BEFORE THE NATIONAL ADJUDICATORY COUNCIL

FINANCIAL INDUSTRY REGULATORY AUTHORITY

In the Matter of Department of Enforcement, Complainant, vs. The Dratel Group, Inc. Southold, NY, and William M. Dratel Southold, NY, Respondents.	DECISION Complaint No. 2008012925001 May 2, 2014

Member firm and its principal willfully engaged in fraudulent cherry-picking scheme, willfully falsified order tickets, failed to identify customer names on order tickets prior to execution, failed to establish and enforce adequate supervisory procedures, and willfully failed periodically to update customer account information. Member firm opened new customer accounts without requiring photo identification and failed independently to test the firm's anti-money laundering program. Held, findings affirmed and sanctions modified.

Appearances

For the Complainant: Samuel L. Barkin, Esq., Andrew T. Beirne, Esq., Lara C. Thyagarajan, Esq., Department of Enforcement, Financial Industry Regulatory Authority

For the Respondents: Irwin Weltz, Esq., Ellenoff Grossman & Schole LLP

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Decision

The Dratel Group, Inc. ("DGI"), and William M. Dratel ("Dratel") appeal a FINRA Extended Hearing Panel's September 28, 2012 decision. The Extended Hearing Panel held that DGI and Dratel: willfully engaged in a fraudulent trade allocation scheme, also known as "cherry picking"; willfully falsified and backdated order tickets, time stamped blank order tickets, and failed to identify customer names on order tickets until after execution; failed to establish, maintain, and enforce supervisory procedures adequate to prevent post-execution allocation of trades and ensure timely and accurate completion of customer order tickets; and willfully failed periodically to update customer account information for 42 customers. The Extended Hearing Panel also found that DGI opened 11 new customer accounts without requiring the customers to show photographic identification and failed independently to test its anti-money laundering ("AML") program in 2006 and 2007.[1]

For these violations, the Extended Hearing Panel barred DGI from day trading and fined the firm a total of $185,000. It also barred Dratel from associating with any member firm in any capacity and ordered him to disgorge $489,000 in ill-gotten gains to FINRA.

After a thorough review of the record, we affirm the Extended Hearing Panel's findings of violation and modify the sanctions it imposed.

I. Background

Dratel's father formed DGI, a FINRA member, in 1980. Dratel entered the securities industry in January 1977 and joined DGI in March 1980. Dratel is registered through DGI as a general securities representative and principal, an equity trader limited representative, a financial and operations principal, a registered options principal, an operations professional, and a general securities sales supervisor. Since August 1999, Dratel has been the sole owner of DGI, and he has operated the firm under a waiver of the two-principal requirement since 2002. During the relevant period, 2005 through 2008, Dratel was the only registered person at DGI and was designated as DGI's chief compliance officer, AML officer, and financial and operations principal ("FINOP"). DGI also employed two to three unregistered individuals to assist Dratel and perform administrative tasks.

DGI operated out of two offices. Its main office, where Dratel worked primarily, was located in East Hampton, New York, and its only branch office, where two unregistered staff members worked, was located on Broad Street in New York City. DGI maintained its customer files and trading records in the New York City office.

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[1] As discussed in more detail in Section III.A.4.a, *infra*, one member of the Extended Hearing Panel dissented with respect to the Extended Hearing Panel majority's finding of willful and fraudulent cherry picking, which he believed was not supported by the preponderance of the evidence. He concluded that the evidence proved negligence, but not fraud. He opined that lesser sanctions would be appropriate.

