FINANCIAL INDUSTRY REGULATORY AUTHORITY
OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT, Complainant, v. CRAIG SCOTT TADDONIO (CRD No. 4773787), and BRENT MORGAN PORGES (CRD No. 4002626), Respondents.	Disciplinary Proceeding No. 2015044823501 Hearing Officer—DMF
DEPARTMENT OF ENFORCEMENT, Complainant, v. EDWARD BEYN (CRD No. 5406273), Respondent.	Disciplinary Proceeding No. 2015044823502 Hearing Officer—DMF **EXTENDED HEARING PANEL DECISION** July 31, 2017

Summary

Respondent Beyn excessively traded customer accounts, in violation of NASD Rule 2310 and FINRA Rules 2111 and 2010, and churned customer accounts in violation of Section 10(b) of the Securities Exchange Act of 1934, Exchange Act Rule 10b-5, and FINRA Rules 2020 and 2010. Beyn also made qualitatively unsuitable recommendations to a customer, in violation of NASD Rule 2310 and FINRA Rules 2111 and 2010. For those violations, Beyn is barred from associating with any FINRA member firm in any capacity.

Respondents Taddonio and Porges failed to exercise reasonable supervision in light of red flags indicating that Beyn and other registered representatives were, or might be, excessively trading customer accounts, and thereby violated NASD Rules 3010(a) and (b) and FINRA Rule 2010. For that violation, Taddonio and Porges are each barred from associating with any FINRA member firm in any principal or supervisory capacity.

Taddonio and Porges also each gave false testimony to FINRA in an on-the-record interview, in violation of FINRA Rules 8210 and 2010. For that violation, Taddonio and Porges are each barred from associating with any FINRA member firm in any capacity.

Appearances

For the Complainant: Danielle I. Schanz, Esq.; Carlos A. López, Esq.; Vaishali Shetty, Esq.; Artur M. Wlazlo, Esq.; and Kevin Hartzell, Esq., Department of Enforcement, Financial Industry Regulatory Authority.

For Respondent Taddonio: *pro se.*

For Respondent Porges: *pro se.*

For Respondent Beyn: *pro se.*

DECISION

I. Introduction and Summary

These consolidated cases arise out of the operations of former FINRA member firm Craig Scott Capital, LLC ("CSC"). Respondent Craig Scott Taddonio was the President, Chief Executive Officer ("CEO") and majority owner of CSC, while Respondent Brent Morgan Porges was the firm's Chief Operating Officer ("COO") and a minority owner. Respondent Edward Beyn was associated with CSC as a registered representative ("RR").

On January 5, 2016, the Department of Enforcement filed a Corrected Complaint containing two charges against Taddonio and Porges.[1] First, the Corrected Complaint alleged that Taddonio and Porges failed to establish, maintain and enforce a reasonable supervisory system at CSC to prevent excessive trading and churning in customer accounts. More

[1] The Corrected Complaint also named CSC as a Respondent and included charges against the firm, as well as the charges against Taddonio and Porges. CSC's FINRA membership was suspended in October 2015 for failing to pay arbitration fees and its membership was cancelled in January 2016. Hearing Transcript ("Tr.") 673; Complainant's Exhibit ("CX-") 11. The firm did not file an Answer or other response to the Corrected Complaint and it was held in default. In accordance with FINRA Rule 9269, the Hearing Officer, rather than the Extended Hearing Panel, will issue a default decision addressing the charges against CSC. Accordingly, this Extended Hearing Panel Decision addresses only the allegations of the Corrected Complaint that concern Taddonio and Porges.

specifically, the Corrected Complaint alleged that Taddonio and Porges were aware of red flags suggesting that certain of the firm's RRs were, or might be, excessively trading customer accounts; that they did not properly address those red flags; and that they failed to take any meaningful measures to ensure that CSC's RRs complied with applicable laws, regulations and rules regarding excessive trading. The Corrected Complaint alleged that Taddonio and Porges thereby violated NASD Rules 3010(a) and (b) and FINRA Rule 2010.[2]

Second, the Corrected Complaint alleged that during Enforcement's investigation, in their sworn on-the-record interviews ("OTRs"), both Taddonio and Porges falsely denied that they were aware of the existence or use of recording devices at CSC or the existence of recorded conversations with CSC customers, when in fact they knew that CSC had utilized a variety of recording systems to record telephone calls with customers. The Corrected Complaint charged that Taddonio and Porges thereby gave false testimony, in violation of FINRA Rules 8210 and 2010.[3]

On March 16, 2016, Enforcement filed a separate Complaint against Beyn. The Complaint alleged that Beyn engaged in quantitatively unsuitable trading (also referred to as."excessive trading") and churning in nine accounts of six CSC customers. The Complaint alleged that Beyn thereby violated NASD Rule 2310 and FINRA Rules 2111 and 2010, with respect to excessive trading, and Section 10(b) of the Securities Exchange Act of 1934, Rule 10b-5, and FINRA Rules 2020 and 2010, with respect to churning. In addition, the Complaint alleged that Beyn recommended qualitatively unsuitable investments to one CSC customer, in violation of NASD Rule 2310 and FINRA Rules 2111 and 2010.[4] Because of the overlap between the excessive trading and churning allegations against Beyn and the failure to supervise allegations against Taddonio and Porges, the Chief Hearing Officer consolidated the two proceedings.[5]

The hearing on the charges against Taddonio, Porges and Beyn was held before the Extended Hearing Panel in January and February 2017. The Panel heard testimony from 15

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[2] A FINRA examiner testified that the investigation leading to the charges in this matter arose out of a May 2014 examination of CSC. Tr. 2415-16, 2424, 3065-66.

[3] Taddonio and Porges were originally represented by the same counsel, who filed an Answer on their behalf denying that they had violated NASD and FINRA rules as alleged in the Corrected Complaint. Their counsel subsequently withdrew and they have represented themselves, *pro se*, throughout the rest of this proceeding, including at the hearing and in post-hearing briefs.

[4] Like Taddonio and Porges, Beyn was originally represented by counsel who filed an Answer on Beyn's behalf, but subsequently withdrew, and since the withdrawal, Beyn has represented himself, *pro se*.

[5] The conduct rules that apply to the allegations against Respondents are those that were in effect at the time of the alleged misconduct. The Corrected Complaint provides that January 2012 through at least December 2014 is the relevant period for the alleged misconduct of Taddonio and Porges, while the Beyn Complaint defines the relevant period as March 2012 through May 2015 for the alleged misconduct of Beyn. Corrected Complaint ("Cor. Compl.") ¶ 1; Beyn Complaint ("Compl.") ¶ 1. Insofar as different rules applied to a Respondent's conduct during the applicable relevant period, the Panel's conclusions regarding each alleged violation in this Decision identify the rules applicable to each portion of the relevant period.

witnesses, including former CSC customers; former CSC associated persons; FINRA staff; and Respondents, and received more than 250 exhibits in evidence.[6] Following the conclusion of the hearing, Enforcement filed its post-hearing brief on April 10, 2017; after receiving several unopposed extensions of time, Porges and Beyn filed their post-hearing briefs on May 30, 2017. Taddonio requested and received yet another extension of time until June 5, 2017, to file his post-hearing brief, but he failed to file a post-hearing brief by that date. Enforcement filed its post-hearing reply brief on June 13, 2017, addressing the post-hearing briefs filed by Porges and Beyn. On the same date Taddonio filed a motion asking the Hearing Officer to allow the filing of his untimely post-hearing brief, together with a proposed post-hearing brief. The Hearing Officer granted Taddonio's motion. Enforcement filed a reply to Taddonio's post-hearing brief on June 23, 2017.

Based upon a careful review of the evidence adduced by the parties, the Extended Hearing Panel concludes that Beyn excessively traded and churned the accounts of certain CSC customers. The Panel finds that the trading in the accounts of the customers was controlled by Beyn and that the level of trading was excessive. The Panel concludes that the number of trades recommended by Beyn combined with the high costs to the customers—costs that were not adequately disclosed—demonstrated that the trading was undertaken primarily for the benefit of Beyn and CSC, rather than the customers. The Panel further concludes that the evidence is sufficient to establish that Beyn acted with scienter, and thus churned the accounts. Finally, the Panel finds that Beyn recommended that a customer make substantial investments in exchange traded notes ("ETNs") without having a reasonable basis to believe that such highly sophisticated and specialized products were suitable for the customer.

The Panel also finds that Taddonio and Porges were made aware of glaring red flags indicating that certain CSC RRs, including Beyn, were, or might be, excessively trading

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[6] On January 5, 2017, less than three weeks before the hearing was scheduled to begin, Beyn moved for a postponement of the hearing on the grounds that he needed additional time to review Enforcement's production of documents pursuant to Rule 9251, which included some five million pages of material. The Hearing Officer denied the motion, noting that (1) Beyn was tardy in seeking a postponement; (2) a postponement of the hearing at such a late date would inconvenience the Panel, the parties and the witnesses, all of whom had blocked out time for the hearing as scheduled; and (3) Beyn had failed to identify any documents or classes of documents relevant to the proceeding that he needed additional time to review in order to defend himself. At the hearing, all the Respondents asserted that they had had difficulty accessing some of the materials included in Enforcement's electronic production. At the conclusion of the hearing, the Hearing Officer held the record open and afforded Respondents an additional month following the hearing in which they could (1) obtain additional assistance from Enforcement in accessing the materials in Enforcement's production; (2) continue to review those materials; and (3) if appropriate, propose additional exhibits to be added to the record and, if necessary, request that the hearing be re-convened in order for the Panel to hear testimony regarding the additional exhibits. At the conclusion of the process, however, only Respondent Taddonio offered additional exhibits in evidence, and he did not request that the hearing be re-convened to take testimony regarding those exhibits. After reviewing the proposed exhibits, the Hearing Officer concluded that most of them had at least some tangential relevance to the issues and therefore admitted Respondents' Exhibits ("RX") RX-6 through RX-19; RX-21 through RX-25; and RX-27 through RX-37. The Extended Hearing Panel considered those exhibits, as well as the testimony received and the exhibits admitted during the hearing, in its deliberations.

customer accounts. The red flags included trading in numerous customer accounts that resulted in turnover rates and cost-to-equity ratios far exceeding levels that the Securities and Exchange Commission ("SEC") and FINRA's National Adjudicatory Council ("NAC") have identified as indicative of excessive trading; active account exception reports generated by CSC's clearing firm documenting high levels of trading activity, large commission charges, significant losses, high turnover rates and high commission-to-equity ratios in the same customer accounts month after month; and customer complaints and arbitration claims.

The Panel finds that the supervisory responses to those red flags were deficient and consisted of half-measures such as reducing commission levels for future trades in accounts in which there were indicia that excessive trading had already occurred. At the same time, no steps were taken to determine whether, in fact, accounts were being excessively traded, to remedy excessive trading that had occurred, or to prevent the RRs from excessively trading other customer accounts. These inadequate measures were coupled with efforts to induce customers to sign documents purporting to approve the trading that was occurring in their accounts without fairly disclosing either the level of trading or the costs the customer was incurring.

The Panel concludes that both Taddonio and Porges were personally responsible for the deficient supervision. Taddonio, as the firm's President and CEO, as well as its sales manager and supervisor, had a duty to respond to the red flags and failed to do so. Insofar as Taddonio attempted to delegate supervisory responsibility for the RRs' trading activity to CSC's Chief Compliance Officers ("CCOs"), the delegation was ineffective because Taddonio was made aware of the red flags and should have understood that the CCOs' actions in response to them were insufficient to satisfy the firm's regulatory responsibilities and protect its customers. And although Porges' primary responsibilities as COO concerned the firm's operations, rather than the RRs' sales practices, his various roles in the firm and his interactions with CSC's RRs, CCOs and customers were sufficient to impose on him a supervisory responsibility to address the clear indications that the firm's RRs were, or might be, excessively trading customer accounts. The Panel finds that instead of exercising supervisory oversight of the RRs to prevent excessive trading of customer accounts, both Taddonio and Porges actively encouraged the RRs' trading and both reaped substantial financial benefits from it. Accordingly, the Panel finds that both Taddonio and Porges failed to exercise reasonable supervision over CSC's RRs.

Finally, the Extended Hearing Panel finds that, at the time of their OTRs, Taddonio and Porges were aware that the firm had purchased a variety of recording devices and that at least some of the firm's principals and RRs had recorded some calls with firm customers. The Panel therefore concludes that both Taddonio and Porges testified falsely in their OTRs when they denied being aware of any recording devices at the firm or of any recordings of telephone calls with customers.

The Extended Hearing Panel concludes that, in order to protect the investing public, Beyn should be barred from associating with any FINRA member firm in any capacity for his violations; that Taddonio and Porges should each be barred from associating with any FINRA member firm in any supervisory or principal capacity for failing to exercise reasonable

supervision; and that Taddonio and Porges should each be barred from associating with any FINRA member firm in any capacity for giving false testimony.

Because both Beyn and Taddonio have filed for bankruptcy, the Panel does not impose any monetary sanctions against them. The Panel notes that if they had not filed for bankruptcy, it would have imposed fines at the very top of the ranges recommended in the Sanction Guidelines for each violation and would have considered requiring them to pay restitution to at least some of the affected customers. Further, considering that the Panel cannot impose monetary sanctions on Taddonio because of his bankruptcy filings, and in light of the bar in all capacities for his false testimony, the Panel also does not impose any monetary sanctions on Porges. If Porges were not barred in all capacities or if monetary sanctions could have been imposed on Taddonio, the Panel would have imposed fines at the very top of the ranges recommended in the Sanction Guidelines for each of Porges' violations and would have considered requiring him to pay restitution to at least some of the affected customers.

II. Background

A. Respondents

1. Taddonio

Taddonio graduated from high school in 2001. He started his freshman year of college but dropped out for personal family reasons. In 2004, Taddonio entered the securities industry with former FINRA member firm GunnAllen Financial, Inc. as an RR. He left GunnAllen in December 2005 and became associated with former FINRA member firm Pointe Capital, LLC. Taddonio obtained his Series 24 license while at Pointe Capital, which subsequently changed its name to JHS Capital Advisors, Inc. In 2010, he moved to former FINRA member firm Brookstone Securities Inc. He left Brookstone in January 2012 after forming CSC with Porges. After CSC went out of business in January 2016, Taddonio became associated with another FINRA member firm, but subsequently became statutorily disqualified.[7]

Taddonio testified that he was a very successful salesman before opening CSC. Within a few months at GunnAllen, he said, he had opened more accounts than anyone in the history of the firm, and within a year he was managing one of the firm's largest client bases. At Pointe Capital/JHS, according to Taddonio, he managed by far the largest client base at the firm. And at

[7] Tr. 655-64, 688-89, 3928; CX-1. *See Craig Scott Taddonio*, No. SD-2117, http://www.finra.org/sites/default/files/NAC_SD-2117_Taddonio-Meyers-Associates_030817.pdf (NAC Mar. 8, 2017) (finding Taddonio statutorily disqualified and denying a Membership Continuation Application to allow him to associate with a FINRA member firm). According to the Central Registration Depository ("CRD"), Brookstone was expelled from FINRA membership in October 2012 for failing to pay fines due to FINRA.

Brookstone he owned his own branch office. When Taddonio left Brookstone to become CEO, President and majority owner of CSC, he was 29 years old.[8]

2. Porges

Porges graduated from high school in 1996. He entered the securities industry in 1999 with former FINRA member firm On-Site Trading, Inc. and left that firm less than a year later. From 2000 until opening CSC with Taddonio in January 2012, Porges was associated with 13 FINRA member firms, including two stints with Brookstone, and had several periods during which he was not associated with any firm. His longest association during that period was with GunnAllen, where he met Taddonio, and he also worked with Taddonio at Pointe Capital and at Brookstone.[9]

Unlike Taddonio, Porges did not claim to have had any notable success as a retail broker. And although Porges had been in the securities industry for more than 10 years before opening CSC with Taddonio, he did not obtain his Series 24 principal's license until 2011, during the process of setting up CSC.[10]

3. Beyn

Beyn graduated from high school in 2007. He took courses at a community college but did not obtain a degree. He began working at Pointe Capital in 2007, while still in high school, and obtained his Series 7 license in May 2008. Taddonio was at Pointe Capital when Beyn worked there, and Taddonio was one of the people who taught Beyn about the securities business. Beyn left Pointe Capital briefly, but returned after about six months, while Taddonio was still working there.[11]

Beyn joined Taddonio's Brookstone branch office in 2010, and like other brokers at the branch, he became associated with CSC in February 2012 when Taddonio and Porges opened the firm for business. Beyn remained at CSC until September 2015, when he left and became the

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[8] Tr. 666-67, 3929-32. Taddonio was not a credible witness and insofar as his testimony conflicted with the testimony of other witnesses, apart from the other Respondents, the Panel rejects it. Taddonio consistently attempted to deny any responsibility for anything that occurred at the firm for which he was the President, CEO and principal owner, and which he named after himself. If Taddonio were believed, he worked diligently at CSC, but had no responsibility for its activities or operations, which he delegated to others. Having had an opportunity to observe Taddonio at length during the hearing, the Panel finds his self-serving testimony disingenuous and not credible.

[9] CX-2; Tr. 893-902.

[10] Tr. 929-30. Like Taddonio, Porges was not a credible witness. Although he was the COO of the firm and a minority owner, he generally disavowed responsibility for anything outside of the firm's financial operations, and even as to that, he claimed to know nothing about the purchases of telephone recording equipment. As discussed below, his responsibilities at the firm were much broader than Porges claimed, and, as with Taddonio, the Panel finds his testimony disingenuous and not credible.

