell rating. During most of the review period, Piper Jaffray had a four point rating scale: strong buy, buy, neutral, and sell. More than 80 percent of the research reports issued contained either “buy” or “strong buy” recommendations, with less than 20 percent of the companies, on average, rated as a “neutral.” Throughout the review period, Piper Jaffray gave less than one percent of companies a “sell” recommendation. In certain cases, the firm would discontinue coverage, usually without explanation, rather than drop a company to a sell rating. In those cases, therefore, Piper Jaffray had only a three point rating system.

³ Piper Jaffray widely distributed its research through public services such as Thompson Financial’s First Call and on its website www.gotoanalyst.com.

**Piper Jaffray Issued Research on Two Companies That Lacked a Reasonable Basis,
Or Was Imbalanced in Violation of Exchange Rule 472**

41. As to two companies, Esperion Therapeutics, Inc. and Triton Network Systems, Piper Jaffray issued research reports that violated Exchange Rule 472 because the research lacked a reasonable basis and was imbalanced.

Esperion Therapeutics, Inc.

42. In August 2000, Piper Jaffray served as co-manager for the IPO of Esperion Therapeutics, Inc. (“Esperion”) and consequently initiated research coverage of Esperion on September 5, 2000 with a “buy” rating. On January 9, 2002, a Piper Jaffray senior research analyst stated in an e-mail to a senior investment banker: “ESPR delayed a pipeline product and completely dropped development of a second pipeline product, giving a reason that was nothing short of hokey. So it was bad news all around...Esperion has not met a single milestone that they have laid out since they went public. Everything has slipped. [Esperion’s CEO] is a good scientist, an awful CEO.”
43. Notwithstanding these statements, Piper Jaffray’s January 2002 industry report “Investing in Biotechnology” and research report on January 24, 2002, both reiterated the existing buy rating (now termed outperform).

Triton Network Systems

44. In July 2000, Piper Jaffray served as co-manager for Triton Network Systems (“Triton”)’s IPO. On August 7, 2000, a Piper Jaffray senior research analyst initiated research coverage of Triton with a “buy” rating and a \$45 price target. Soon after the IPO, shares of Triton reached a high of \$47.75, but the value of the stock quickly declined. Piper Jaffray maintained a “buy” rating while the stock price declined to \$1 13/16 over the next eight months.
45. On March 30, 2001, the analyst issued a “blast” e-mail to institutional clients with cautionary statements about Triton due to the likely loss of a key customer, Advanced Radio Telecom, which was considering a Chapter 11 bankruptcy filing. Other than the “blast” e-mail, Piper Jaffray did not issue a new research report directly on that information at that time. Notwithstanding this negative news, Piper Jaffray maintained a “buy” rating. Another month passed before Piper Jaffray disclosed in a broadly disseminated research report Triton’s problems with this customer while downgrading Triton to a neutral on May 1, 2001. After two more months, when Triton was trading below \$1, the research analyst told the head of Piper Jaffray’s equity research department, that since the company was in bankruptcy proceedings, “we can drop now if banking says ok.” Piper Jaffray discontinued coverage of Triton with a last published rating of neutral.

Piper Jaffray Threatened to Drop Research Coverage of Emisphere Technologies, Inc., If it Did Not Award Piper Jaffray the Lead Manager Role in an Offering

46. In September 1999, Piper Jaffray attempted to compel Emisphere Technologies, Inc. to select it for investment banking business by informing company executives that it would drop research coverage of the company if it was not selected as the lead manager for an offering of Emisphere's securities. Piper Jaffray's threatening conduct undermined competition for investment banking services, and was contrary to Exchange Rules 476(a)(6) and 401.

Piper Jaffray Failed to Disclose That it Received Payments From Proceeds of Certain Underwritings, In Part, To Publish Research Regarding The Issuer

47. From 1999 through 2001, Piper Jaffray received payments out of the proceeds of certain underwritings to compensate the firm for services that included publishing research on the issuer. These payments were made in the form of "research guarantees" or "research checks." During this period, Piper Jaffray accepted more than \$1.8 million in exchange for, among other services, issuing research reports. Despite having an obligation to do so, the firm failed to disclose in research reports or elsewhere that it received the payments, in part, as compensation for issuing the reports. For example:
48. In June 1999, Piper Jaffray received a \$400,000 research check in connection with a \$200 million high yield debt offering in April 1999 for Just for Feet. Piper Jaffray was not a manager on the offering and did not disclose this payment in its ongoing research or elsewhere.
49. In July 1999, Piper Jaffray received a \$150,000 check in connection with an offering of common stock by JDS Uniphase Corp. Although Piper Jaffray was not an underwriter in the offering, the firm received the payment, in part, for continued research coverage of the company.
50. In March 2001, Piper Jaffray received a \$120,000 research check in connection with an underwriting that went effective in May 2001 for Comverse Technology Inc. Piper Jaffray failed to disclose in research it published on the company that it had received this compensation, in part, for issuing research regarding the subject company.