II. Procedural History

In May 2010, FINRA's Department of Enforcement ("Enforcement") filed a seven-cause complaint. Cause one alleged that, between October 1, 2005 and December 31, 2006 [hereafter, the "Cause One Review Period"], DGI and Dratel willfully executed a fraudulent trade allocation scheme, in violation of Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act"), Exchange Act Rule 10b-5, and NASD Rules 2120 and 2110.[2] Specifically, the complaint alleged that Dratel "cherry picked" profitable day and overnight trades for his personal account while steering unprofitable or less profitable trades to his discretionary customers' accounts.[3] The complaint alleged that Dratel effected the cherry-picking scheme by purchasing securities for his personal account and his discretionary customers' accounts in one of two firm accounts and delaying the allocation of the purchases to either his personal account or a discretionary customer's account until he knew whether the security had appreciated in value such that a short-term trade would yield a profit to the owner and ultimate seller of the security. Cause one of the complaint alleged that, as a result of this scheme, Dratel's personal account reaped exorbitant profits while the discretionary customers' accounts sustained losses in day and overnight trading.

Cause two of the complaint alleged that, between October 1, 2005, and December 31, 2006, Dratel and DGI willfully falsified and backdated order tickets and time-stamped blank order tickets to further the cherry-picking scheme. Cause two alleged that DGI wilfully violated Section 17(a) of the Exchange Act and Exchange Act Rules 17a-3(a)(6) and (7), and that DGI and Dratel violated NASD Rules 2110 and 3110. Cause three alleged that, between February 2005 and December 2006, Dratel and DGI failed to identify customer names on order tickets until after execution to further the cherry-picking scheme, in violation of NASD Rules 2110 and 3110(j). Enforcement withdrew cause four. Cause five alleged that, between January 2005 and December 2007, DGI and Dratel failed to establish, maintain, and enforce supervisory procedures adequate to prevent post-execution allocations of trades and ensure timely and accurate completion of customer order tickets, including the identification of customer names before execution, in violation of NASD Rules 2110 and 3010(a) and (b). Cause six alleged that, between November 2004 and January 2008, DGI and Dratel willfully failed to update periodically customer account information for 42 customers. Cause six alleged that DGI wilfully violated Section 17(a) of the Exchange Act and Exchange Act Rules 17a-3(a)(6) and (7), and that DGI and Dratel violated NASD Rules 2110 and 3110. Cause seven alleged that, between August 2006 and January 2008, DGI opened 11 new customer accounts without requiring the customers

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[2] The conduct rules that apply in this case are those that existed at the time of the conduct at issue.

[3] The Extended Hearing Panel decision stated generally that, for purposes of its decision in this case, a "day trade" refers to the purchase and sale (or short sale and purchase to cover) of a security within a single trading day or <u>within two consecutive trading days</u>. Generally, day trading refers to intra-day orders to effect both purchase and sale transactions. *See* FINRA Rule 2130 (Approval Procedures for Day-Trading Accounts). Because the trades at issue in this case are both intra-day and overnight, in this decision we will refer to the trades as "day and overnight trades."

to show photographic identification and failed independently to test DGI's AML program in 2006 and 2007, in violation of NASD Rules 2110 and 3011(b) and (c).

Dratel and DGI generally denied all allegations of misconduct.

In a September 28, 2012 decision, the Extended Hearing Panel found violations as alleged in the complaint and imposed the sanctions discussed above.

This appeal followed.

III. Findings of Fact and Conclusions of Law

A. Causes One, Two, and Three – Willful and Fraudulent Cherry Picking and Willful Use of Falsified, Inaccurate, and Incomplete Order Tickets

The complaint alleged, and the Extended Hearing Panel found, that DGI and Dratel employed a scheme to fraudulently allocate profitable trades to Dratel's personal account and unprofitable or less profitable trades to DGI's discretionary customers' accounts. The Extended Hearing Panel also found that, in furtherance of the fraudulent scheme, Dratel and DGI altered or manipulated DGI's trading tickets by time stamping blank tickets, time stamping tickets inaccurately, altering time stamps, and time stamping order tickets without identifying customer names. The Extended Hearing Panel further found that, in conjunction with the fraudulent scheme, DGI and Dratel failed to disclose material information to DGI's discretionary customers. We affirm the Extended Hearing Panel's findings under causes one, two, and three.[4]