[11] CX-3; Tr. 2040-52.

owner of an office of supervisory jurisdiction ("OSJ") with another FINRA member firm. He left that firm in March 2016 and has not been registered since then.[12]

B. CSC's Business

CSC applied for FINRA membership in 2011 and its membership was approved in January 2012. Taddonio and Porges jointly created and owned CSC. The name of the firm was derived from Taddonio's first and middle names and, at least initially, Taddonio owned 80% of the firm, compared to Porges' 20% share. Taddonio served as the firm's CEO and President, while Porges was the COO. [13]

CSC began operations in February 2012 in the same offices that had been used by Taddonio's Brookstone branch, and the Brookstone branch's RRs transferred their registrations to CSC, along with their customers' accounts. The RRs who transferred included Beyn, as well as three other RRs whose trading of customer accounts is at issue in this case: Zachary Bader, David Cannata and Michael Venturino.[14]

Initially CSC had about 15 salesmen, while at its height, the firm had as many as 35-40 RRs.[15] The firm's sales staff included both experienced senior brokers, such as Beyn, Bader, Cannata and Venturino, and junior brokers who were engaged primarily in prospecting for new customers. The junior brokers made cold calls from lead sheets obtained from Dunn & Bradstreet and other sources, attempting to convince potential customers to make an account-opening transaction, generally in a mainstream stock, explaining that the firm would charge only a $99 commission for the trade. Junior brokers were required to open 40 new CSC accounts in order to become senior brokers. According to Taddonio, CSC brokers made more than 5,000 calls per day, 25,000 calls a week, and 100,000 calls per month.[16]

If a junior broker convinced a customer to open an account and make an opening trade, the account was promptly transferred from the junior broker to a senior broker, who attempted to persuade the customer to invest more money with CSC, in many cases by touting an "earnings play" strategy. As explained to the customers, the earnings play strategy involved purchasing a stock shortly before an expected earnings announcement, in the hope that the announcement would generate a jump in the price of the stock, after which the stock would be sold to realize gains. Taddonio provided lists of companies with upcoming earnings announcements to the RRs

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[12] CX-3; Tr. 2052-55. Beyn's lack of credibility is discussed at length below.

[13] Tr. 664-67; CX-11. Taddonio and Porges held both direct ownership interests in CSC and indirect ownership interests through Morgan Scott, LLC (a name derived from Porges' and Taddonio's middle names). According to Porges, during the course of CSC's operations, an entity that provided financing for the company received an ownership interest, reducing his and Taddonio's ownership shares. Tr. 666-67, 904-05.

[14] Tr. 669-70.

[15] Tr. 145, 670-71.

[16] Tr. 178-79, 1671-73, 1685-87, 3991. Former CCO RC testified that Porges managed the cold-callers, monitoring the number of calls they made and ensuring that they were on the phone as much as possible. Tr. 179-81.

and, according to Respondents, the RRs researched the companies' past earnings announcements to identify those with a history of reporting favorable earnings. The RRs then recommended that their customers invest in those companies prior to the upcoming announcements, apparently on the theory that the companies' past performance was a good indicator that their future earnings statements would also be favorable, leading to an increase in the value of the companies' stock.[17] The earnings play strategy may not have been promoted by all of the firm's RRs, but it was utilized by the four RRs whose trading of customer accounts is at issue in this proceeding, Beyn, Bader, Cannata and Venturino.

As a FINRA staff witness acknowledged, earnings play investing is a legitimate, although speculative, investment strategy.[18] It is common knowledge that publicly traded companies are required to make quarterly and annual earnings disclosures, which provide valuable information about the level of success and trends of the companies' business; that analysts develop and publicize expectations regarding upcoming earnings disclosures; and that the value of a company's stock often rises or falls significantly based on the substance of an earnings announcement and how the announced earnings compare to analysts' expectations.

Enforcement did not allege that the earnings play strategy, or any other strategy employed by CSC or its RRs, was inherently unsuitable for the firm's customers. Instead, Enforcement argued that the actual trading in certain customers' accounts was excessive.

In employing their earnings play strategy, Beyn, Bader, Cannata and Venturino effected frequent, short-term trades in their customers' accounts, placing the trades primarily as "riskless principal transactions," for which the customers were charged markups and markdowns, rather than as agency transactions, for which the customers would have been charged commissions.[19]

Briefly, a riskless principal transaction occurs when a firm purchases a security in its own account and then uses it to fill an existing buy order from a customer, or the firm sells a security from its own account and then fills the sale with a security it obtains through an existing customer sell order. For a buy transaction, the firm charges the customer a higher price per share than it paid—a "markup"; for a sell transaction, the firm pays the customer a lower price per share than it received—a "markdown." The total markup or markdown charge to the customer for the transaction is the amount of the markup or markdown multiplied by the number of shares.

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[17] Tr. 1694-1711, 1794-97.

[18] Tr. 3470-72.

[19] All of the Respondents, as well as other witnesses who testified in this proceeding, acknowledged that markups and markdowns are effectively "commissions" on trades. Accordingly, unless otherwise clear from the context, references to "commissions" in the testimony and exhibits in this proceeding, as well as in this Decision, encompass markups and markdowns in addition to agency commissions.

For example, the total markup or markdown to a customer for the purchase or sale of 5,000 shares with a $.50 markup or markdown would be $2,500.[20]

FINRA does not prohibit member firms from executing customer transactions on a riskless principal basis or from charging customers markups or markdowns on such transactions. Rule 2121 provides, in relevant part, "if a member buys for his own account from his customer, or sells for his own account to his customer, he shall buy or sell at a price which is fair, taking into consideration all relevant circumstances, including market conditions with respect to such security at the time of the transaction, the expense involved, and the fact that he is entitled to a profit …." NASD, and now FINRA, has had for decades a policy under which a markup or markdown in excess of 5% has been viewed as presumptively unfair, but the Supplemental Material explaining Rule 2121 states that "[t]he '5% Policy' is a guide, not a rule"; "[a] mark-up pattern of 5% or even less may be considered unfair or unreasonable under the '5% Policy'"; and "[d]etermination of the fairness of mark-ups must be based on a consideration of all the relevant factors, of which the percentage of mark-up is only one."

CSC gave the RRs authority to decide whether to execute a customer buy or sell transaction on a riskless principal basis and to set the amount of the markups and markdowns they charged customers for riskless principal trades, so long as the markups or markdowns did not exceed 5%, or certain lower limits that CSC established at various times either as a general firm policy or for particular accounts. In addition to the markups or markdowns determined by the RRs, however, CSC charged customers a $99 "Firm Commission" on each trade. The markups and markdowns, as well as the Firm Commissions, were paid to CSC. CSC then paid a percentage of the markups and markdowns to the RRs, but retained the balance of the markups and markdowns as well as the entire Firm Commission. Taddonio conceded that most of the firm's revenues were commissions paid by the firm's customers.[21]

Customers received trade confirmations from CSC's clearing firm for each trade in their accounts. At the top of each confirmation certain information regarding the transaction was clearly set out, including the trade date, the name of the security, the quantity purchased or sold, and the price per share. Also clearly set out along the right hand side of the confirmation was the "Principal" amount of the trade, equal to the disclosed price times the quantity; the "Firm Commission" of $99; and the "Net Amount," comprising the Principal and the Firm Commission. To the left of and below this information, in smaller type, was a section entitled "Special remarks for this transaction." For riskless principal transactions, the special remarks included language such as the following: "Riskless Principal"; "Reported Price $XX.XX"; and "Commission Equivalent $0.XXXX per share." To accurately calculate the costs incurred for the trade, a customer would have had to note and understand the significance of this information,

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[20] Such a transaction is "riskless" because the firm has a buy or sell order from its customer in hand before it purchases or sells the security for its own account. Riskless transactions thus differ from those in which a firm fills a buy order from its own pre-existing inventory in the security or fills a sell order by adding the customer's security to the firm's own inventory.

[21] Tr. 220-23, 672.

and then multiply the number of shares by the Commission Equivalent amount and add the $99 Firm Commission.[22]

III. Beyn Excessively Traded and Churned Customer Accounts

A. Facts

The Complaint alleges that Beyn engaged in excessive trading in nine accounts of six customers. Four of the six testified at the hearing: EK, owner of a business that builds sun rooms in Georgia; BM, a self-employed aviation sales rep from Kansas; and TP and EH, partners in a construction business in Texas. The Panel finds these customers' testimony generally credible. Each customer answered the questions in a straightforward, direct manner; each customer's testimony was internally consistent; and the testimony of each customer was consistent with the testimony of the other customers.

1. Customer EK

Customer EK testified that his post-high school education includes two years of trade school and less than one year of college. Prior to opening his CSC account, his hands-on investing experience was limited to a single trade in a self-directed brokerage account he opened about 20 years before he agreed to open his CSC account. He lost money on that trade and vowed never to trade again. His income from his construction business is about $26,000 per year, and he also receives Social Security.[23]

EK opened his CSC account in March 2012 after receiving cold calls from a CSC junior broker. He originally agreed to invest $5,000 with CSC, after which his account was passed along to Beyn. Beyn told EK that he would make him a lot of money. Their conversations became very personal and EK felt that Beyn was a friend and trusted him. EK invested another $350,000 in his CSC account, telling Beyn it was all the money he had for retirement, and that he had no investment experience and would have to rely on Beyn. Beyn told him not to worry.[24]

EK testified that Beyn told him the charges would be $99 per trade. Beyn never mentioned markups or markdowns or riskless principal trading, and EK had never heard of those terms. Beyn told EK that he would be employing an "earnings play" strategy, under which he would monitor companies when they made earnings announcements, buying the stocks before the announcements and making money when the stocks went up in value. EK did not have sufficient investment knowledge to understand or evaluate Beyn's strategy.[25]

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[22] CX-142. CSC did not disclose its markup or markdown policies or the amounts of markups or markdowns that could be charged on its website; a customer could only learn of those, if at all, through discussions with the customer's RR. Tr. 2007.

[23] Tr. 2495-2503.

[24] Tr. 2499-2500, 2507, 2510-11, 2528-33, 2544.

[25] Tr. 2511-15.

EK signed his account opening documents even though there were some inaccuracies because Beyn said it was just a formality and he should not worry about the inaccuracies. EK also signed a margin agreement that Beyn said would make his account more flexible.[26]

All of the investment decisions in EK's account were based on Beyn's recommendations. Beyn would call EK about a hot company that was about to make an earnings announcement and EK would accept Beyn's recommendation. EK relied on Beyn totally; Beyn told EK he spent hours each night researching companies for investment. EK received confirmations for the trades, but he did not understand that he was being charged more than the $99 Firm Commission disclosed on the confirmations.[27]

From March 1, 2012, through August 31, 2013, there were 115 trades in EK's CSC account. EK incurred costs of over $188,000 for the trades and realized a net loss of more than $231,000. The annualized cost-to-equity ratio in EK's account was over 70%, meaning that EK would have had to realize annual returns of that amount just to break even.[28] The annualized turnover was 18.61, representing the number of times in one year that EK's portfolio of securities was exchanged for another portfolio of securities.[29]

2. Customer BM

Customer BM has a college degree. He is self-employed and his business earns about $300,000 per year, of which he pays himself about $200,000 with the rest going for expenses. Prior to opening his CSC account, BM's self-directed investing experience was limited to an investment of about $50,000 in Garmin stock, because he knew one of the company's founders; about $25,000 in Taser stock, because he learned that they made body cameras for police and believed that police departments would be buying more of them; and a few investments in aviation stocks—companies he knew about from his business.[30]

BM opened his CSC IRA account in January 2015 based on a cold call from a junior broker. Initially he intended to invest just $10,000, but after his account was passed to Beyn, Beyn called to say that he could not invest such a small amount of money effectively, so BM sent another $240,000, for a total of $250,000. BM's new account form listed his investment objective as "maximum growth," which the form defined as "[m]aximum capital appreciation with higher risk and little to no income."[31]

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[26] Tr. 2513-14, 2518-27; CX-164.

[27] Tr. 2538-39, 2545.

[28] CX-13A. The cost-to-equity ratio measures the amount an account has to appreciate annually just to cover commissions and other expenses and is obtained by dividing total expenses by average monthly equity.

[29] CX-13A.

[30] Tr. 373-76, 378-81, 393, 443-44, 447-49, 454.

[31] Tr. 377-78, 382-83, 451-52; CX-159.

Beyn told BM that he could increase the value of his account by $40,000 within three to four months, but did not explain how he would do that. Beyn did not disclose how much BM would be charged for trading in his account, but BM understood it was the $99 per trade Firm Commission shown on every confirmation. BM was not familiar with the terms markup or markdown as applied to stock trades.[32]

The trades in BM's account were based on Beyn's recommendations. Beyn called BM at least twice a week telling him about stocks Beyn wanted to purchase for BM's account, saying the companies would be announcing earnings and describing how much money they would "book" from the trades. Beyn made the decisions about which stocks to buy, how much to buy, and when to sell. BM followed Beyn's recommendations except once when Beyn recommended an airline stock. Because BM knew the airline industry, he rejected that recommendation, thinking it was not a good time to buy airline stocks. BM did not realize he was losing money in his account until he began receiving account statements. He understood the losses were due to some bad investment choices, but Beyn always said they would make up the losses on the next trade.[33]

From January 1, 2015, through May 31, 2015, there were 80 trades in BM's CSC IRA account. BM incurred a total cost for those trades of more than $52,000 and suffered a net loss of more than $65,000. The annualized cost-to-equity ratio for BM's account was over 70%. The annualized turnover rate was 23.29.[34]

3. Customer TP

Customer TP was born in 1940 and obtained B.S. and M.S. degrees in engineering. When his CSC accounts were open, he was the president of a construction company that he co-owned with customer EH, who is discussed below. TP opened a Brookstone account in response to a solicitation to purchase Facebook shares prior to Facebook's IPO, and Beyn became his Brookstone broker. At the time, TP was disappointed in the performance of his accounts at another FINRA member firm, and Beyn persuaded him to move his IRA account to Brookstone, telling TP he would win 12 of every 15 trades. When Beyn moved to CSC, TP transferred his account to CSC, with Beyn again telling him he would win 12 of every 15 trades. Prior to opening accounts with Brookstone and CSC, TP had accounts with other FINRA member firms.[35]

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[32] Tr. 384, 387-88, 400, 410, 426-27. BM testified, credibly, that Beyn never discussed with him what the charges would be for investing through CSC, but at some point BM mentioned the $99 Firm Commission to Beyn, who responded, "I don't get that." Beyn did not disclose what BM was actually being charged. BM testified that he inferred from Beyn's statement that he did not receive the entire $99. Tr. 387, 427-28.

[33] Tr. 395-400, 409-11, 470, 474-75.

[34] CX-13A.

[35] Tr. 1404-17.

TP had both an IRA and an individual account at CSC. TP had about $1.4 million in his IRA and hoped to grow it to $5 million, but he testified he did not want to speculate in that account and his CSC new account form for the IRA listed his objective as growth, which was defined as "capital appreciation through quality equity investments and little or no income."[36] In contrast, TP was willing to speculate in his individual account and the objective for that account was listed as speculation. TP testified that he expected the accounts to be traded differently based on his different objectives, but in fact TP's account statements show that Beyn traded both accounts the same.[37]

TP testified that he was busy running his construction business and accepted all of Beyn's recommendations. Beyn told TP he was employing an earnings play strategy, buying a stock before the company's earnings announcement and selling when the price of the stock jumped. Beyn selected the stocks to purchase, decided when and how much to buy, and when to sell. TP was reluctant to agree to Beyn's recommendation to buy one stock, but Beyn convinced him to make the purchase. His understanding was that the total charge for each trade in his accounts was the $99 Firm Commission disclosed on his confirmations. It was not until he was contacted by FINRA and told how much he had actually paid that he realized he had paid markups and markdowns in addition to the Firm Commissions.[38]

From May 1, 2012, through December 31, 2013, there were 154 trades in TP's CSC individual account. TP incurred costs totaling nearly $81,000 for the trades and suffered a net loss of more than $66,000. The annualized cost-to-equity ratio for TP's individual account was 71.5%. The annualized turnover for his individual account was 22.43. From April 1, 2012, through December 31, 2013, there were 662 trades in TP's CSC IRA. TP incurred costs of almost $600,000 for those trades and suffered a net loss of over $786,000. The annualized cost-to-equity ratio for TP's IRA was just under 34%.The annualized turnover for his IRA account was 10.72.[39]

4. Customer EH

Customer EH is TP's partner in the construction business. He was born in 1943 and has a B.E. degree in civil engineering. A broker at Brookstone called EH based on a referral from TP after TP opened his Brookstone account. Like TP, EH agreed to open a Brookstone account in order to purchase Facebook shares prior to Facebook's IPO. After EH opened his Brookstone

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[36] CX-141; Tr. 1418-24. The IRA that TP transferred first to Brookstone and then to CSC had a value of about $1.4 million, but initially TP knew there was a delay in transferring $200,000 of that amount which was invested in an illiquid investment. TP was unaware when the $200,000 was transferred into his CSC account, and mistakenly believed that the increased value of his CSC account shown on his account statements was attributable to gains on trading, rather than the transfer. As a result, for several months, TP mistakenly believed his account was gaining in value, or that his losses were less than they actually were. Tr. 1434-38; CX-239.

[37] CX-140; CX-141; Tr. 1423-29.

[38] Tr. 1432-33, 1442-43, 1454-57, 1461.

[39] CX-13A.

account, it was reassigned to Beyn. When Beyn moved to CSC, EH transferred his account from Brookstone to CSC. Prior to opening his Brookstone and CSC accounts, EH had invested in individual and IRA accounts at other FINRA member firms and had a particularly strong interest in gold and silver investments.[40]

One of EH's accounts was held in the name of a limited partnership through which he invests. The first new account form for that account, which EH signed in February 2012, has both a pre-printed indication that his objective was speculation and a hand-written indication that his objective was maximum growth; a second new account form for the limited partnership account that EH signed in January 2013 also indicates his objective was maximum growth. EH's other CSC account was an IRA into which he transferred approximately $1.4 million from an existing IRA at another FINRA member firm. The new account form for that account lists EH's investment objective as growth. EH testified that he had a growth objective for both accounts.[41]

EH and Beyn spoke frequently about investments in both of his CSC accounts. In general, according to EH, he invested in securities based on Beyn's recommendations. EH testified, however, that he went to Beyn with the suggestion to invest in leveraged gold and silver exchange traded funds ("ETFs"). EH said that he likes to invest in gold and silver and likes leveraged gold and silver investments. EH insisted, however, that although he wanted to invest in leveraged ETFs, he did not understand and did not propose investing in exchange traded notes ("ETNs") of any type.[42]

From March 1, 2012, through July 31, 2014, there were 323 trades in EH's CSC individual account. EH incurred total costs of more than $261,000 for the trades and suffered a

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[40] Tr. 1202-07, 1211-12, 1254-55; RX-12; RX-13; RX-27; RX-28.