Piper Jaffray Failed to Ensure Public Disclosure of Payments It Made from the Proceeds of Underwritings to Brokerage Firms To Issue Research Coverage Regarding Its Investment Banking Clients

51. From 1999 through 2001, at the direction of certain issuer clients, Piper Jaffray paid portions of certain underwriting proceeds to other brokerage firms to initiate or continue research coverage on issuers for which Piper served as lead or co-manager. It knew that these payments were, in part, for research. Piper Jaffray did not take

steps to ensure that the brokerage firms paid to initiate or continue coverage of its investment banking clients disclosed that they had been paid to issue such research. Further, Piper Jaffray did not disclose or cause to be disclosed the fact of such payments.

52. For example, in 2000, Piper Jaffray paid underwriting proceeds of \$100,000 to another underwriter in conjunction with Piper Jaffray's lead manager position on Onyx Pharmaceuticals' ("Onyx") stock offering. While this underwriter was not invited to participate in Onyx's offering, the payment was made in response to a letter dated September 22, 2000 from the underwriter asking for \$300,000 in "underwriting participation" for continued research and market making. A representative of the underwriter wrote, "From August 31, 1999 until August 15, 2000, we were the only firm in print on Onyx Pharmaceuticals and we remain a Strong Buy rating." Piper Jaffray did not ensure this payment was disclosed to the public by the underwriter in its published research on Onyx.
53. In April 2000, Piper Jaffray, acting as lead manager for an offering for Buca, Inc. directed the payment of an aggregate of \$105,000 to three brokerage firms for the issuance of research. In February 2001, while assisting in another investment banking transaction for Buca, Inc., Piper Jaffray distributed \$225,000 to other firms for their research coverage. Piper Jaffray did not ensure that these payments were disclosed to the public.

**Piper Jaffray Failed to Adequately Supervise Its Research Analysts
and Investment Banking Professionals**

54. During the relevant period, Piper Jaffray's management failed adequately to monitor the activities of the firm's research and investment banking professionals to ensure compliance with Exchange Rules and the federal securities laws. Among other things, this failure to supervise gave rise to and perpetuated the above-described violative conduct.

Violations of Exchange Rules

55. Exchange Rule 476(a)(6) prohibits member organizations from engaging in practices that constitute conduct inconsistent with just and equitable principles of trade.
56. Exchange Rule 401 requires member organizations to adhere at all times to the principles of good business practice in the conduct of their business affairs.
57. Exchange Rule 472 governs communications with the public, including requirements relating to research communications and research reports.
58. Exchange Rule 342 requires that member organizations maintain appropriate supervisory control over all business activities to ensure compliance with securities

laws and regulations, and this includes providing a separate system of follow-up and review to guarantee the proper exercise of authority and responsibility.

DECISION

The Hearing Panel, in accepting the Stipulation and Consent, found the Firm guilty as set forth above by unanimous vote.

PENALTY

In view of the above findings, the Hearing Panel, by unanimous vote, imposed the penalty consented to by the Firm of a censure and total payment of \$32,500,000 as specified in the Final Judgment entered in connection with a related action with the Firm and the Securities and Exchange Commission (“Final Judgment”) the payment provisions of which are incorporated by reference herein:

- a. \$12,500,000, as a penalty;
- b. \$12,500,000, as disgorgement of commissions, fees and other monies;
- c. \$7,500,000, to be used for the procurement of Independent Research as described in the undertaking set forth in Addendum A: Undertaking to the Final Judgment (“Addendum A”), incorporated by reference herein; and

In addition, the Firm shall complete an undertaking to ensure compliance with the terms provided in Addendum A, including an undertaking to inform the Exchange in writing that it has policies, systems, and procedures reasonably designed to ensure compliance with the provisions of Addendum A.

For the Hearing Panel

Edward W. Morris, Jr.
Chief Hearing Officer