1. DGI and Dratel

During the Cause One Review Period, DGI had approximately 70 customer accounts in which Dratel exercised discretionary trading authority. In approximately 40 of those accounts, Dratel engaged in some day and overnight trading in addition to long-term investing. Dratel did not engage exclusively in day and overnight trading in any of the discretionary customers' accounts, and all of those accounts held many long-term investments. Enforcement confined its allegations of fraudulent cherry picking to 25 discretionary customers' accounts. Enforcement excluded from its allegations 15 discretionary customers' accounts in which Dratel executed two or fewer day and overnight trades during the 15-month Cause One Review Period. Most of the 25 discretionary customers [hereafter, the "Discretionary Customers"] were friends and family of Dratel and long-term clients of DGI.

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[4] Under causes two and three, the Extended Hearing Panel found violations during the periods alleged in the complaint (October 2005 through December 2006 for cause two and February 2005 through December 2006 for cause three). We affirm these findings with respect to cause two. Given the record evidence with respect to cause three, we confine our findings of violation under cause three to October 2005 through December 2006 as well.

Dratel executed almost exclusively day and overnight trades in his personal account.[5] He described his trading in his personal account as "purely day trading" to avoid market risk, and he held few positions overnight and no positions longer than overnight.

During the 15-month Cause One Review Period, Dratel executed 501 day and overnight trades in his personal account at DGI and more than 1,200 day and overnight trades in the accounts of the 25 Discretionary Customers. Dratel initiated all positions, for Discretionary Customers' accounts and his personal account, in one of two firm accounts – the Average Price Listed Account or the OTC Principal Account [together, the "Firm Account"].[6] DGI executed purchases or short sales in the Firm Account, and DGI's staff, at Dratel's direction, allocated the positions or portions of the positions to one or more Discretionary Customers' accounts or Dratel's personal account. Dratel testified that some of the Firm Account trades were single customer and some were "bunched" trades, meaning that he would execute one or more purchases or short sales of a particular security in the Firm Account and allocate the stock or short positions to one or more customers. Sometimes his personal account would be included among the "customer" accounts to which he allocated securities from bunched trades.

DGI cleared on a fully-disclosed basis through Oppenheimer & Co. ("Oppenheimer"). DGI's two administrative employees in the New York City office had direct access to Oppenheimer's order entry and allocation systems, which enabled DGI employees to enter and allocate trades independently. DGI entered all of its orders for real-time direct market purchases or short sales between the Firm Account and "the Street" through Oppenheimer's Order Management System ("OMS"). OMS documented the time that a trade was routed and executed in hours, minutes, and seconds. OMS closed when the market closed at 4:00 p.m. DGI used Oppenheimer's back-office system, FiNet, to allocate trades from the Firm Account to customer accounts or Dratel's personal account and to process cross trades between customer accounts and between Dratel's personal account and customer accounts. Oppenheimer generated DGI's confirmations based on entries into the FiNet system.[7] FiNet recorded only the trade and date and did not record time of entry or execution of an order. FiNet remained open and accessible until 7:00 or 8:00 p.m., and DGI employees sometimes entered allocations into FiNet well after the market closed at 4:00 p.m.

Dratel conceded that, when he purchased stock by placing an order through the Firm Account, it was not possible to determine via the OMS ticket for which customer account the

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[5] Dratel maintained one regular trading account and two individual retirement accounts at DGI. The trading that we discuss in this decision occurred primarily in Dratel's regular trading account.

[6] DGI used the Average Price Listed Account to trade stocks listed on the New York Stock Exchange. DGI used the OTC Principal Account for stocks traded on The Nasdaq Stock Market, Inc. or over-the-counter securities. In 2005 and 2006, DGI did not conduct any proprietary trading in these accounts, and the accounts were flat at the end of every day.

[7] Oppenheimer mailed trade confirmations and monthly account statements to DGI's customers and provided copies to DGI.

trade was designated (i.e., Dratel's personal account or a Discretionary Customer's account). Only FiNet tickets identified customer accounts.