[41] CX-174; CX-175; CX-176; Tr. 1209-27. EH testified that he did not make the handwritten change in the investment objective on the first new account form for his limited partnership account. RC, who approved the form as the firm's CCO, testified that he made an identical change on another customer's new account statement at the time he approved it because he did not believe a speculation objective was suitable for the customer. Tr. 238. Although RC was not asked about the change to EH's new account form, a comparison of the two forms strongly suggests that RC also made the same change to EH's form.

[42] ETFs, like mutual funds, are pooled investment funds, but unlike mutual funds, ETF shares trade like stocks and can be bought and sold on exchanges at prices that fluctuate during the trading day. There are many types of specialized ETFs and some are structured to achieve results that are multiples or reverse (inverse) multiples of a particular index. ETNs, on the other hand, are unsecured debt obligations of the issuer, with the issuer promising to pay the holder of the ETN an amount determined by the performance of the underlying index or benchmark on the ETN's maturity date (typically 10, 30 or in some cases even 40 years from issuance), minus any specified fees. ETNs trade on exchanges throughout the day at prices determined by the market, similar to ETFs, but unlike ETFs, ETNs do not buy or hold assets to replicate or approximate the performance of the underlying index.

Regardless whether an exchange traded product ("ETP") is an ETF or an ETN, most leveraged ETPs "reset" every day, which means they are only designed to accomplish the stated leveraged objective on a daily basis, not over a longer period, and holding them for a period longer than a day may significantly increase the risks associated with the investment. *See* "*The Lowdown on Leveraged and Inverse Exchange-Traded Products*," http://www.finra.org/investors/lowdown-leveraged-and-inverse-exchange-traded-products.

net loss of more than $576,000. The annualized cost-to-equity ratio for EH's individual account was more than 21%. The annualized turnover for his individual account was 8.41. From April 1, 2012, through July 31, 2014, there were 398 trades in EH's IRA. EH incurred total costs of more than $426,000 for the trades and suffered a net loss of approximately $985,000. The annualized cost-to-equity ratio for EH's IRA was more than 18%. The annualized turnover for his IRA account was 8.25.[43]

5. Customers WR and JB

The other two Beyn customers at issue, WR and JB, did not testify at the hearing. Enforcement, however, offered the testimony of a FINRA examiner regarding conversations he had with both WR and JB. The statements made by WR and JB in those conversations were hearsay.[44] "[I]t is well established that hearsay evidence is admissible in administrative proceedings and can provide the basis for findings of violation, regardless of whether the declarants testify."[45]

> In determining whether to rely on hearsay evidence, it is necessary to evaluate its probative value and reliability, and the fairness of its use. The factors to consider include the possible bias of the declarant, the type of hearsay at issue, whether the statements are signed and sworn to rather than anonymous, oral or unsworn, whether the statements are contradicted by direct testimony, whether the declarant was available to testify, and whether the hearsay is corroborated.[46]

In this case, the hearsay evidence consists of unsworn statements by the customers during telephone conversations as recalled by the examiner, not sworn or even unsworn statements directly from the customers. The examiner did not conduct structured interviews with the customers using a prepared list of standard questions, and did not make detailed notes of the conversations. The examiner did make some notes, which were provided to the Respondents before the examiner testified, but the notes were not offered in evidence and the examiner did not have the notes before him when he testified. Thus, he simply related the gist of his conversations with the customers as he recalled the conversations at the time of the hearing, and it was clear from his answers to questions from Respondents and the Panel that the examiner did not recall

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[43] CX-13A.

[44] Hearsay is generally defined as a statement made by a declarant, other than a statement made while the declarant is testifying at the current hearing, that is offered to prove the truth of the matter asserted in the statement. *See* Fed. R. Evid. 801(c). In this instance, the declarants were customers WR and JB, and Enforcement offered the statements that they made to the examiner during telephone conversations to prove the truth of the matters asserted during those conversations about WR's and JB's interactions with Beyn. The examiner's testimony regarding his recollection of WR's and JB's statements is not itself hearsay.

[45] *Scott Epstein*, Exchange Act Release No. 59328, 2009 SEC LEXIS 217, at *46-47 (Jan. 30, 2009).

[46] *Charles D. Tom*, 50 S.E.C. 1142, 1145 (1992) (footnotes omitted).

the conversations in detail. Under these circumstances, the Panel does not give substantial weight to the examiner's testimony.[47]

Enforcement did, however, offer other evidence regarding these customers. WR had two CSC accounts, with Beyn serving as his broker on both accounts. The first account was active from June through September 2013. During that brief period, Beyn made 94 trades in the account, marking 77 as solicited. WR incurred total costs of more than $46,000 for those trades and suffered a net loss of approximately $86,000. The annualized cost-to-equity ratio in this account was approximately 183%, and the annualized turnover was 52.7.[48]

Although WR closed his first CSC account in September 2013, he opened a second CSC account with Beyn that was active from April through July 2014. For the second account, Beyn marked all 88 trades as solicited. WR incurred costs of nearly $49,000 for the trades and suffered a net loss of approximately $53,000. The annualized cost-to-equity ratio in this second account was more than 546%, and the annualized turnover was 177.87.[49]

JB's account was open for more than a year before it became active during the period April through July 2014, the same period during which WR's second account was active. During that four-month period, Beyn made 106 trades in JB's account, marking all but one as solicited. JB incurred costs totaling almost $66,000 for the trades and suffered a net loss of approximately $66,000. The annualized cost-to-equity ratio for JB's account was more than 573%, and the annualized turnover was 188.55.[50]

B. Discussion

1. Quantitatively Unsuitable Trading

The suitability rules have long been interpreted to prohibit "quantitative unsuitability," which looks at the frequency and cost of recommended trading, rather than the qualities of the particular investments being recommended, to identify excessive trading in customer accounts initiated by the firm or its RRs.[51] The quantitative unsuitability prohibition reflects concern that recommendations leading to frequent, high-cost trading are more likely to serve the interests of the firm and its RRs than the customers. Such trading is inconsistent with the "fair dealing"

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[47] Enforcement also relies on allegations in a statement of claim filed by an attorney on behalf of WR in a FINRA arbitration. CX-139. The statement of claim, however, merely lays out WR's allegations, as articulated by his attorney. WR did not sign the statement of claim or attest to the accuracy of the allegations. Therefore, the Panel does not give the allegations any significant weight.

[48] CX-13A; CX-131.

[49] CX-13A; CX-135.

[50] CX-13A; CX-208; CX-209.

[51] Until July 9, 2012, FINRA's suitability standard was set forth in NASD Rule 2310; after July 9, 2012, FINRA Rule 2111 governed.

standard embodied in FINRA's rules.[52] In the nine accounts of six Beyn customers at issue in this case, Enforcement calculated that the customers paid total commissions (including markups, markdowns and Firm Commissions) of more than $1.5 million, of which Beyn's share amounted to almost $650,000, and suffered total losses of more than $2.9 million.[53]

The NAC has explained: "To demonstrate excessive trading, or quantitative unsuitability, requires proof of two elements. The first element is broker control over the account in question. The second element is excessive trading activity inconsistent with the customer's financial circumstances and investment objectives."[54]

a. Control

The first element, that the RR exercised *control* over trading in the customer's account, represents a significant distinction from qualitative unsuitability, which requires only that the RR have *recommended* an unsuitable investment. An RR exercises control over a customer's account if the RR makes the trading decisions, either because the RR has formal discretionary authority, or because the RR makes trades without obtaining prior authorization from the customer. Even if the RR does obtain the customer's authorization for every trade, however, the SEC has held that:

> a broker's de facto control over an account may be established when the customer relies on the representative such that the representative controls the volume and frequency of transactions. Alternatively, de facto control exists where a customer routinely follows a registered representative's recommendations. In that context, we have considered whether the customer had sufficient understanding to make an independent evaluation of the broker's recommendations.[55]

The four Beyn customers who testified all stated, credibly, that they relied on Beyn to determine the trading strategy for their accounts; to identify the companies in which to invest; and to determine when and how much to invest and when to sell. They also testified that they routinely followed Beyn's recommendations. While the other two Beyn customers did not testify, the trading in their accounts was similar to the trading in the testifying customers' accounts, but with even greater frequency and even higher cost-to-equity ratios, and Beyn himself marked nearly every transaction in their accounts as solicited. The customers who testified did not evince sufficient understanding of the trading in their accounts to independently

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[52] NASD IM-2310-2(b)(2); *John M. Reynolds*, 50 S.E.C. 805, 809 n.13 (1991).

[53] CX-13A; CX-13B.

[54] *Dep't of Enforcement v. Davidofsky*, No. 2008015934801, 2013 FINRA Discip. LEXIS 7, at *27 (NAC Apr. 26, 2013) (internal quotation marks and footnotes omitted).

[55] *Ralph Calabro*, Exchange Act Release No. 75076, 2015 SEC LEXIS 2175, at *18 (May 29, 2015) (internal quotation marks and footnotes omitted); *see also Dep't of Enforcement v. Medick*, No. E9B2003033701, 2009 FINRA Discip. LEXIS 7, at *34 (NAC July 20, 2009) ("*De facto* control is established when the client routinely follows the broker's advice because the customer is unable to evaluate the broker's recommendations and to exercise independent judgment.") (internal quotation marks and footnote omitted).

evaluate the full significance of Beyn's recommendations. EK and BM were inexperienced investors, while TP and EH were more experienced, but all four were unaware of the costs they were incurring for Beyn's trading in their accounts. All of them believed they were paying just $99 per trade and that any losses in their accounts were attributable to unsuccessful stock picks by Beyn, a risk that they accepted when they agreed to open a CSC account and follow Beyn's earnings play investment strategy. They did not realize that because they were being charged large markups and markdowns on the transactions in their accounts, the trading was primarily for the benefit of Beyn and CSC, regardless whether there were market gains or losses on the individual transactions. While the other two Beyn customers did not testify, the Panel concludes that they, too, were ignorant of the full amount of the costs they were incurring because the testimony of the other four customers established a pattern of non-disclosure and because no rational investor would knowingly agree to incur costs at the levels Beyn charged.

The Panel considered Beyn's testimony describing the customers as highly sophisticated investors and claiming that he discussed the risks and costs of each trade, including markups and markdowns, with the customers. The Panel, however, rejects all of Beyn's testimony in that regard, as well as Beyn's other self-serving statements, as not credible.

During Enforcement's investigation, while he was still associated with CSC, Beyn gave sworn testimony generally favorable to Taddonio and Porges in three OTRs. Later in 2015, however, Beyn left CSC after being placed on heightened supervision, and opened his own OSJ with another FINRA member firm. In his Answer to Enforcement's Complaint, which was filed in May 2016, Beyn leveled a wide variety of accusations against Taddonio and Porges, blaming them for the levels of trading in the customers' accounts. Beyn signed a notarized "Verification" stating, under penalty of perjury, that he had read the Answer, knew its contents and "that the same is true based on my personal knowledge of the facts of this matter." In June 2016, Enforcement took a fourth sworn OTR of Beyn during which he contradicted the sworn testimony he had given during his first three OTRs and accused Taddonio and Porges of a variety of improper actions relating to their supervision of CSC and interference in Enforcement's investigation.

At the hearing, however, once again in sworn testimony, Beyn recanted the statements in his verified Answer and in his fourth OTR, asserting that he had not read the Answer before swearing to its accuracy and had misunderstood the clear and unambiguous questions he was asked during his fourth OTR. Beyn also admitted, however, that when he opened his OSJ, he felt he would have an easier time transferring his customers from CSC if he had less competition from Taddonio and Porges. Beyn said he was furious because many of his customers decided to stay at CSC. He stated: "I was trying to get [Porges and Taddonio] looked at more carefully so I could have an easier time of convincing my clients that our firm was a better choice."[56] The Panel concludes that Beyn lied under oath at his June 2016 OTR in order to injure Taddonio and Porges and advance his own interests.

[56] CX-116A; CX-116B; CX-116C; CX-116D; Tr. 2063-2162, 3855-57.

Moreover, the Panel observed Beyn as he testified at the hearing. Beyn was evasive, avoiding direct responses to clear questions; his testimony was inconsistent; and his demeanor suggested that he was formulating answers that he thought might be helpful to his case rather than providing candid responses to the questions. The members of the Panel, all of whom have sat on numerous Hearing Panels over the years, unanimously agree that Beyn was one of the least credible witnesses they had ever encountered.

Apart from Beyn's lack of credibility, his characterization of the testifying customers as sophisticated investors who were actively involved in making investment decisions in their accounts was contrary to the Panel's assessment of the customers based on their testimony. In fact, the Panel finds that the customers were experienced and competent businessmen who mistakenly trusted and relied on Beyn to manage their investments while they managed their businesses.

For example, Beyn testified that EK told him he actively traded his account at another FINRA member firm, in contrast to EK's testimony that he made only a single trade in that account. Beyn also testified that EK told him he traded penny stocks at another FINRA member firm and lost $100,000. According to Beyn, he tried to explain the risks of trading on earnings to EK, but EK responded that he was not a child and Beyn should simply give him information and EK would make the investing decisions. Beyn testified that EK had a schedule for Beyn to follow and wanted Beyn to bring him several recommendations at a time, some long-term and some short-term, and then review each recommendation with him. Beyn claimed that he and EK would discuss the markups and markdowns Beyn charged and that EK never had a problem with Beyn's charges while he was Beyn's customer at CSC. Beyn described EK as a "very sophisticated" investor.[57] The Extended Hearing Panel rejects Beyn's testimony on these matters as not credible. Instead, the Panel finds that EK was an inexperienced, unsophisticated investor who relied entirely on Beyn in making investments in his CSC account. The Panel rejects Beyn's testimony that he discussed markups and markdowns with EK; rather, the Panel finds that EK reasonably believed that he was being charged only $99 per trade.

Beyn testified that BM (1) was very knowledgeable about companies in the aerospace industry, explaining industry stocks to Beyn, including their one-year highs, their 200-day average prices and their market capitalizations; (2) had traded previous accounts before opening his CSC account; and (3) elected to pursue the earnings play strategy after Beyn carefully explained the risks. According to Beyn, he told BM that the earnings play strategy was very speculative and urged him to open an individual account to pursue that strategy, but BM decided to pursue it in his CSC IRA, even though that account did not have a speculation investment objective. Beyn testified that he and BM spoke about every trade and he explained to BM each markup and markdown he charged.[58] Once again, the Panel rejects Beyn's testimony based on the Panel's assessment of the relative credibility of Beyn and BM. Like EK, BM was an

[57] Tr. 3889-3900.

[58] Tr. 3861-68.

inexperienced and unsophisticated investor who trusted Beyn. In particular, the Panel rejects Beyn's testimony that he disclosed the amount of markups and markdowns he charged when making trades in BM's account and credits BM's testimony that he believed he was being charged only $99 per trade.[59]

Beyn testified that he ignored the growth objective listed for TP's IRA, making speculative investments utilizing the earnings play strategy, because he spoke to TP and knew TP's "real" objective for the account. According to Beyn, TP was very knowledgeable about investments and the markets. Beyn claimed he told TP about the websites where he researched companies for investments, and that he and TP worked together to find companies in which to invest TP's accounts. Beyn testified that TP rejected many of Beyn's recommendations and that TP brought many potential investments to Beyn, asking Beyn to research them. According to Beyn, he told TP that many of the investments TP wanted to make were unsuitable for an IRA, but TP nevertheless wanted to make the investments.[60] As with EK and BM, the Extended Hearing Panel rejects Beyn's testimony based on the Panel's assessment of Beyn's credibility, as compared to TP's. While TP had more investing experience than EK and BM, it was clear from his testimony that he was not a sophisticated investor and was far more involved in managing his construction business than his CSC accounts. The Panel credits TP's testimony that although he intended to speculate in his individual account, he expected that the trading in his IRA would be different, and would reflect the more conservative growth objective listed for the account. The Panel finds that TP trusted Beyn to recommend trades in the two accounts based on the different objectives listed and in particular that TP was not aware that he was being charged markups and markdowns on trades in both accounts, in addition to the $99 Firm Commission.[61]

Beyn described EH as one of the most sophisticated customers he has ever had, with a vast knowledge of all products, but particularly gold, silver, natural gas and oil investments. According to Beyn, he explained his earnings play strategy to EH and told him it was highly speculative, but EH responded that he had bought many companies in the past in anticipation of

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[59] Respondents' exhibits include a CSC form entitled "Intent to Maintain Active Account" signed by BM that contains financial information that is consistent with BM's testimony and indicates that his prior investment experience involved approximately six cash account trades, no trades on margin, and no options trades annually over the prior five years. Respondents' exhibit RX-37also includes some of BM's account statements for his account at another FINRA member firm listing his only holding as Taser stock, which is again consistent with his testimony

[60] Tr. 3868-78.

[61] Respondents' exhibits included account statements for TP's Brookstone account before TP transferred his account to CSC. RX-14. The statements indicate that TP's number one account objective was speculation, but the Brookstone account was an individual account; TP acknowledged that he also had a speculation objective for his CSC individual account. It was TP's CSC IRA for which he listed a growth objective. TP's Brookstone account statements also show that TP transferred various investments into his Brookstone account that reflected a pre-existing interest in gold and silver investments. Once again, during his testimony TP acknowledged that he intended to invest in leveraged gold and silver ETFs, but not ETNs, in his individual CSC account, where he was willing to speculate. TP denied, however, that he wanted to purchase gold or silver ETFs or ETNs in his IRA, because he understood those were speculative investments and he did not want to speculate in that account. Tr. 1615. The Panel finds TP's testimony credible in that regard.

earnings. Beyn claimed that EH told him he had a lot of experience trading both ETFs and ETNs. Beyn testified that EH was part of many investment blogs and would reject many of Beyn's recommendations. In some cases, according to Beyn, he had to keep EH apprised hourly with information about the ETNs in which he invested. Beyn claimed that he and EH reviewed the commissions and trades in EH's accounts, including the turnover rates and cost-to-equity ratios. Beyn insisted that EH knew of the performance of his accounts, understood the losses he was incurring, and knew he was in full control of the investments in his accounts.[62]

Of the four Beyn customers who testified, EH was clearly the most experienced. In his testimony, EH acknowledged that he liked gold and silver investments and brought gold and silver investment ideas to Beyn, including investments in leveraged gold and silver ETFs. Further, Respondents offered in evidence account statements for EH's IRA at another FINRA member firm, before he transferred that account to CSC, which indicate that EH made numerous unsolicited investments in gold and silver ETNs and ETFs, including leveraged products, as well as a few other speculative investments, such as commodities ETFs.[63]

Nevertheless, the Panel rejects Beyn's testimony that EH was a sophisticated investor with a vast knowledge of investment products; that EH had past experience with earnings play investing; that EH rejected many of Beyn's recommendations; and, most importantly, that he and EH reviewed the commissions and trades in EH's accounts, including the cost-to-equity ratios, and that EH was satisfied. The Panel, having observed EH during his testimony, does not find him to be a sophisticated investor. The Panel credits EH's testimony that he was unaware that he invested in ETNs, as opposed to ETFs, and that he did not understand those products, even though the evidence indicates that he had invested in them in an account at another FINRA member firm. The most likely explanation, the Panel concludes, is that EH made the investments at the prior firm without fully understanding the nature of the products he was purchasing. Indeed, the clearest indication that EH was not a sophisticated investor is that he purchased and held products that were not intended for retail investors and were not designed to be held for more than a single day. Further, EH's principal concern was not the nature of the investments in his account, but that he was misled as to the costs of the trading in his account, believing that he was being charged only the $99 Firm Commission for each trade. EH's testimony in that regard is credible because it is consistent with the testimony of the other customers and because no

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[62] Tr. 3879-89.

[63] Respondents' other exhibits relating to EH include (1) RX-12, account statements from an EH individual account at another FINRA member firm in 2005 listing his investment objective as capital appreciation and his risk tolerance as moderate, and showing account holdings of mostly blue chip stocks with little trading; (2) RX-13, an account statement from EH's account at Brookstone, where Beyn was also his RR, indicating that EH's number one objective was speculation; and (3) RX-27, a November 2003 new account form for an EH account at another FINRA member firm indicating that EH had 20 years of experience in stocks and bonds and 10 years in options, and that his objective was capital appreciation, with a primary risk profile of moderate and a secondary risk profile of aggressive/speculative. None of the information in these exhibits shows that EH was able to independently evaluate Beyn's recommendations, particularly since EH was unaware of the markup and markdown costs he would incur.

sophisticated, or even any unsophisticated, investor who understood what he was being charged for the trades in his account would have authorized the trading that took place in EH's accounts.

Accordingly, the Panel finds that Beyn exercised de facto control over the trading in the accounts of EK, BM, TP and EH.[64]

The Panel also finds the evidence sufficient to support a finding that Beyn exercised de facto control over the trading in the accounts of the two customers who did not testify. WR had two accounts at CSC, at different times, with Beyn as his RR for both accounts. As explained above, Beyn traded both accounts actively and marked 77 of 94 trades in the first account and all 88 trades in the second account as solicited.[65] Similarly, Beyn marked 105 of 106 trades in JB's account as solicited. As opposed to the four customers who testified, Beyn did not claim that either WR or JB was a sophisticated investor who could and did independently evaluate Beyn's recommendations. Finally, the cost-to-equity ratios for WR's two accounts and JB's account were so outrageously high that no rational customer who was aware of the actual charges for the trading would have agreed to incur them.

b. Excessive Trading

The second element required to prove quantitative unsuitability is "excessive trading," which focuses on the frequency and cost of the trading. The SEC and the NAC have considered the rate of turnover of the account and the costs incurred by the customer as compared to the value of the account as the key considerations in determining whether the trading was excessive. High turnover is viewed as inconsistent with traditional investment guidance, while high cost-to-value makes it less likely that the customer can profit from the trading and more likely that the

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[64] *See Calabro*, 2015 SEC LEXIS 2175, at *21 & n.23 (finding that the RR "exercised de facto control over [the customer's] account because [the customer] routinely followed [the RR's] recommendations. [The customer] deferred to [the RR] with respect to establishing (and altering) account strategy, selecting securities, and determining when and in what quantities to trade them. When [the RR] informed [the customer] of transactions that [the RR] selected or had already implemented, [the customer] felt he could not object to them because of his lack of knowledge and expertise"); *see also Michael David Sweeney*, 50 S.E.C. 761, 766 (1991) (finding control where "[w]ith few exceptions, the customers did not initiate the transactions in their accounts, nor did they fully understand the trading therein. When the customers decided to effect the transactions at issue, they were relying totally on the [RRs]. Indeed, the [RRs'] consultations with their customers on investment choices were merely a formality, since the customers invariably followed their recommendations"); *Richard G. Cody*, Exchange Act Release No. 64565, 2011 SEC LEXIS 1862, at *43 (May 27, 2011), *aff'd*, 693 F.3d 251 (1st Cir. 2012) (finding that respondent "maintained *de facto* control because the Customers did not independently evaluate his recommendations but rather acquiesced in his trades"); *Joseph J. Barbato*, 53 S.E.C. 1259, 1277 (1999) (concluding that the RR exercised de facto control where the customer "testified that he placed his trust and confidence in [the RR] and allowed him to decide what to buy or sell in the account").

[65] Respondents' exhibits include account statements for WR's account at another FINRA member firm during the same general time frame as his two CSC accounts. Those account statements list WR's investment objective as speculation and his risk tolerance as maximum risk, and the statements show purchases of speculative stocks and leveraged ETFs. All of the transactions in that account, however, are marked as solicited, and as a result, the Panel does not find that the trades indicated WR was a sophisticated investor who could have independently evaluated Beyn's recommendations. *See* RX-15 through RX-19.

firm and the RR will be the primary beneficiaries. These considerations are typically expressed as numerical values, the annualized turnover rate and the annualized cost-to-equity percentage. As the SEC recently explained:

> The turnover rate represents the number of times in one year that a portfolio of securities is exchanged for another portfolio of securities and is calculated by dividing the total account purchases by the average account equity and annualizing the number. The cost-to-equity ratio measures the amount an account has to appreciate annually just to cover commissions and other expenses and is obtained by dividing total expenses by average monthly equity. While there is no definitive turnover rate or cost-to-equity ratio that establishes excessive trading, we have held that a turnover rate of 6 or a cost-to-equity ratio in excess of 20% generally indicates that excessive trading has occurred. … Other relevant factors in determining the existence of excessive trading include the number and frequency of trades; the client's investment objectives and financial condition, age, and retirement status; and the existence of unauthorized trades.[66]

Applying these standards to Beyn's trading of the accounts of the six customers, there is no question that the trading in most of the accounts was excessive. According to Enforcement's calculations, the annualized cost-to-equity ratio for BM's account was 70.86% and the annualized turnover rate was 23.29; for EK's account the annualized cost-to-equity was 70.78% and the annualized turnover was 18.61; for TP's individual account the annualized cost-to-equity was 71.50% and the annualized turnover was 22.43, while for TP's IRA the annualized cost-to-equity was 33.86% and the annualized turnover was 10.72; for EH's individual account the annualized cost-to-equity was 21.28% and the annualized turnover was 8.41, while for EH's IRA the figures were 18.1% and 8.25; for WR's first CSC account the annualized cost-to-equity was 182.66% and the annualized turnover was 52.7, while for WR's second CSC account the figures were 546.28% and 177.87; and finally, for JB's account the annualized cost-to-equity was

[66] *Calabro*, 2015 SEC LEXIS 2175, at *32-34 (internal quotation marks, footnotes, and citations omitted); *see also Davidofsky*, 2013 FINRA Discip. LEXIS 7, at *30 & nn.29-30, and cases cited therein.

573.37% with an annualized turnover of 188.55. With the exception of EH's IRA, all of these figures are indicative of excessive trading.[67]

With regard to the other relevant factors, the number of trades in the customers' accounts ranged from a high of 662 trades in TP's IRA over a period of 20 months to a low of 80 trades in BM's account over a period of just five months. The frequency of trades ranged from a low average number of trades of 6.38 per month in EK's account to a high of over 31.5 trades per month in TP's IRA.[68]

In most of the accounts, the client's investment objective was listed as speculation, but Beyn traded the accounts the same regardless of the listed objective, as shown by the trading in TP's IRA, with a listed objective of growth. Similarly, Beyn traded all the accounts the same way regardless of the customer's stated financial condition or age. Nevertheless, Beyn contends that the trading was consistent with the customers' financial circumstances and investment objectives either as set forth in their new account documentation, or as he understood them from his discussions with the customers. He insists that the customers all wanted to speculate and that they were aware of the speculative nature of the earnings play strategy he employed in their accounts.

The Extended Hearing Panel concludes that the trading in the accounts of the customers was excessive even assuming that they all wished to speculate and without regard to their actual financial condition, age or retirement status. The Panel acknowledges that active trading to effect an earnings play strategy, leading to turnover rates well above six, could conceivably be suitable for certain sophisticated customers who understand the risks associated with such trading. The Panel can conceive of no investors, however, for whom cost-to-equity ratios at the levels found

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[67] CX-13A. The Enforcement staff member who prepared the charts summarizing the trading in the Beyn accounts at issue, as well as the larger number of accounts discussed below with regard to the failure to supervise charge against Taddonio and Porges, explained his methodology, and the underlying trading records, account statements and other materials he relied on were introduced in evidence. Tr. 552-645; CX-12; CX-14; CX-222 through CX-262. Respondents did not challenge the accuracy of the calculations or the underlying data. Respondents did argue that in some cases the summaries unfairly considered only a portion of the time period during which an account was open, but if an account is heavily traded during only a portion of the time that it is open, it is appropriate to consider whether the trading during that period was excessive. Respondents also questioned the use of annualized turnover rates and cost-to-equity ratios where an account was open, or heavily traded, for a period of less than a year, but annualized figures are typically relied on to allow meaningful comparisons between accounts that are heavily traded over different time periods, and in any event, the charts also include non-annualized turnover rates and cost-to-equity ratios, which are also indicative of excessive trading. The Panel, therefore, finds the charts prepared by Enforcement provide reliable evidence regarding the level of trading in the customer accounts at issue. Furthermore, regardless of the time period or calculation methodology used, the rate of trading in the accounts and the level of costs imposed on the customers were so outrageous that they clearly indicated Beyn was excessively trading the accounts for his own benefit, rather than in the interests of the customers. *Cf. Dep't of Enforcement v. Merhi*, No. E072004044201, 2007 NASD Discip. LEXIS 9, at *11 n.6 (NAC Feb. 16, 2007) ("Enforcement's calculation of a 94.17% cost-to-equity ratio was slightly less than the actual rate of 94.85%. This difference is immaterial to our finding that [respondent] traded excessively.").

[68] CX-13A.

in most of the Beyn customers' accounts at issue would be suitable. Arguably, a customer who wanted to speculate using the earnings play strategy might benefit from a high account turnover if the cost of trading was low. In six of the nine Beyn customers' accounts, however, the annualized cost-to-equity ratios were over 70%, with two more than 500%. No customer could expect to earn a reasonable return on speculative trading with costs of those magnitudes.

To the extent that Beyn's customers understood and agreed to a speculative investment strategy, they would reasonably have understood that they were accepting high market risk, *i.e.*, the possibility that the securities in which they invested might decrease in value. And indeed none of the customers who testified complained about losses they incurred in speculative accounts as a result of market forces. Rather, they objected to Beyn's unconscionable charges for making the trades in their accounts, charges that were not disclosed by Beyn or clearly set forth in the trade confirmations they received. Indeed, in some of the customers' accounts much or all of the losses were attributable to the costs of trading rather than to losses on the trades themselves.[69]

The Panel finds that the only accounts in which excessive trading was not clear simply from the turnover rates coupled with the cost-to-equity ratios were EH's individual account, with an annualized turnover rate of 8.41 and an annualized cost-to-equity ratio of 21.28%, and EH's IRA, for which the annualized turnover rate was 8.25 and the annualized cost-to-equity ratio was 18.1%. It is conceivable that some reasonable sophisticated investor might knowingly agree to speculative trading at such levels. As explained above, however, the Panel finds that Beyn did not disclose to EH the costs that he was incurring for the trading in his account, and that EH reasonably believed that he was being charged only $99 per trade. Under those circumstances, the Panel concludes that the trading in both of EH's accounts was excessive.

Accordingly, the Panel concludes that Beyn engaged in excessive, quantitatively unsuitable trading in nine accounts of six CSC customers, in violation of NASD Rule 2310, for trading prior to July 9, 2012; FINRA Rule 2111, for trading beginning on July 9, 2012; and FINRA Rule 2010 for the entire period.[70]

2. Churning

Enforcement also alleged that Beyn churned the customers' accounts, in violation of Section 10(b) of the Securities Exchange Act of 1934, SEC Rule 10b-5, and FINRA Rules 2020 and 2010. The standards for finding churning are the same as those for excessive trading, except that to establish churning the evidence must also show that Beyn acted with scienter, which "requires proof that a respondent intended to deceive, manipulate, or defraud, or acted with

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[69] *See* cost and loss figures for customers set forth in CX-13A.

[70] NASD's Suitability Rule 2310 was replaced by FINRA's Suitability Rule 2111 as of July 9, 2012. A violation of any applicable NASD or FINRA rule is also a violation of FINRA Rule 2010's requirement that FINRA member firms and their associated persons observe high standards of commercial honor and just and equitable principles of trade.

severe recklessness involving an extreme departure from the standards of ordinary care."[71] In a recent churning case finding scienter, the NAC noted that "[t]he cost-to-equity ratio and turnover rate for [the customer's] account were so high that [the respondent] must have known that he was acting in reckless disregard of [the customer's] interests – [the customer] had to earn nearly 45 percent per year simply to break even." The NAC also stated that "the amount of commissions that [the respondent] generated from trading [the customer's] account demonstrates that he acted with scienter."[72]

Applying the NAC's reasoning here, the cost-to-equity ratios and turnover rates for most of the customer accounts support a finding that Beyn churned the accounts. Once again, the exception is EH's accounts. The Panel finds, however, that the trading in EH's account must be viewed as part of a pattern of Beyn excessively trading customer accounts. Furthermore, Enforcement calculated that Beyn's share of the commissions on the trades in the customer accounts at issue was nearly $650,000, which under the NAC's reasoning also supports a finding that he churned the accounts.

Accordingly, the Hearing Panel concludes that Beyn churned nine accounts of six FINRA customers in violation of Section 10(b) of the Securities Exchange Act of 1934, Rule 10b-5, and FINRA Rules 2020 and 2010. [73]

IV. Beyn Recommended Qualitatively Unsuitable Investments to a Customer

A. Facts

Enforcement alleged that Beyn made unsuitable recommendations to customer EK to invest in iPath S&P 500 VIX Short Term Futures ETNs ("VXX") and in two leveraged ETNs, VelocityShares 3X Long Gold ETN ("UGLD") and Velocity Shares 3X Long Silver ETN ("USLV").

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[71] *Davidofsky*, 2013 FINRA Discip. LEXIS 7, at *31-32 (internal quotation marks and footnotes omitted). A finding of a violation of Section 10(b) and Rule 10b-5 also requires proof that the Respondents used "any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange." 17 C.F.R. § 240.10b-5. This requirement is plainly satisfied here because the RRs communicated with the customers by telephone and the excessive trades were effected through various means of interstate commerce and the facilities of national securities exchanges.

[72] *Davidofsky*, 2013 FINRA Discip. LEXIS 7, at *33.

[73] In his post-hearing brief, Beyn contends that the Panel cannot find that he excessively traded or churned the accounts of WR and JB because they did not testify. Beyn is incorrect. There is no requirement that a customer testify in order for a FINRA Hearing Panel to conclude that the customer's account was excessively traded or churned. Rather, as with other alleged violations, Enforcement must introduce evidence sufficient to establish a *prima facie* case in support of the charges and must prove the violations charged by a preponderance of the evidence, considered as a whole. In this case, as explained above, the levels of trading in the accounts, including especially the cost-to-equity ratios, together with the fact that Beyn marked the vast majority of the trades as solicited, is sufficient to establish a *prima facie* case of excessive trading and churning, and there is no credible evidence in the record to the contrary.

In June 2012, EK invested more than $63,000 in VXX, about 20% of the value of his account, and held the VXX until June 2013, when it was sold at a loss of $42,500.[74] VXX was an extraordinarily complex product that was "linked to the performance of the S&P 500 VIX Short-Term Futures™ Index Total Return and the S&P 500 VIX Mid-Term Futures™ Index Total Return," and was "designed to provide access to equity market volatility through the CBOE Volatility Index ('VIX Index') futures." It was intended "to provide investors with access to equity market volatility through a liquid investment, and [could] be used as [a] short-term tactical vehicle[] to express views on the direction of volatility or as [a] customizable solution[] to manage or hedge risk in a portfolio."[75] Without question, VXX is a highly complex product that is intended only for highly sophisticated investors with specialized investment needs.