OD worked in DGI's New York City office from 1987 through 2011 primarily as a receptionist. OD testified that she maintained all of DGI's trading records. OD received confirmations for the preceding day's trades from Oppenheimer every morning and reconciled them with order tickets and allocation sheets from the prior day.[8]

2. Enforcement's Investigation of DGI

In 2006, Enforcement began an investigation of DGI when a FINRA monitoring system detected an increase in the number of "as of" trades that DGI executed during late 2005 and early 2006.[9] Between March 2006 and March 2007, Enforcement requested that DGI produce sales blotters, order tickets, and confirmations for "as of" trades that occurred between January 2005 and March 2006, and it asked respondents to explain why 120 trades were processed as "as of" trades.

In April 2007, Enforcement sent examiner PH to DGI's New York City office to review trading records and facilitate DGI's production of documents. PH found numerous faxed instruction sheets for allocations of securities positions established in the Firm Account and allocated to customer accounts and Dratel's personal account. Dratel appeared to have sent the facsimiles from the East Hampton office to the New York City office at or near the close of business on the trading day or the following day, suggesting that Dratel provided the New York City office with allocation instructions at or after the close of the market. Enforcement thereafter requested that DGI produce copies of all facsimile sheets containing allocation instructions. Additionally, PH was unable to locate all of the trade tickets for the "as of" transactions that Enforcement identified in its earlier requests for information. Enforcement sent follow up requests for more than 60 order tickets that DGI did not produce and PH could not locate on site.[10]

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[8] For each trading day, DGI maintained a commission run, daily activity run, order tickets stapled to confirmations, and allocation instruction sheets that Dratel sent from the East Hampton office to DGI's New York City office. Each day's compilation of records were bound together and maintained in boxes and cabinets on site.

[9] Respondents criticized Enforcement for failing to provide details regarding the pool of FINRA members to which FINRA's monitoring system compared DGI. Such details, however, are not relevant because Enforcement offered this evidence to explain what initially triggered the investigation that later led to allegations of cherry picking and to identify some "as of" trades that were part of the fraudulent allocation scheme. The complaint does not allege that DGI violated FINRA rules by executing excessive numbers of "as of" trades or more "as of" trades than other member firms.

[10] The Extended Hearing Panel found, after hearing PH's testimony and reviewing DGI's trade tickets and other records, that PH was credible and thorough in her review of DGI's records. The credibility determinations of the initial fact finder are entitled to considerable weight and deference because they are based on hearing the witness's testimony and observing

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During the onsite visit, PH also found order tickets that appeared to be altered or for which the time stamps were missing, inaccurate, or contradicted by other documentation in DGI's files. These and other irregularities in DGI's records caused PH to question the reliability of DGI's trade tickets.[11]

3. The Mechanics of Trading at DGI

All of the trades at issue in this case were day and overnight trades. Dratel opened a position (with a purchase or short sale) in the Firm Account through OMS on one day and closed the position (by selling or covering the short) on the same day or the next day. DGI executed all orders to open positions through OMS in the Firm Account. DGI thereafter allocated the purchases or short sales executed in the Firm Account into a customer account or Dratel's personal account through the FiNet system.[12] When Dratel closed out a position, he either sold directly from the customer or his personal account into the market or transferred the stock to the Firm Account for sale.

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her demeanor. *Harry Friedman*, Exchange Act Release No. 64486, 2011 SEC LEXIS 1699, at *16 (May 13, 2011). These credibility determinations "can be overcome only where there is substantial evidence for doing so," and we find none to exist in this case. *Dennis Todd Lloyd Gordon*, Exchange Act Release No. 57655, 2008 SEC LEXIS 819, at *38 (Apr. 11, 2008). Furthermore, the record evidence corroborates PH's testimony. Facsimile sheets indicated that Dratel often communicated allocation instructions to the New York City office after he closed out positions and could reliably assess profitability.