EK invested the remaining balance of his account, approximately $120,000, in UGLD and USLV in August 2013, and EK still held those positions when his account was transferred out of CSC in October 2013.[76] The prospectus for UGLD and USLV explained:

> The ETNs are intended to be daily trading tools for sophisticated investors to manage daily trading risks. They are designed to achieve their stated investment objectives on a daily basis, but their performance over different periods of time can differ significantly from their stated daily objectives. The ETNs are riskier than securities that have intermediate or long-term investment objectives, and may not be suitable for investors who plan to hold them for a period other than one day. Accordingly, the ETNs should be purchased only by knowledgeable investors who understand the potential consequences of investing in the applicable Index … and of seeking daily compounding leveraged long or leveraged inverse investment results, as applicable. Investors should actively and frequently monitor their investments in the ETNs, even intra-day. *It is possible that you will suffer significant losses in the ETNs even if the long-term performance of the applicable Index is positive, in the case of the Leveraged Long ETNs, or negative, in the case of the Leveraged Inverse ETNs.*[77]

As with VXX, plainly these ETNs were intended only for highly sophisticated investors with specialized needs.

B. Discussion

As noted above, FINRA's suitability standard was set forth in NASD Rule 2310 until July 9, 2012, after which FINRA Rule 2111 governed. While the texts of the two rules differ

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[74] CX-170, at 32 (sale), 121 (purchase); CX-166, at 1-2 (trade confirmations). EK purchased 4,000 VXX, but after a reverse split in October 2012, he owned only 1,000 at the time of sale. CX-170, at 93.

[75] CX-171, at 38-43.

[76] CX-170, at 4 (transfer), 16 (purchase); CX-166, at 3- 4 (trade confirmations).

[77] CX-173 (emphasis in original).

somewhat, the substance is the same: an RR who recommends a transaction to a customer must have a reasonable basis to believe that the transaction is suitable for the particular customer to whom the recommendation is made. This requirement is referred to as "qualitative suitability." In determining whether a recommended transaction is qualitatively suitable, under NASD Rule 2310, the RR was required to consider "the facts, if any, disclosed by such customer as to his other security holdings and as to his financial situation and needs," while under FINRA Rule 2111, the RR is required to consider "the customer's investment profile [which] includes, but is not limited to, the customer's age, other investments, financial situation and needs, tax status, investment objectives, investment experience, investment time horizon, liquidity needs, risk tolerance, and any other information the customer may disclose to the member or associated person in connection with such recommendation."

As the NAC recently explained, there are two steps in a suitability analysis:

> First, a broker must conduct a reasonable investigation and conclude that a recommendation could be suitable for at least some investors. ... This reasonable diligence is referred to as "reasonable-basis" suitability. Second, the broker must assess whether an investment recommendation is suitable for the specific customer to whom it is made, and to tailor recommendations to a customer's financial profile and investment objectives. ... This "customer-specific" suitability turns on the particular facts and circumstances of the customer's situation.[78]

Beyn did not argue that VXX, UGLD or USLV was a suitable investment for EK, and the Extended Hearing Panel finds that they were not suitable. As the descriptions of the investments set forth above make clear, the products in question were designed primarily for institutional or highly sophisticated individual investors who would reasonably invest in the products under very narrowly defined circumstances. EK was not such an investor and VXX, UGLD and USLV were plainly not appropriate investments for him. Beyn, however, contends that he did not solicit EK to make those investments; rather, according to Beyn, EK brought the idea of the investments to him and EK made the investments on an unsolicited basis against Beyn's advice.

Beyn claimed that CSC prohibited brokers from soliciting customers to buy ETNs and that he remembered EK calling to make an unsolicited purchase of VXX when VXX was all over the news. In fact, EK's VXX purchase is marked as solicited on the firm's trade blotter, but Beyn asserted that he must have erroneously entered the trade.[79] The Panel rejects Beyn's testimony about the circumstances of EK's purchase of VXX. For the reasons explained above, the Panel finds all of Beyn's self-serving testimony not credible; in contrast, the Panel finds EK's testimony that Beyn recommended all the purchases in his account, and that he did not even

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[78] *Dep't of Enforcement v. Luo*, No. 2011026346206, 2017 FINRA Discip. LEXIS 4, at *27-28 (NAC Jan. 13, 2017) (citations omitted).

[79] Tr. 2249-50; CX-262, at 27.

know what an ETN is, quite believable.[80] The Panel finds EK to be an inexperienced, unsophisticated investor who would have had no reason to even know about, much less to make an unsolicited purchase of, an investment product such as VXX. Further, the evidence shows that customers of several other CSC brokers made similar purchases of VXX on the same day EK made his purchase and all those purchases were also marked as solicited.[81] The Panel concludes that Beyn made an unsuitable recommendation to EK to purchase VXX.

Unlike the VXX purchase, Beyn marked EK's purchases of UGLD and USLV as unsolicited. According to Beyn, EK directed Beyn to buy gold and silver ETNs in his account, even though Beyn advised EK that they were not safe investments and had been created for day trading. According to Beyn, EK understood the risks of investing in UGLD and USLV but still directed Beyn to purchase them. Beyn testified he remembered arguing with EK about the purchases, but Beyn asserted that EK was really hard-headed and told Beyn that he knew gold and silver and was certain that their prices would increase. Beyn also testified that he tried to get EK to sell the UGLD and USLV on the day he bought them, at a small gain, but EK insisted on keeping the investments. According to Beyn, EK could have avoided losses on the investments if he had only listened to Beyn.[82]

EK, however, testified that Beyn brought those investments to him. According to EK, Beyn "convinced [him] that these were great stocks, for the simple reason, if you make any money off of them, they will pay three times as much," but Beyn never explained to EK that he could lose three times as much if the prices of gold and silver fell or otherwise explain the risks associated with the investments. EK acknowledged that he authorized the purchases.[83]

Once again, the Panel does not credit Beyn's testimony, but rather credits EK's description of the circumstances under which he invested in UGLD and USLV. As with VXX, it is highly unlikely that an inexperienced and unsophisticated investor such as EK would have identified and initiated an investment in products such as UGLD and USLV. Beyn, however, was well aware of those investment products because his customers TP and EH had invested in them through Beyn. The Panel, therefore, finds that Beyn recommended that EK invest in UGLD and USLV without having a reasonable basis to believe that they were suitable investments for EK.

Accordingly, the Extended Hearing Panel concludes that Beyn made qualitatively unsuitable investment recommendations to EK, in violation of NASD Rule 2310 and FINRA Rule 2010, with regard to the VXX purchase, and in violation of FINRA Rules 2111 and 2010, with regard to the UGLD and USLV purchases.

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[80] Tr. 2547-48.

[81] CX-262, at 27-28; Tr. 2250-55.

[82] Tr. 3898-3900.

[83] Tr. 2556-58.

V. Taddonio and Porges Failed to Exercise Reasonable Supervision over the RRs

In its post-hearing brief, Enforcement argued that the Extended Hearing Panel should find that during the period from January 2012, when CSC's FINRA membership was approved, through the end of 2014, CSC RRs Beyn, Bader, Cannata and Venturino excessively traded 37 accounts of 30 CSC customers and churned some of the accounts, and that the Panel should also find that Taddonio and Porges failed to fulfill their supervisory responsibilities by allowing the excessive trading and churning to occur. Apart from the evidence regarding Beyn's customers and their accounts discussed above, however, Enforcement offered very limited evidence regarding the 30 customers and 37 customer accounts at issue in the failure to supervise charge.[84] The Panel finds it unnecessary to determine whether the 37 accounts were, in fact, excessively traded. Rather, the Panel finds it sufficient to address three issues: (1) were Taddonio and Porges made aware of red flags, *i.e.*, circumstances indicating that the RRs were, or might be, excessively trading customer accounts; (2) if so, were the firm's responses to the red flags, whether by Taddonio or Porges or other firm principals, sufficient to fulfill CSC's supervisory responsibilities for the RRs' sales practices; and (3) if the firm's responses to red flags were not adequate, did Taddonio and Porges each bear responsibility for the supervisory failures.[85]

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[84] Aside from Beyn's customers discussed above, the Extended Hearing Panel heard testimony from only one of the 30 customers, DB, who farms, runs cattle and operates a feed lot in Nebraska, and who was a customer of Bader. DB's testimony was similar to that of Beyn's customers. He was solicited to open a Brookstone account through a cold call; he had no prior hands-on investing experience; he agreed to open an account in the name of his company, BB, Inc., with a small $3,000 investment; Bader took over the account and DB's account was transferred to CSC after the firm opened; Bader persuaded DB to invest much more than he had originally intended; Bader claimed that he would return the additional sums invested as soon as the account was profitable, and just trade the profits; the account was not profitable and Bader persuaded DB to invest more money and to trade on margin; DB relied entirely on Bader for the investments in his account; and Bader never discussed or disclosed what the charges would be for the trading in DB's account. Ultimately DB incurred losses of over $400,000 on the account, with total costs of over $200,000, an annualized cost-to-equity ratio of nearly 200%, and an annualized turnover rate of nearly 52. Tr. 1073-1154; CX-12. The Panel finds that Bader controlled the account and excessively traded it. The Panel did not hear directly from any of the other customers, although a FINRA examiner described his conversations with a few of them. For the reasons set forth above, the Panel does not find it appropriate to place significant weight on the examiner's recollection of his conversations. Thus, the only reliable evidence in the record regarding the remainder of the 30 customers and 37 accounts is the account documentation and trading records. While that evidence supports a conclusion that the accounts were excessively traded, the Panel does not find it definitive and thus makes no findings that the RRs actually controlled the accounts and excessively traded them.

[85] The trading in the 37 accounts is summarized in CX-12. The 37 accounts and 30 customers do not include the account of Beyn customer BM, which was opened and traded in 2015, after the relevant period for the failure to supervise charge against Taddonio and Porges. On the other hand, the 37 accounts do include some Beyn customers and accounts that were not included in Enforcement's allegations against Beyn discussed above. Because the Panel finds it necessary to determine, for purposes of the failure to supervise charge, only whether there were red flags indicating that Beyn was or *might be* excessively trading the additional customer accounts, the Panel finds no conflict from Enforcement including additional Beyn customers and accounts in the failure to supervise charge that were not cited in the excessive trading allegations against Beyn.

A. Taddonio and Porges Were Made Aware of Red Flags Indicating Excessive Trading by the RRs

It is beyond dispute that there were ample red flags indicating that Beyn, Bader, Cannata and Venturino were, or might be, excessively trading customer accounts. The most glaring red flag was the trading itself, all of it carried out openly by the four RRs, with all of the trading details reflected in CSC's books and records. As quoted above, the SEC has held that a turnover rate of 6 or a cost-to-equity ratio in excess of 20% is an indication that excessive trading has occurred. Enforcement calculated annualized turnover rates above six for all the 37 customer accounts, with 13 of the accounts having annualized turnover rates in excess of 100 and the highest over 262. Enforcement also calculated that all but two of the 37 accounts had annualized cost-to-equity ratios in excess of 20%, with 25 of the accounts having annualized cost-to-equity ratios in excess of 100%, the highest being more than 824%, indicating that, on an annualized basis, the customer would have needed a return of more than 824% just to break even on the trading in the account. Beyn was the RR assigned to twelve of the accounts; Bader was the RR on seven of the accounts; Cannata was the RR on nine of the accounts; and Venturino was the RR on nine of the accounts.[86]

There were more than 9,000 trades in the 37 accounts with total costs of just under $6 million, and the overwhelming majority of the trades were marked as solicited by the RRs. The turnover rates in the accounts combined with the cost-to-equity ratios in the accounts made it highly unlikely that the customers would realize any profits on the trading in their accounts, even if the trading was otherwise successful in generating gains. And indeed, in the 37 customer accounts analyzed by Enforcement, the customers incurred total losses of more than $9 million. Not one of the 37 accounts realized overall profits from the trading. On the other hand, CSC and the four RRs earned millions of dollars in commissions from the trading, suggesting that the RRs were trading to further their own interests and the interests of CSC, rather than the interests of their customers. These circumstances constituted red flags indicating that the RRs were, or might be, exercising de facto control over and excessively trading the accounts.[87]

RC was the firm's CCO from its inception in January 2012 until January 2013.[88] He testified that while he was the CCO, Taddonio and Porges reviewed the commissions and

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[86] CX-12.

[87] Respondents contended that Enforcement unfairly chose accounts, giving a misleading picture of the investment experience of CSC's customers. But a FINRA examiner testified the accounts were chosen because they were the firm's most active accounts and the most profitable—for the firm. Tr. 2429-30. Not surprisingly, the examiner also testified that Beyn, Bader, Cannata and Venturino were the top revenue producers at the firm. Tr. 2424-26; CX-12. Given their focus on the commissions and revenues generated by the RRs, as owners of the firm, Taddonio and Porges would have been particularly aware of the trading in those accounts.

[88] RC started in the securities industry in 1980 and has been registered since 1989. Prior to joining CSC, RC had four years' experience as a CCO, but had about 20 years' total experience in compliance. RC was hired after answering an advertisement on Craigslist, having known Porges at another FINRA member firm. He worked on CSC's FINRA membership application during 2011. When CSC was approved for membership and opened for business, RC became the CCO. Tr. 128-44; CX-6.

revenue generated by the RRs on a daily, weekly and monthly basis, and that Taddonio was reviewing accounts and interacting with the brokers constantly.[89] At the same time, Porges was reviewing each RR's trading and commissions for purposes of determining the amounts due to the RR.[90] From those reviews, Taddonio and Porges were certainly aware of the volume and frequency, the costs to the customers, and the results—for the customers, the RRs and the firm—of the trading that was taking place in the customer accounts managed by Beyn, Bader, Cannata and Venturino.

Enforcement also alleged that, apart from the trading itself, the firm's CCOs made Taddonio and Porges aware of red flags indicating that the RRs might be excessively trading customer accounts.

Early in his tenure as CCO, RC developed an "active account worksheet" that the firm's RRs were required to complete periodically for each active account they handled. The active account worksheets were used for the first time in May or June 2012, only a few months after CSC had opened for business. At that point, RC was able to create a list of approximately 30 actively traded accounts that were performing poorly and he asked the RRs on the accounts, including Beyn, Bader, Cannata and Venturino, to complete a worksheet for each of their accounts on the list. The worksheets required the RR to enter data regarding total realized and unrealized profits and losses in the account, as well as total commissions and fees, for the past 12 months or from the inception of the account, whichever was less; asked the RR to indicate on a percentage basis the extent to which the customer relied on the RR for investment strategies and advice; asked the RR to briefly describe the customer's investment strategy; asked the RR to indicate the percentage of transactions that were solicited and unsolicited; and allowed the RR to describe any questions regarding the relationship with the customer or any areas in which the RRs could use help with the customer. RC provided a list of the active accounts as well as the completed worksheets to Taddonio and Porges, and he had Taddonio sign the completed worksheets as "Sales Management" to demonstrate he was aware of what was occurring in the accounts. According to RC, he went through the same process a few months later, in the fall of 2012, and this time he listed approximately 50-60 poorly performing active accounts, including many that had been on his first list, and again asked the RRs to complete a worksheet for each of their accounts on the list and gave the worksheets to Taddonio and Porges.[91] The Panel finds that these worksheets, reflecting so many poorly performing, actively traded accounts, should have contributed to Taddonio's and Porges' recognition that the RRs were, or might be, excessively trading customer accounts.

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[89] Tr. 1827-28. RC's testimony was consistent with the testimony of other former CSC personnel regarding Taddonio's and Porges' in-depth oversight of the revenue generating aspects of the firm, and with the Panel's observations of Taddonio and Porges during the hearing.

[90] Tr. 2291-92.

[91] Tr. 198-220, 1941-42; CX-45.

Taddonio and Porges terminated RC's association with CSC as of February 1, 2013, and hired JG to serve as CSC's CCO.[92] JG continued as the firm's CCO until September 2015, shortly before the firm's membership was suspended for failing to pay arbitration fees.[93]

After JG replaced RC as the firm's CCO, he arranged for CSC to begin receiving monthly active account exception reports from its clearing firm. In accordance with criteria set by the clearing firm, a customer account was listed on the report if it met any of the following criteria for the month: commissions (including markups or markdowns) totaling $2,500 or more; 10 or more trades; a commission-to-equity ratio of five percent or more; or a loss in account value of 20% or more. The reports organized accounts meeting these criteria by RR and for each account showed, *inter alia*, the value of the account at the end of the current month and the past month and the percentage of gain or loss in value; the number of solicited and unsolicited trades for the month; the total commissions and the commission-to-equity ratios for the current month, the last three months and the last 12 months; the number of trades and commission amounts for each of the past 12 months; and the annualized turnover rate for the current month, the past three months and the past 12 months.[94]

JG, Taddonio and Porges each received the active account exception reports electronically, but each month JG also printed hard copies and forwarded the hard copies to Taddonio and Porges, along with certain other exception reports from the clearing firm. JG explained the active account exception reports to Taddonio and Porges and expected them to review the reports because they were the sales managers "and this was information the sales manager needed."[95]

JG testified that by the time he received the active account exception report for July 2013, he was seeing a pattern with the same customers and brokers showing up on the reports on a regular basis. The brokers who appeared regularly included Beyn, Bader, Cannata and Venturino. The July 2013 report indicated, for example, that there had been 54 solicited trades during the month in the account of Beyn customer WR, for which WR had been charged commissions of more than $21,000; the annualized turnover rate for the account based on that trading was more than 226; and the commission-to-equity ratio for just the month of July was

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[92] In determining what weight to give to the testimony of RC, the Panel considered the anger and resentment RC expressed throughout his cross-examinations regarding his termination from CSC, as well as RC's interest in minimizing his own responsibility for the supervision of the RRs. Tr. 1925-26. The Panel credits his testimony insofar as it was consistent with the documentary evidence and the testimony of other witnesses. Similarly, in determining what weight to accord to the testimony of JG, the Panel considered his testimony that his memory has been less reliable since he underwent chemotherapy for cancer, as well as his interest in minimizing his responsibility for supervising the RRs. Tr. 2698. Once again, the Panel credits his testimony insofar as it was consistent with the documentary evidence and the testimony of other witnesses.

[93] JG has been in the securities industry since 1978 and had approximately 13 years' experience as a CCO when he joined CSC. Tr. 2701-03; CX-7.

[94] Tr. 2713-14, 2719-28, 2734; CX-74 through CX-76; CX-78 through CX-81; CX-83 through CX-91.

[95] Tr. 2721-23.

over 46%. The July report also indicated that there had been 750 solicited trades in July in the account of Cannata customer DB, for which DB had been charged commissions of more than $273,000; the annualized turnover rate for DB's account was over 940; and the commission-to-equity ratio for just the month of July was over 29%. The July report showed that there had been 11 solicited trades that month in the account of Venturino customer ATL, Inc. for which ATL had been charged commissions of nearly $7,000; the annualized turnover rate in ATL's account was nearly 52; and the commission-to-equity ratio for just July was over 13%. The July report showed that there had been 311 solicited trades in the account of Bader customer JB that month for which JB had been charged commissions of more than $130,000; the annualized turnover, based on more than $13 million in purchases during July, was nearly 126; and the commission-to-equity ratio for just the July trading was over 10%.[96] Other reports, both before and after July 2013, contained equally striking red flag data regarding the trading in the accounts identified by Enforcement.[97]

In addition to the active account exception reports from CSC's clearing firm, JG continued to require RRs to complete the active account worksheets begun by RC. JG's worksheets required the RRs to indicate the customer's realized and unrealized losses in the account, as well as the amount of commissions and fees charged, for the past 12 months or since the inception of the account and the average number of transactions per month in the account. The RRs were also supposed to provide a detailed narrative addressing the account's performance, trading volume, commissions and fees; indicate the extent to which the customer relied on the RR for investment strategy and advice; provide a description of the customer's investment profile and trading strategy; indicate the percentages of trades that were solicited and unsolicited; and state how satisfied the customer was with the account's performance, based on recent conversations with the customer.[98]

The active account worksheets allowed the RRs to enter self-serving statements regarding the account's performance, the customer's reliance or lack of reliance on the RR, the customer's trading strategy and the customer's satisfaction with the performance of the account. JG did not attempt to independently confirm these statements, even when the forms showed that the customer had incurred large losses and high commissions, but indicated that the customer was nevertheless fully satisfied. Even so, the worksheets prepared by Beyn, Bader, Cannata and Venturino contained glaring red flags, including data reflecting the vast disparity between the substantial losses suffered by the customers and the large amounts of commissions charged by the RRs, as well as facially incredible explanations of the RRs' supposed interactions with the customers. JG testified that "initially" he provided copies of the worksheets to Taddonio and Porges for them to review.[99]

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[96] Tr. 2758-59; CX-80, at 4-6, 8.

[97] Tr. 2723-71; CX-74 through CX-76; CX-78; CX-79; CX-81; CX-83 through CX-91.

[98] CX-72; Tr. 2817-18.

[99] CX-72; Tr. 2818-20.

Taddonio and Porges were also aware of customer complaints and arbitrations arising out of the trading in customer accounts. For example, in July 2013, JB, a 90-year-old Cannata customer, filed a FINRA arbitration claim against CSC, Taddonio, Porges, Cannata and others alleging excessive trading and churning in his account;[100] in November 2013, Beyn customer EK, discussed above, filed a FINRA arbitration claim against CSC, Beyn, Taddonio, Porges and JG alleging excessive trading and churning in his account;[101] in January 2014, Porges received a letter from Beyn customer TP, discussed above, complaining about losses in his IRA account and in response, according to a note in the file, Porges reviewed the trading in the account and discussed his review with TP;[102] in March 2014, Bader customer BB filed a FINRA arbitration claim against CSC alleging churning and unauthorized trading of BB's account;[103] in August 2014 Beyn customer WR, discussed above, filed a FINRA arbitration claim against CSC alleging churning and unsuitable recommendations in his account;[104] and in December 2014, Bader customer PG filed a FINRA arbitration claim against CSC, Taddonio, Porges, Bader and others alleging that Bader had churned his account.[105]

In light of these facts, the Panel concludes that both Taddonio and Porges were made aware of many red flags indicating that CSC RRs Beyn, Bader, Cannata and Venturino were, or might be, excessively trading CSC customer accounts.

B. Supervisory Responses to Red Flags

During the relevant period, CSC's supervisory responsibilities were governed by NASD Rule 3010.[106] Rule 3010(a) required CSC to "establish and maintain a system to supervise the activities of each registered representative … that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable NASD Rules." More specifically, Rule 3010(a)(2) required CSC to designate "an appropriately registered principal(s) with authority to carry out the supervisory responsibilities of the member for each type of business in which it engages," and Rule 3010(a)(5) required "[t]he assignment of each registered person to an appropriately registered representative(s) and/or principal(s) who shall be

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[100] CX-199. The annualized cost-to-equity ratio in the account was over 327%, with total costs of over $95,000 and total losses of over $188,000. CX-12.

[101] CX-171.

[102] CX-152.

[103] CX-206. The annualized cost-to-equity in the account was almost 195%, with costs of over $210,000 and total losses of more than $420,000. CX-12.

[104] CX-139.

[105] CX-188. The annualized cost-to-equity in the account was over 356%, with costs of more than $71,500 and losses of nearly $80,000. CX-12.

[106] NASD Rule 3010 was supplanted by FINRA Rule 3100 effective December 1, 2014. Although Enforcement's Corrected Complaint defined the relevant period as January 2012 through at least December 2014, Enforcement only alleged that Taddonio and Porges violated NASD Rule 3010, not FINRA Rule 3100. Therefore, the Panel limits its violation finding accordingly.

responsible for supervising that person's activities." Rule 3010(b)(1) required that CSC "establish, maintain, and enforce written procedures to supervise the types of business in which it engages and to supervise the activities of registered representatives … that are reasonably designed to achieve compliance with applicable securities laws and regulations, and with the applicable Rules of NASD."

The NAC has explained:

> NASD Rule 3010 has been applied to require that supervisors exercise "reasonable" supervision. … "The standard of 'reasonable' supervision is determined based on the particular circumstances of each case." … The "presence of procedures alone is not enough. Without sufficient implementation, guidelines and strictures do not assure compliance." In addition to requiring an adequate supervisory system, "[t]he duty of supervision includes the responsibility to investigate 'red flags' that suggest that misconduct may be occurring and to act upon the results of such investigation." … "Once indications of irregularity arise, supervisors must respond appropriately."[107]

CSC's supervisory structure was quite limited. It included Taddonio as the President and CEO, Porges as the COO, and the CCOs, initially RC and subsequently JG. The supervisory responses to the red flags regarding possible excessive trading came primarily from the two CCOs.

There were no significant actions to address the red flags indicating that excessive trading was, or might be, occurring while RC was the CCO. RC had the RRs complete active account worksheets, as discussed above, and he testified he made some recommendations to individual RRs to limit trading or reduce commissions in some accounts, but RC did not believe he had authority to impose such restrictions on the RRs by himself. According to RC, he had authority to reduce the commission (including a markup or markdown) on an individual trade if it exceeded 5% (or, at some point in RC's tenure, a lower amount that the firm had established, with Taddonio's and Porges' approval, as a maximum that the RR's could charge), but RC did not have authority to impose any general limitation on an RR's discretion to set commissions on trades. Instead, RC testified, he gave Taddonio a list of accounts that he thought should be placed on reduced commission, based on the information in the active account worksheets, and Taddonio said he would review the information and take care of it, but RC testified that neither Taddonio nor Porges took any steps whatsoever to address the issue.[108]

When JG became the CCO, he recommended, and Taddonio and Porges approved, a reduction in the maximum allowable markup or markdown at the firm from 5% to 3.2%, including the $99 Firm Commission. In addition, over time, as JG identified customer accounts

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[107] *Dep't of Enforcement v. Rooney*, No. 2009019042402, 2015 FINRA Discip. LEXIS 19, at *60-61 (July 23, 2015) (quoting *Ronald Pellegrino*, Exchange Act Release No. 59125, 2008 SEC LEXIS 2843, at *33 (Dec. 19, 2008)).

[108] Tr. 202-03, 220-21, 1826, 1829, 1831-32, 1841-43, 1846, 1848-50, 1941-42.

that he believed were being excessively traded, he recommended, and Taddonio and Porges approved, reductions in the maximum markups and markdowns that could be charged for future trades in just those accounts, as a measure "[t]o help restore the account to profitability."[109] In some cases, those maximum markups and markdowns were as low as one-half of one percent, including the $99 Firm Commission. But even when an account was so limited, JG did not recommend, and Taddonio and Porges did not require, any corrective action for past trading, such as reimbursing the customer for excessive markups and markdowns previously paid; limiting the number, size or frequency of future trades in the account under the reduced commission charge; or limiting the RRs' trading of other accounts.[110]

Also during JG's tenure, CSC began seeking customers' written acceptance of the trading in actively traded accounts. With input from Taddonio and Porges, as well as JG, the firm created a form letter that was sent to actively traded accounts as determined by JG. This "Active Account Letter," initially signed by Taddonio as CSC's "Sales Manager" and later by Porges as the firm's COO, expressed appreciation for the business given to CSC; pointed out that the customer's account was "actively traded"; expressed trust that the customer was satisfied with the RR's handling of the account; and invited the customer to ask questions about the services provided or the activity in the account. The letter further asked the customer to confirm the investment objective, and the net worth, liquid net worth and annual income figures set forth in the customer's account opening documents, and "to confirm our understanding that the orders we have executed for you are in accordance with your objectives and risk capital limits; and that you are fully aware of the nature, frequency, risk factors, profits or losses associated with the transactions in your account and the cost of borrowing money to purchase and carry positions on margin." The letter included a signature line for the customer to give the requested confirmations.[111]

Although JG admitted that the letters were sent because of concern that the trading in an account might be excessive,[112] the Active Account Letters did not express any concerns about

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[109] CX-93; Tr. 2776-90.

[110] Tr. 2771-87, 3368-69; CX-93; CX-98. For example, DB was a Cannata customer. During the period July 1, 2013, through April 30, 2014, Cannata effected 1,680 trades in DB's account on which DB suffered losses in excess of $1.2 million while incurring costs of nearly $700,000, with an annualized cost-to-equity ratio of nearly 170%. With the approval of Taddonio and Porges, JG cut the maximum commission for trades in DB's account to 1%, including the $99 Firm Commission, on July 10, 2013, and, again with the approval of Taddonio and Porges, to 0.75% on August 27, 2013. DB's account statements, however, show that the trading in his account continued apace in spite of the lower commission rates, and his account continued to suffer losses. JG brought the activity and losses in JB's account to the attention of Taddonio and Porges, and he also pointed out to them that Cannata was day trading other accounts, but neither JG, nor Taddonio, nor Porges imposed any general limitation on Cannata's trading of customer accounts. Tr. 2840-78; CX-12; CX-214 through 217; CX-245.

[111] Tr. 2792-93. *See, e.g.*, CX-147 (Active Account Letter signed by Taddonio); CX-182 (Active Account Letters signed by Porges). JG testified that when he gave Active Account Letters to Taddonio for his signatures, he also provided backup information for each letter explaining the trading in the account that had caused him to prepare the letter, with the expectation that Taddonio would review the material before signing the letter. Tr. 2796-97.

[112] Tr. 2802.

the level of trading or costs in the account, or give the customer any data as to the actual trading that had occurred or the costs the customer had incurred for the trades. And although the letters sought a positive, signed response from the customer, at least in the initial months the letters were used, the firm did not restrict trading in the account pending receipt of the customer's signed confirmation, even if the customer never responded. On the other hand, the RRs were aware of the customers to whom Active Account Letters had been sent and were allowed to contact the customers to encourage them to sign and return the requested confirmations, and several customers testified that, in fact, they had been urged to sign and return Active Account Letters.[113]

In some cases, instead of asking a customer to confirm information in an Active Account Letter, the firm requested that the customer execute a sworn "Affidavit of Support." Like the Active Account Letter, the Affidavit of Support sought the customer's acquiescence in the trading that was occurring in the customer's account. The Affidavit of Support included a statement that the customer "understood that there was a good chance that I would lose money in my account"; that the customer did not "feel that trading in the account is excessive"; a statement that the RR "reviews the frequency of the transactions with me including turnover ratio issues and cost-equity considerations"; and a statement that the customer "believe[d] that the size and frequency of the transactions are suitable for me …."[114]

Although JG was the CCO of the firm, he could not explain how the firm came to use the Affidavit of Support form. Further, JG testified that it was Taddonio or Porges who came to him to advise him that the RR wanted to send an Affidavit of Support to a customer, and indeed it was the RR, not Compliance, that sent the Affidavits of Support to the customer. Furthermore, as with the Active Account Letters, RRs were permitted to contact customers to encourage them to sign and return Affidavits of Support, and customers testified that Beyn did just that. Finally, as with the Active Account Letters, the Affidavits of Support did not give the customers any data as to the actual trading that had occurred in their accounts or the costs the customers had incurred for the trades.[115]

The Hearing Panel concludes that the supervisory responses to the red flags indicating that Beyn, Bader, Cannata and Venturino were, or might be, engaged in excessive trading of customer accounts were not reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable NASD Rules, regarding excessive trading of customer accounts, and thus failed to fulfill CSC's supervisory obligations under NASD Rule 3010.

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[113] Tr. 2793-2804, 3100-03.

[114] *See, e.g.*, CX-149; CX-169; CX-215.

[115] Tr. 1258-60, 2814-16, 3287-88; CX-149; CX-177; CX-215.

C. Taddonio's and Porges' Responsibility for the Failure to Supervise

In their closing presentations to the Panel at the hearing and in their post-hearing briefs, Taddonio and Porges, while not conceding that there were red flags or that the supervisory responses were inadequate, argued, on somewhat different grounds, that they were not personally responsible for any supervisory failures that occurred. Both Taddonio and Porges pointed to their lack of supervisory experience when CSC was operating and asserted that, in recognition of that fact, they hired experienced CCOs to oversee the RRs' sales practices and ensure that CSC fulfilled its supervisory obligations under Rule 3010. In substance, both of them asserted that, having turned supervision over to the CCOs, they were unconcerned about the red flag information they received, believing they had no responsibility for the RRs' sales practices. Their arguments in that regard differed somewhat. Taddonio asserted that the CCOs had been delegated all supervisory responsibility for the firm's operations, including overseeing sales practices; Porges, while agreeing with Taddonio about the CCOs' responsibilities, argued that as COO, his responsibilities were limited to operational matters, such as overseeing the firm's finances, and that he exercised no authority over the RRs.

The Extended Hearing Panel first considers whether Taddonio bore responsibility for CSC's supervisory failures. Taddonio was the President and CEO of CSC, as well as its principal owner, and the SEC has made it plain that "a brokerage firm's president is ultimately responsible for supervision, unless he or she has delegated that responsibility to someone else at the firm and does not know or have reason to know that the responsibility is not being properly exercised." Even if the president delegates particular functions to another person, once on notice of the firm's continuing failure to satisfy regulatory requirements, the president is "obligated to respond with utmost vigilance and take remedial action."[116]

As explained above, Taddonio claimed to have delegated all supervisory responsibility to the CCOs. He acknowledged that as CEO, the CCOs reported to him "[f]or certain things," in the sense that they kept him informed about what was happening in the firm, but he insisted he did not supervise the CCOs; indeed, no one supervised them, according to Taddonio. And he did not think the CCOs expected him to review the materials, such as active account exception reports from the clearing firm, that they provided to him, because the materials were pretty thick and detailed. He did not review the active account worksheets that were given to him, other than the few that he signed when RC was the CCO. And although he signed those reports as "Sales Management," which he acknowledged was an indication that he was a manager of the firm, in Taddonio's view, "certainly there's a difference between a supervisor and a manager," and he was not a supervisor of the sales staff.[117]

The CCOs, however, took issue with Taddonio's description of their supervisory responsibilities. RC testified that when he was at CSC, Taddonio was the CEO, President and

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[116] *Wedbush Sec., Inc.*, Exchange Act Release No. 78568, 2016 SEC LEXIS 2794, at *29-31, 34 (2016), *appeal docketed*, No. 16-73284 (9th Cir. Oct. 12, 2016).

[117] Tr. 690-99.

sales manager of the firm; Porges was the COO and also a sales manager; and he reported to both Taddonio and Porges. RC testified that his employment contract gave him no responsibility for supervising the RRs, but rather his role was limited to "compliance and administration and operations," and he had no authority to hire, or set salaries or commission rates for the firm's RRs. He testified that Taddonio and Porges exercised responsibility for managing and instructing the firm's sales force. RC testified he did not supervise anyone at the firm, no one reported to him and he did not manage anyone.[118]

JG also testified that he reported to both Taddonio and Porges; his employment contract said nothing about him supervising the firm's RRs; he had no authority to set salaries or commission levels for RRs or to terminate RRs; and he interacted with the sales staff only with respect to compliance issues. He testified that Taddonio and Porges both had responsibility for managing and instructing the sales force with respect to sales.[119] NM, a former CSC junior broker, also testified that based on his observations at the firm, Taddonio and Porges managed and supervised the firm's sales representatives, with Porges being more responsible for the junior brokers, and both Taddonio and Porges interacted with the senior brokers.[120]

Similarly, CSC's written supervisory procedures ("WSPs") did not support Taddonio's contention that the CCOs supervised the firm. CSC's WSPs, while including provisions addressing sales practice oversight, including suitability and churning issues, simply indicated that the supervisory responsibility rested with a "Designated Supervisor." The WSPs also had a "Designation of Supervisors" section indicating that it "include[d] [CSC's] designated supervisors responsible for supervision of the areas of business indicated," but in fact the section simply listed the firm's principals with broad areas of responsibility. Taddonio was listed, not only as President and CEO of the firm, but also as Sales Manager and Branch Manager. Beyond those descriptions of their titles, the WSPs simply indicated that each individual had "ORG Chart Supervision." No organizational chart, however, was included in the WSPs.[121] The NAC has found WSPs deficient where they "did not identify who was responsible for … supervision [of an area of firm operations], the supervisory steps that such person should take, the frequency of supervisory reviews, how such reviews should be documented, or how to document the steps

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[118] Tr. 145-47, 152.

[119] Tr. 2707-10.

[120] Tr. 1664-67.