[11] Dratel testified that many of the unreliable, inaccurate, and altered trade tickets that PH found at DGI were completed by someone in the New York City office and not by him, and he therefore could not explain the discrepancies. For instance, a series of order tickets for trades that occurred on January 18, 2006, included tickets for cross trades between several of DGI's discretionary customers. One sell side ticket was time stamped <u>2</u>:22 p.m. on January 18, but the corresponding buy side ticket for the other side of the cross trade was time stamped <u>12</u>:22 p.m. on the same day. Dratel noted that the handwriting on the tickets was not his, and that he told his New York City office staff to time stamp both tickets for both sides of the cross trade at 2:22 p.m. He had no explanation for the discrepancy. The record included other examples of inaccurate time stamps and manually altered tickets.

[12] For each trade, DGI opened a position with one OMS ticket for a purchase into the Firm Account and allocated some or all of the position with one FiNet sell ticket from the Firm Account and FiNet buy tickets for each customer account that received an allocation or Dratel's personal account.

VP worked as Dratel's sales assistant from October 2005 through September 2006 in DGI's New York City office.[13] VP testified that, for real time market purchases and sales, Dratel contacted VP (or OD in VP's absence)[14] by telephone and directed her to place orders, generally early in the day. VP entered the orders into OMS and, for each order, gave Dratel the execution price and order identification number from OMS over the phone so that Dratel could record them on each OMS order ticket. When Dratel called in an OMS order, Dratel generally did not identify the customer or customers (including Dratel's personal account) for whom he was purchasing the stock.[15]

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[13] Before joining DGI, VP was a sales assistant at Oppenheimer, and she was familiar with Oppenheimer's order entry and allocation systems when she joined DGI. While at DGI, VP was primarily responsible for manually entering trades on OMS and allocations on FiNet. She testified that she also prepared a daily "buying powers" sheet for Dratel. The "buying powers" sheet advised Dratel of the equity in each client account for the day. After the close of trading each day, VP prepared an "up/down" sheet for Dratel, which listed the specific stocks held by DGI's client accounts and reported how the stocks' prices fared throughout the day.

VP replaced AL. AL originally joined DGI in 1987 as a receptionist and data entry person. By 1998, she assumed the position of sales assistant and began entering trades for DGI into OMS, allocating trades on FiNet, and opening new customer accounts. She left DGI in September 2005 and returned in March 2007.

[14] OD testified that her responsibilities generally did not include entering orders or allocating trades in the Oppenheimer systems unless the responsible person (VP from October 2005 through September 2006 and AL at all other times) was away from her desk or out of the office.

[15] VP testified that she did not need to know customer names because all the trades were executed in the Firm Account. She testified that, for day and overnight trades, she did not receive allocation instructions until after Dratel closed out the positions, generally at approximately 4:00 p.m. VP stated that the term "closing out" a position, as used during her testimony, meant the sale on the same day or next day of a position that Dratel opened in the Firm Account.

VP also testified that sometimes Dratel communicated the allocations within one or two hours of the opening trade, and sometimes she received allocation instructions throughout the day but waited until the end of the day to input the information into FiNet. VP concluded, however, that she received the majority of Dratel's allocation instructions between 3:30 and 4:00 p.m. or later, particularly on heavy trading days. The Extended Hearing Panel found that VP's testimony was credible. The credibility findings of the initial fact finder are entitled to considerable weight and deference, and we find no basis to overturn the Extended Hearing Panel's determinations here. *Daniel D. Manoff*, 55 S.E.C. 1155, 1161-62 & n.6 (2002). VP's testimony also is supported by documentary evidence of manipulated time stamps, time stamps from the middle of the night, such as 3:20 a.m., and facsimiles of allocation instructions that indicate that they were faxed from the East Hampton office at, near, or after the close of the market. Additionally, PH testified that the vast majority of DGI's faxed order tickets and faxed