[121] CX-117 through CX-130. The record does include an exhibit containing several putative organizational charts for CSC. CX-70. Only one of those charts, labeled "Reporting lines—Sales Supervision" supports Taddonio's contention, listing RC at the top of the chart, with Taddonio and Porges shown reporting to him. CX-70, at 2. No foundation, however, was laid for this chart. No witness testified at to the origins of the chart or to its accuracy, while RC denied it was accurate. Moreover, even if it were accurate, it shows Taddonio and Porges as the direct supervisors of the RRs, with Beyn, Bader, Cannata and Venturino reporting directly to Taddonio. Thus, if the chart were accepted as accurate, it would not avail Taddonio's argument that he had no supervisory responsibility to address red flags indicating that the RRs were or might be excessively trading customer accounts.

taken as a result of supervisory reviews."[122] Most glaringly, for purposes of this case, the ambiguities in the WSPs meant that no one had clear responsibility for evaluating the suitability of individual trades or the quantity of trading in customers' accounts.[123]

There is considerable additional evidence that Taddonio functioned as the firm's sales manager and kept close track of the RRs' sales activities. For example, Taddonio provided the RRs with lists of companies with upcoming earnings announcements and sent emails encouraging the RRs to trade certain stocks.[124] When Taddonio was leaving on his honeymoon in November 2012, shortly after Hurricane Sandy hit the east coast of the United States, he sent the RRs a rousing email, stating:

> I'm on my way to the airport but its already November 5th which means we only have 17 days left in the month because we lose a day and a half for thanksgiving on the 22nd and 23rd.
>
> We HAVE to treat the next 2 weeks like the last 2 weeks of the month and try to raise as much money as possible and open as many accounts as we can the next 2 weeks!! It is IMPERATIVE that you work harder the next 2 weeks than you ever have!! Remember this is your Christmas paycheck and I know everyone wants to have an amazing Christmas even better than we did last year! Noone wants to be embarrassed and have to apologize to their families and friends and tell them that the market got tough in October do [sic] they had a rough few months and couldn't get them what they wanted.
>
> I promise that if you if you put your head down the next 2 weeks and pitch accounts the second you walk in for 2 hours, open one account and then trade and raise money for the next two hours you will be shocked at how much you accomplish the next 2 weeks. Then take a 30 minute break for lunch and pitch new accounts for another hour and a half to two hours and finish the day trading and raising money. Then take ur [sic] dinner break and again pitch for 2 hrs and then spend the rest of the night staying late and cultivating your clients talking to them about the hurricane and all the craziness going on right now I promise you

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[122] *Dep't of Mkt Regulation v. Lane*, No. 20070082049, 2013 FINRA Discip. LEXIS 34, at *49 (NAC Dec. 26, 2013), *aff'd*, Exchange Act Release No. 74269, 2015 SEC LEXIS 558 (Feb. 13, 2015).

[123] *Compare* Tr. 3362-63 (former CCO JG testifying that he believed that suitability assessments were the responsibility of Taddonio and Porges as the sales supervisors) *with* Tr. 703, 3703, 4016-18, 4056 (Taddonio and Porges denying responsibility for suitability reviews). *But see* CX-101, at 5; CX-103; Tr. 701-04 (Rule 8210 request response during the investigation signed by Taddonio stating "As part of my supervisory responsibilities, I electronically review clients [sic] activity daily. This allows me to review transactions for among other factors as [sic]... suitability .... I also review various monthly reports including the monthly Active Account Reports ...." Taddonio subsequently recanted this statement during the investigation and submitted an alternative version that, *inter alia*, described Porges as the firm's "Sales Manager," the CCOs as the "designated branch supervisor," and Taddonio as a "manager" but not a "supervisor.").

[124] CX-46, at 4-5, 10; Tr. 801-03, 1711.

> they will be VERY responsive. It gives you a chance to show your clients that you are a human being just like them with a family and friends and issues just the same as them and bit [sic] just a salesman trying to get the next sale. …
>
> After speaking about the hurricane ease your way into a pitch …. [Taddonio then provided a detailed sales pitch using the damage from the hurricane to recommend investments in Home Depot stock.]
>
> I went through the earnings this morning and I'm going to give you a breakdown of which ones I like and y [sic] as well now. Let's raise some $$$$![125]

Taddonio also encouraged and rewarded the RRs, including Beyn, Bader and Cannata, with such awards as "Top Producing Broker," "Most Money Raised," "Most New Accounts," and "Biggest Producer."[126] And as the majority owner of CSC, Taddonio earned substantial amounts as a result of the commissions charged by Beyn, Bader, Cannata and Venturino for trading in the 37 accounts identified by Enforcement.[127]

The Panel finds, therefore, that Taddonio acted as the firm's sales manager and supervisor,[128] as well as its President and CEO, and that he did not delegate all supervisory responsibility for the RRs' sales activities to the CCOs. As a result, under the WSPs he was a "Designated Supervisor" with supervisory responsibilities for monitoring the suitability of trading in customer accounts, including whether such trading was excessive.[129] But even assuming that Taddonio had effectively and reasonably delegated all responsibility for monitoring the suitability of the RRs' trading to the CCOs, he knew of red flags indicating that Beyn, Bader, Cannata and Venturino were, or might be, excessively trading numerous customer accounts and of the inadequate supervisory responses to those red flags, and was thus on notice

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[125] CX-46, at 9-10; Tr. 258-62, 794-801.

[126] CX-62; Tr. 1742-43, 2290-91.

[127] The 37 accounts were charged commissions, including markups and markdowns, totaling more than $4.7 million and Firm Commissions totaling more than $875,000 for trading that led to losses totaling over $9 million in the 37 accounts. CX-12. CSC kept all the Firm Commissions as well as a portion of the commissions that varied among the RRs. Taddonio's salary at CSC was $500,000, and in addition he received capital distributions based on the firm's profits. Tr. 842-43.

[128] The Panel rejects Taddonio's claim that he was a manager but not a supervisor. First, the Panel rejects Taddonio's testimony regarding his role at the firm, and his testimony regarding the role of the CCOs as not credible. Second, as explained below, whether a person is a "supervisor" depends on that person's level of responsibility and authority. There is no question that Taddonio was the person with the greatest responsibility for and authority over the senior brokers' sales practices at CSC. He was unquestionably their supervisor.

[129] Taddonio's supervisory responsibility in that regard was not necessarily exclusive. RC apparently believed he had some responsibility to evaluate RRs' trading for suitability, including excessive trading. Tr. 1874-75. In contrast, JG denied he had any responsibility for reviewing trades for suitability, asserting that suitability assessments were the responsibility of the "sales supervisors," who he had identified as Porges and Taddonio. Tr. 3213, 3224-27. But even assuming that the CCOs were "Designated Supervisors" for purposes of the WSPs, the Panel finds that Taddonio also had supervisory responsibility as the sales manager.

of the firm's continuing failure to satisfy regulatory requirements. As a result, regardless of any delegations to the CCOs, Taddonio was required to respond with utmost vigilance and take remedial action, yet he failed to do so.

Taddonio argued that he was not experienced in supervision and compliance issues, and hired experienced CCOs for that reason. Taddonio asserted that he and Porges replaced RC with JG because RC was not undertaking the sort of compliance and supervision oversight they had seen at other firms. Taddonio testified that when JG took over, he was impressed with the steps JG took with respect to active accounts. Under these circumstances, Taddonio contended, he reasonably relied on the CCOs and therefore his supervision was reasonable.

The Panel disagrees. Taddonio qualified as a principal and elected to use that qualification to become President, CEO and principal owner of a FINRA member firm. In doing so he was obliged to understand and undertake the responsibilities of the chief executive of a member firm. Taddonio was not ignorant of the RRs' sales activities; on the contrary, he very actively encouraged them. Taddonio testified that he could and did review the RRs' trading electronically and he even monitored Bader's trading while Taddonio was on his honeymoon, sending Bader congratulatory messages.[130] And he was not ignorant of the CCOs' concerns about the level of the RRs' trading or the steps the CCOs took to address those concerns, because they involved him in those processes. But as explained above, it should have been obvious to Taddonio, in fulfilling his obligations as President and CEO, that those steps were inadequate to ensure that his firm was meeting its supervisory responsibilities and protecting its customers from improper sales practices by its RRs.

Porges was not the President or CEO of the firm and he held only a minority ownership interest. He argues that his area of responsibility was the firm's financial operations, and that he was never assigned responsibility for supervising the sales practices of Beyn, Bader, Cannata or Venturino. Porges insists that to the extent he became aware of any red flags, it was not appropriate for him to second guess the much more experienced CCOs of the firm.

While the evidence indicates that Porges had primary responsibility for the firm's financial operations, his role at the firm was not limited to that. Porges was one of the two owners and sales managers of the firm, and both CCOs testified that they reported to Porges as well as Taddonio.[131] Porges was actively involved in hiring the two CCOs and in terminating RC, the first CCO.[132] Porges was involved in the creation of the Active Account Letters that the firm sent to customers whose accounts were being heavily traded, and although Taddonio initially signed the Active Account Letters, Porges assumed responsibility for signing the letters and for taking calls from customers who received the letters and had concerns.[133] RC sent

[130] Tr. 706-08, 803-06; CX-47.

[131] Tr. 145, 2707-10; CX-103, at 3.

[132] Tr. 139-142, 252-55, 2705-06.

[133] Tr. 930-42, 2753, 2790-92.

Porges, as well as Taddonio, the active account worksheets prepared by the RRs and JG sent him, as well as Taddonio, the active account exception reports generated by CSC's clearing firm.[134] In a statement sent in response to a FINRA Rule 8210 request during the investigation, Porges described himself as the "non-producing branch Sales Manager" and stated that he oversaw "registered representative production, monitoring monthly commissions and compensation and related chargebacks."[135] Along with Taddonio, Porges was responsible for the awards that were given to the RRs, including Beyn, Bader, Cannata and Venturino.[136] Like Taddonio, Porges reaped substantial rewards from the commissions generated by the RRs' trading in customer accounts, including markups, markdowns and Firm Commissions as a result of his minority ownership interest in the firm.[137]

The SEC has held that "determining if a particular person is a 'supervisor' depends on whether, under the facts and circumstances of a particular case, that person has a requisite degree of responsibility, ability or authority to affect the conduct of the employee whose behavior is at issue."[138] In that case, the SEC found that an individual who was not the direct manager of an RR who engaged in misconduct was a "supervisor" of the RR because he exercised some supervisory responsibilities over all branch office areas, including sales, operations, and compliance, and he participated in hiring and disciplinary decisions with respect to brokers in the RR's branch. The SEC found that he failed to take appropriate action when information came to his attention indicating that the RR might have engaged in improper activities. The SEC stated:

> We have made it abundantly clear that supervisors must act decisively when an indication of irregularity is brought to their attention. That irregularity need not be a violation of the securities laws. Decisive action is necessary whenever supervisors are made aware of suspicious circumstances, particularly those that have an obvious potential for violations.[139]

Porges qualified as a principal and assumed authority as CSC's COO. Porges had the ability or authority to affect the conduct of Beyn, Bader, Cannata and Venturino and he had ample indications that they were, or might be, excessively trading customer accounts, so there was an obvious potential for violations of NASD or FINRA rules and the securities laws and regulations. Porges should also have realized that the steps implemented by the CCOs were insufficient to fully address the issue. The SEC has stated: "When indications of impropriety

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[134] Tr. 204-05, 2721-22.

[135] CX-103, at 3; Tr. 917-18. Notably, although both Taddonio's and Porges' signed statements included in CX-103 indicated that the CCO, JG, was the "designated branch supervisor," no statement from JG acknowledging his supposed supervisory responsibility was included.

[136] Tr. 1744, 2288, 2291-92.

[137] CSC paid Porges $300,000 initially, and his pay was increased to $350,000 in 2014. His pay was treated as guaranteed distributions of capital, rather than as salary or commissions. Tr. 916-17.

[138] *George J. Kolar*, 55 S.E.C. 1009, 1016 (2002) (quoting *John H. Gutfreund*, 51 S.E.C. 93, 113 (1992)).

[139] *Id.* at 1015-16.

reach the attention of those in authority, they must act decisively to detect and prevent violations of the securities laws."[140] Porges took no actions whatsoever to detect and prevent excessive trading of customer accounts.

Accordingly, the Extended Hearing Panel concludes that both Taddonio and Porges failed to reasonably supervise the trading in customer accounts by CSC's RRs in order to ensure that they did not excessively trade customer accounts, and they both thereby violated NASD Rules 3010(a) and (b) and FINRA Rule 2010.

VI. Taddonio and Porges Gave False Testimony in Their OTRs

A. Facts

The Corrected Complaint alleges that Taddonio and Porges gave false testimony during their OTRs regarding the recording of telephone calls between CSC and its customers. An Enforcement investigator testified that during its, investigation Enforcement received information from a former CSC employee that CSC or its RRs taped telephone calls between the RRs and the firm's customers. During a February 13, 2015 OTR, former CSC RR Bader testified that all calls from customers to the firm were automatically recorded by the firm, and that the RRs were also required to record their calls with customers. Bader asserted that there was a system to record outgoing calls on each RR's computer. Bader claimed that Taddonio required the RRs to record their calls to customers in case there was an instance where there was confusion about a trade, so that Taddonio could then listen to the phone call and determine the facts. Bader said that senior brokers were required to record all calls but junior brokers were given digital recording devices of a different nature, because they did not have their own computers. Bader said he believed the calls he recorded were all saved as files on both his CSC computer and a central CSC server. He testified that the equipment he used to make the recording was a small box next to the computer that had a simple on and off switch. He testified that Taddonio and Porges would review recordings with junior brokers to help them improve their sales presentations. Bader confirmed his earlier testimony regarding the recording of telephone calls between RRs and customers during a second OTR on February 26, 2015.[141]

Enforcement took Porges' OTR on March 18, 2015, and asked him about the recording of calls at CSC. Porges testified: "I have never seen or heard a tape-recording. There is no system at the firm for recording or maintaining recordings. You know, that's it." He acknowledged that an individual RR might have decided on his own to record some calls, but stated that, if so, "it was absolutely done without our knowledge and certainly without, you know, compliance or anyone

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[140] *World Trade Fin. Corp.*, Exchange Act Release No. 66114, 2012 SEC LEXIS 56, at *43 (Jan. 6, 2012) (citation omitted), *aff'd*, 739 F.3d 1243 (9th Cir. 2014).

[141] Tr. 1159-99, 1366-78; CX-115. In addition to Bader's OTR testimony, Enforcement introduced testimony given by former CSC RR Cannata during a FINRA arbitration hearing in which Cannata stated that some of his calls with his CSC customers were recorded and that his supervisors listened in on some of his calls. CX-42; CX-43. Cannata's arbitration hearing testimony was hearsay, the recording of calls was mentioned only in passing, and the Panel gives the testimony little weight.

else's permission." Porges flatly denied that the firm ever gave out hand-held recorders to junior brokers to record calls with customers. After Enforcement advised Porges that other witnesses had testified about recordings at the firm, Porges stated: "I have absolutely no knowledge of that. I have not seen a recorder. As far as I know, although I'm not a big tech guy, I've spoken with our IT vendor and there is no system that we have for recording calls, you know, so I got nothing."[142]

Two days later, on March 20, 2015, Enforcement took Taddonio's OTR and asked him about recordings at CSC. Like Porges, Taddonio denied any knowledge of recordings. He flatly denied that the firm used recording devices to record calls of senior or junior brokers, or of "any person associated with the firm," or of "conversations of customers." According to Taddonio, "I don't know of any recordings, anything." He denied that CSC "ever [had] in place any technology for the purpose of recording telephone conversations"; denied that "the firm otherwise provide[d] to its registered representatives, trainees or other associated persons any technology and/or devices for the purpose of recording telephone conversations"; and denied that "anyone at the firm ever use[d] any devices and/or technology to record conversations with customers."[143]

The Enforcement investigator testified that a few days later, on March 26, 2015, he and a co-worker made an unscheduled visit to CSC's offices, where they copied a total of 10 hard drives on nine firm computers, including the computers of Taddonio, Porges, Beyn, Bader, Cannata and several other RRs. When Enforcement reviewed what had been copied, Enforcement found no recordings of telephone calls on any of the copied hard drives.[144]

Nevertheless, Enforcement did introduce evidence, in addition to the OTR testimony of Bader and the arbitration testimony of Cannata, supporting its allegations that customer calls were, in fact, recorded at CSC.[145]

- Enforcement offered firm records showing that the firm purchased a variety of recording equipment during the years it was open. Invoices submitted in evidence

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[142] CX-116.

[143] CX-114.

[144] Tr. 1162-67. The investigator testified that he discovered software on some of the computer hard drives that can be used for forensically deleting files from computers, so that the deletions cannot be identified, but he also acknowledged that the software can be used for other purposes. Tr. 1196, 1378.

[145] Bader's OTR testimony was hearsay for purposes of the hearing because Bader did not appear before the Panel; and given Bader's conduct and character as described in the testimony and exhibits offered in evidence, including the fact that he was fired by Taddonio and Porges, the Panel finds the testimony unreliable and accords it no weight. Tr. 1732-36, 3266-67.

show that 50 recording devices of various types were purchased by the Firm from June 2012 to April 2014 for a total cost of $4,300.20.[146]

- Enforcement introduced photographs of the firm's offices that showed recording equipment in plain view on RRs' desks.[147]

- Enforcement offered documents showing that a contractor hired by CSC to archive its records copied more than 5000 .wav audio files from Taddonio's CSC computer. The file path data listed for the .wav files indicated that they were created with a USB recorder, which can be used to record telephone calls on a computer. The file descriptions show that many of the files were created before CSC came into existence, but other file descriptions show that the files were created during the time CSC was in business and some of the file descriptions include the names of CSC customers whose accounts are at issue in this proceeding. Enforcement was unable to obtain the .wav files from the contractor. It appears that the contractor deleted the files from its website in 2015 after CSC encountered financial problems and stopped paying the contractor's fees.[148]

- Former CSC junior broker NM testified that he and some other CSC brokers recorded calls with customers. He testified that Taddonio and Porges encouraged him to record calls for quality and training purposes. NM could listen to his calls and see how he sounded and if he needed to improve his sales pitch. NM testified that he emailed one of his recorded sales calls to Taddonio, seeking pointers from Taddonio on his sales presentation techniques. NM testified he discussed the call with Taddonio, who told him he sounded good, and that Taddonio did not seem surprised that NM had recorded the call or tell NM he should not record calls. Enforcement introduced the email from NM to Taddonio with the attached recording, confirming NM's testimony.[149]

- Enforcement also introduced an email from Taddonio to Porges attaching a recording of a call between Porges and a customer who had registered a complaint regarding his account. The file name on the attached recording matched one of the file names on the list of .wav files copied from Taddonio's computer by CSC's contractor.[150]

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[146] CX-18; CX-19; Tr. 2298-37. The devices included not only recorders but also various types of peripheral equipment.

[147] CX-41; CX-44; Tr. 3044-49.

[148] CX-16; CX-17; CX-34; CX-41; Tr. 1167-98, 1374-75.

[149] CX-22; CX-23; CX-24; Tr. 1720-29.

[150] CX-16, at 13; CX-25; CX-26; CX-27; Tr. 865, 1054, 1057-59, 1180, 2833-34.

B. Discussion

Even though Enforcement did not find recordings of telephone conversations on the copied hard drives, the Extended Hearing Panel finds sufficient evidence to conclude that there were recording devices in use at CSC and that at least some calls between CSC associated persons and CSC customers were recorded. Indeed, in his statement to the Panel on the final day of the hearing, Taddonio acknowledged, "[c]learly now I am aware that there were brokers [at CSC] that recorded calls," but he asserted that the firm itself did not record calls and that he was unaware that brokers were recording calls at the time of his OTR.[151] Similarly, in his statement to the Panel on the final day of the hearing, Porges acknowledged that his OTR testimony was wrong insofar as he indicated that no telephone calls were recorded, but like Taddonio, he asserted that his testimony was given in good faith and that he was unaware that any calls with customers had been recorded.[152]

The Extended Hearing Panel does not find Taddonio's and Porges' testimony that they were unaware that CSC or its RRs had any telephone call recording devices or technology or that any calls with customers were recorded credible. There is ample evidence that the firm purchased various types of telephone recording equipment for its RRs. The evidence further established that former CSC sales assistant SM emailed receipts for purchases of the equipment to Porges, and the Panel finds credible her testimony that she had to obtain prior directions or approval from Porges before making purchases such as the recording equipment. The Panel further credits NM's testimony that Taddonio and Porges encouraged RRs to record calls with customers as well as NM's testimony that he emailed a recorded call with a customer to Taddonio and subsequently discussed his sales presentation during the call with Taddonio, seeking feedback, and that Taddonio did not seem surprised that the call had been recorded or direct NM to cease recording calls. The Panel finds Taddonio's and Porges' claims that they were unaware that the firm's RRs were recording calls not credible because the photographic evidence introduced by Enforcement shows that the devices were in plain sight on the RRs' desks.

Finally, the Panel notes (1) the list of .wav files from Taddonio's computer includes a .wav file with a description that includes a customer's unusual last name;[153] (2) Enforcement introduced an email dated April 23, 2013, from Taddonio to Porges attaching a .wav file with the same file description, as well as the .wav file itself, which is a recording of a call between Porges and the customer, who was complaining about activity in his account;[154] (3) Porges prepared a memo to the CCO dated April 23, 2013, the same date as the email, describing his conversation with the customer, which took place on April 16, 2013, according to Porges' memo.[155] Based on

[151] Tr. 3997-98.

[152] Tr. 3743-44.

[153] CX-16, at 13.

[154] CX-25; CX-26; CX-27.

[155] CX-108, at 29.

this evidence, the Panel concludes that Taddonio recorded the telephone call between Porges and the customer on his computer; that Taddonio subsequently emailed the recording to Porges; and that Porges likely used the recording in preparing the memo to compliance describing the substance of the call. This sequence of events strongly suggests that both Taddonio and Porges were well aware that at least some calls between CSC and its customers were recorded.

Considering the totality of the evidence, the Extended Hearing Panel concludes that both Taddonio and Porges knowingly gave false testimony during their OTRs to the effect that they were unaware of any recording equipment at the firm or any recording of telephone calls with customers of CSC. As the NAC recently stated: "It is well settled that providing false or misleading information to FINRA in response to a FINRA Rule 8210 request violates both Rule 8210 and FINRA Rule 2010."[156] Accordingly, the Panel concludes that, by testifying falsely during their OTRs, Taddonio and Porges violated FINRA Rules 8210 and 2010.[157]

VII. Sanctions

A. Beyn

Enforcement requested that for his excessive trading and churning violations the Extended Hearing Panel bar Beyn in all capacities; impose substantial fines for both excessive trading and churning; and order Beyn to pay restitution to the six affected customers totaling more than $2 million. For making qualitatively unsuitable recommendations to customer EK, Enforcement requested that the Panel impose an additional six month suspension and an additional $50,000 fine. The Panel, however, finds that, because Beyn's unsuitable recommendations to EK were made in the context of his excessive trading of EK's account, it is more appropriate to impose a single sanction covering both Beyn's excessive trading and churning violations and his qualitative unsuitability violations.[158]

For excessive trading or churning, the Sanction Guidelines recommend a suspension in any or all capacities for a period of one month to two years, or, in egregious cases, a longer suspension of up to two years or a bar. Further, the Sanction Guidelines direct: "Strongly

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[156] *Dep't of Enforcement v. Merrimac Corp. Sec., Inc.*, No. 2011027666902, 2017 FINRA Discip. LEXIS 16, at *11 (NAC May 26, 2017).

[157] Although the Panel concludes that Taddonio and Porges were aware that there was recording equipment at the firm and that calls had been recorded, the Panel also notes that "[s]cienter is not an element of a FINRA Rule 8210 violation and, accordingly, there is no requirement that we find that false information was intentionally submitted to FINRA." *Id.*, at *12.

[158] *See Dep't of Enforcement v. Fox & Co. Invs., Inc.*, No. C3A030017, 2005 NASD Discip. LEXIS 5, at *37 (NAC Feb. 24, 2005) ("[W]here multiple, related violations arise as a result of a single underlying problem, a single set of sanctions may be more appropriate to achieve [FINRA's] remedial goals.") (citation omitted), *aff'd*, 58 S.E.C. 873 (2005). If the Panel were applying a separate sanction for just the unsuitable recommendations in EK's account, it would bar Beyn in all capacities considering the gross unsuitability of Beyn's recommendations and the various aggravating factors discussed below which are applicable to both the excessive trading and the qualitative unsuitability violations.

consider barring an individual for reckless or intentional misconduct (*e.g.*, churning)." Similarly, for unsuitable recommendations, the Guidelines provide: "Suspend individual respondent in any or all capacities for a period of 10 business days to two years. Where aggravating factors predominate, strongly consider a bar for an individual respondent."[159]

Beyn's excessive trading and churning of customer accounts was egregious, as were his unsuitable recommendations to EK. Several of the applicable relevant factors listed in the Guidelines apply: (1) Beyn has accepted no responsibility for or acknowledged his misconduct—indeed, during the hearing he expressed no regrets for his actions or any concern about the losses suffered by his customers; (2) Beyn did not, prior to detection, attempt to remedy his misconduct or to pay restitution to the injured customers; (3) Beyn engaged in numerous acts and a pattern of misconduct; (4) Beyn engaged in the misconduct over an extended period of time; and (5) the misconduct caused substantial injury to the affected customers.[160] The Panel finds no mitigating factors that would justify any sanction less that a complete bar for Beyn's excessive trading and churning, or for his unsuitable recommendations to EK.[161]

Beyn argued before and during the hearing that FINRA cannot impose any type of monetary sanction on him because he has filed for bankruptcy under Chapter 13 of the Bankruptcy Code. As a general matter, pursuant to 11 U.S.C. § 362(a), the filing of a bankruptcy petition operates to automatically stay proceedings outside the bankruptcy court. There are a number of exceptions from the automatic stay, however. One exception, found in 11 U.S.C. § 362(b)(25)(A), provides that the automatic stay does not apply to "the commencement or continuation of an investigation or action by a securities self regulatory organization to enforce such organization's regulatory power." Accordingly, this proceeding was not stayed by Beyn's bankruptcy filing, and the Panel had authority to conduct the hearing and issue this Decision.

But another exception to the automatic stay provision, 11 U.S.C. § 362(b)(25)(B), provides that the stay does not prevent "the enforcement of an order or decision, *other than for monetary sanctions*, obtained in an action by [a] securities self regulatory organization to enforce such organization's regulatory power" (emphasis added). The quoted language would appear to allow FINRA to impose and enforce an order barring or suspending Beyn, in spite of his bankruptcy filing, but not an order imposing monetary sanctions. The NAC appears to have adopted this interpretation, stating in another case: "There is no indication that the United States bankruptcy court presiding over [Respondent's] personal bankruptcy action lifted the automatic stay for an action to enforce a decision imposing monetary sanctions. *See* 11 U.S.C. § 362

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[159] FINRA Sanction Guidelines ("Guidelines") at 78, 95 (2017), http://www.finra.org /industry/sanction-guidelines.

[160] Guidelines at 7.

[161] Beyn did not provide substantial assistance to FINRA in its examination and/or investigation, which might have been a mitigating factor. On the contrary, the Panel finds his changing stories during his OTRs, including the testimony he gave against Taddonio and Porges in his final OTR, but which he recanted at the hearing, indicate that he provided inaccurate or misleading testimony to Enforcement, which is an aggravating factor. In that regard, the Panel finds that Beyn's claim during the hearing that he did not understand the questions he was asked during his OTRs was not credible.

(b)(25)(B). Therefore, we shall not impose any monetary sanctions."[162] Accordingly, the Extended Hearing Panel will not impose any monetary sanctions on Beyn. But for the pending bankruptcy proceeding, however, in light of the aggravating factors discussed above and the absence of any mitigating factors, the Panel would have imposed fines at the very top of the ranges recommended in the Sanction Guidelines for each violation and would have considered ordering Beyn to make restitution to at least some of the customers.

B. Taddonio and Porges

1. Supervision

The Guidelines for "Failure to Supervise" recommend a fine of $5,000 to $73,000 and, in egregious cases, consideration of a suspension for up to two years or a bar. The guidelines list three principal considerations specifically relevant to sanctions for failure to supervise: (1) whether the respondent ignored red flags that should have resulted in additional supervisory scrutiny; (2) the nature, extent, size and character of the underlying misconduct; and (3) the quality and degree of the supervisor's implementation of the firm's supervisory procedures and controls.[163] The principal considerations applicable to all violations are also relevant when setting sanctions for a failure to supervise.

As explained above, Taddonio and Porges ignored many red flags suggesting that some of the firm's RRs were, or might be, engaged in excessive trading of customer accounts—red flags that should have triggered supervisory oversight and remedial steps significantly beyond those initiated by the firm's CCOs. The underlying sales practices affected numerous customers, generating large commissions for both the firm and the RRs and large losses for the customers. Neither Taddonio nor Porges made any effort to implement any adequate procedures or controls to assess or halt the trading. In addition, (1) neither Taddonio nor Porges acknowledged any responsibility for the actions of the RRs or for the failure to supervise them; (2) neither Taddonio nor Porges took any effective steps to remedy the misconduct; (3) the sales practices continued throughout the life of the firm; (4) the practices affected a large number of customer accounts generating enormous costs to the customers; and (5) the sales practices directly benefited Taddonio and Porges, as owners of the firm, by generating large commissions for the firm.

Under these circumstances, the Panel concludes that both Taddonio and Porges should be barred in all principal and supervisory capacities. Even looking at the facts in a light most favorable to them, they were completely incompetent as supervisors. The more difficult question is whether they should be barred in all capacities, as Enforcement requested.

In another case involving supervisory violations, the NAC explained:

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[162] *Dep't of Enforcement v. Pellegrino*, No. C3B050012, 2008 FINRA Discip. LEXIS 10, at *80 (NAC Jan. 4, 2008), *aff'd*, Exchange Act Release No. 59125, 2008 SEC LEXIS 2843 (Dec. 19, 2008).

[163] Guidelines at 104.

> After careful consideration of these circumstances, we find that barring [Respondent] in all principal capacities is needed to deter him from again engaging in supervisory violations. For the reasons explained above, [Respondent's] failure to supervise was egregious, and we do not think that merely suspending [Respondent] in a principal capacity for a limited duration of time would be sufficient to ensure that he fully understands the need to comply with the obligations and responsibilities that principals shoulder. In this regard, we note that [Respondent] not only failed to supervise, he focused on boosting sales in the face of numerous red flags of abusive sales practices. In short, to permit [Respondent] to be entrusted with supervisory responsibilities again would place customers at too great a risk.
>
> We do not conclude, however, that suspending [Respondent] in non-principal capacities is needed to deter him from engaging in other types of violations. Although we find that [Respondent's] failure to supervise was a serious violation, it was a failure in his capacity as a supervisor, not as a general securities representative.[164]

Applying the same reasoning, the Panel concludes that, while barring Taddonio and Porges in all principal capacities is required to protect the investing public, the facts do not support a bar in all capacities.[165]

With regard to fines or restitution, it appears from both the record in this proceeding and Taddonio's CRD record that he filed for bankruptcy under Chapter 7 of the Bankruptcy Act in September 2016. Accordingly, the Panel will not impose any monetary sanctions against Taddonio. Porges, on the other hand, has not filed for bankruptcy, and thus could be subject to monetary sanctions. Given that the Panel cannot impose monetary sanctions on Taddonio, however, and considering Porges' somewhat lesser responsibility for the failure to supervise, the Panel has determined to also not impose monetary sanctions against Porges for his failure to supervise. As with Beyn, but for Taddonio's bankruptcy, the Panel would have imposed fines at the top of the range recommended in the Sanction Guidelines and would have considered whether to order restitution to at least some customers.

2. False Testimony

The SEC has explained:

> Just as refusing to respond at all to requests for information undermines NASD's ability to conduct investigations, supplying false information to NASD during an investigation, as [Respondent] did here, "mislead[s] NASD and can conceal

[164] *Pellegrino*, 2008 FINRA Discip. LEXIS 10, at *78-79.

[165] In limiting the sanction for failing to supervise to barring Taddonio and Porges in all supervisory and principal capacities, the Panel is mindful that they are also being barred in all capacities for giving false testimony.

> wrongdoing" and thereby "subvert[s]" NASD's ability to perform its regulatory function and protect the public interest. Because of the risk of harm to investors and the markets posed by such misconduct, we conclude that the failure to provide truthful responses to requests for information renders the violator presumptively unfit for employment in the securities industry. Where, as here, there are no factors mitigating the risk of future harm, a bar is an appropriate remedy.[166]

The Sanction Guidelines indicate that a principal consideration in setting sanctions for providing untruthful information to FINRA is the "[i]mportance of the information requested as viewed from FINRA's perspective." In this case, the recordings that Taddonio and Porges were questioned about could have been critically important to Enforcement's investigation and to the Panel's evaluation of the charges, because such recordings of conversations with customers could have provided clearer and more reliable evidence of the interactions between the firm and its customers than the testimony of witnesses. While it is impossible to be certain that the contractor who had archived CSC's records still retained any recordings as of the dates of Taddonio's and Porges' OTRs, if they had testified truthfully, Enforcement would at least have had an earlier opportunity to seek the recordings from the contractor. By not testifying truthfully, Taddonio and Porges deprived Enforcement of that opportunity.

Accordingly, the Panel will bar Taddonio and Porges from associating with any FINRA member firm in any capacity for giving false testimony.

VIII. Order

The Extended Hearing Panel concludes that:

(1) Respondent Beyn engaged in quantitatively unsuitable trading in the accounts of customers, in violation of NASD Rule 2310, for trading prior to July 9, 2012; FINRA Rule 2111, for trading beginning on July 9, 2012; and FINRA Rule 2010 for the entire period;

(2) Respondent Beyn churned the accounts of customers, in violation of Section 10(b) of the Securities Exchange Act of 1934, Exchange Act Rule 10b-5, FINRA Rules 2020 and 2010, and NASD Rules 2120 and 2010;

(3) Respondent Beyn made qualitatively unsuitable recommendations to a customer, in violation of NASD Rule 2310 and FINRA Rule 2010, with regard to one unsuitable recommendation, and in violation of FINRA Rules 2111 and 2010, with regard to two other unsuitable recommendations;

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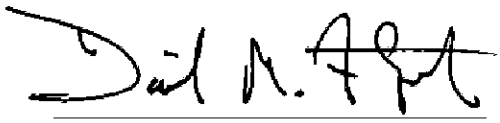
[166] *Geoffrey Ortiz*, Exchange Act Release No. 58416, 2008 SEC LEXIS 2401, at *32 (Aug. 22, 2008) (citation omitted).

(4) Respondents Taddonio and Porges both failed to reasonably supervise the sales practices of CSC's registered representatives in light of red flags indicating that certain registered representatives were, or might be, excessively trading customer accounts, in violation of NASD Rules 3010(a) and (b) and FINRA Rule 2010; and

(5) Respondents Taddonio and Porges gave false testimony during a FINRA investigation, in violation of FINRA Rules 8210 and 2010.

For his violations, Respondent Beyn is barred from association with any FINRA member firm in any capacity. For their failures to supervise, Respondents Taddonio and Porges are barred from association with any FINRA member firm in any principal or supervisory capacity. For giving false testimony, Respondents Taddonio and Porges are barred from association with any FINRA member firm in any capacity.

For the reasons set forth above, no monetary sanctions are imposed against any of the Respondents.[167] If this decision becomes FINRA's final disciplinary action, the bars will take immediate effect.



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For the Extended Hearing Panel

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Jeffrey D. Pariser, Esq. (via electronic mail)

[167] The Extended Hearing Panel has considered and rejects without discussion all other arguments of the parties.