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AL corroborated VP's testimony that Dratel provided allocation instructions generally after he closed out positions in the Firm Account. AL testified that she would receive an order from Dratel to open a position and would enter the order in OMS (in the Firm Account). She stated that, sometime during the day, Dratel would send her the other side of the order to make the Firm Account flat. Then he would fax to her a FiNet ticket, if the allocation involved only one customer (or Dratel's personal account), or an allocation instruction sheet, if it involved more than one customer, and she would input the allocations into FiNet. She stated that this process occurred at various times throughout the day and Dratel's allocation instructions sometimes arrived after the market closed.[16]

Dratel testified that both he and the New York City office staff shared the responsibility for completing DGI's order tickets. Dratel testified that, for both OMS and FiNet tickets, he sometimes time stamped and prepared tickets himself in the East Hampton office and, on other occasions, time stamped tickets and mailed them blank to the New York City office. At still other times, Dratel testified, he directed the New York City office staff to time stamp blank tickets and complete them later in the day when he supplied allocation information.

The Extended Hearing Panel pressed Dratel for additional details regarding his order-entry process. For single customer trades, either in a customer account or in Dratel's personal account, Dratel stated that he called VP to enter an OMS trade to open a position in the Firm Account, time stamped an OMS ticket, and would receive from the New York City office the price and execution number, which he would enter onto the time-stamped OMS ticket in the East Hampton office. Dratel time stamped each OMS ticket horizontally when he entered the order and vertically when the order was executed. These tickets bore the account number for the Firm Account and did not identify the name or account number of the customer to whom the trade ultimately would be allocated. At the same time as execution, Dratel time stamped a blank FiNet sell ticket for the transfer from the Firm Account and a blank FiNet buy ticket for the purchase by a customer account or his personal account.[17] Later in the day, he faxed completed FiNet

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allocation instruction sheets bore facsimile times after 4:00 p.m., and the Extended Hearing Panel found PH credible.

[16] OD's testimony also corroborated VP. OD testified that she received in the mail blank, time-stamped FiNet order tickets that Dratel already had faxed to VP. When she received the blank FiNet tickets, she stated, she completed the tickets based on allocation instruction sheets provided by Dratel and maintained them in DGI's files.

[17] Dratel testified that he always ensured that the OMS ticket and FiNet ticket(s) had the same execution time stamp. VP testified that, in instances in which she (and not Dratel) completed FiNet tickets, she would reset or roll back the time stamp machine to ensure that the time stamps on the FiNet tickets were the same as the time stamps on the OMS tickets used to open positions. VP testified that she did this on most days. VP indicated that she never discussed changing the time stamp with Dratel. Rather, OD told her when she joined DGI that the firm regularly reset the time stamp for FiNet order tickets. OD denied this. On this point, the

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tickets to VP or OD, or relayed allocation information to them via telephone call.[18] The FiNet tickets served as the "allocation instructions" for single customer trades. Sometimes, however, Dratel ordered the New York City office to time stamp blank FiNet order tickets (at the time of the OMS execution) and hold them until he later provided allocation instructions.[19]

For multiple customer (or bunched) trades, Dratel called the opening position into the New York City office and sometimes built the position throughout the day, then faxed allocation instructions on a sheet later in the day or at the end of the day.[20] When Dratel called the opening position into the New York City office, he directed the staff to time stamp several blank FiNet tickets at that time to match the OMS time stamps.[21] After receiving allocation instructions from Dratel, the New York City office completed the previously time-stamped FiNet tickets and input the allocations into FiNet.[22]

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Extended Hearing Panel found that VP's testimony was "very credible" and noted that she was not a long-term employee of DGI and appeared to have harbored no animosity towards Dratel. We defer to the Extended Hearing Panel's credibility finding which, given the irregularities in the time stamps on DGI's trade tickets, are not contradicted. *See Manoff*, 55 S.E.C. at 1161-62 & n.6.

[18] Dratel testified that, at the end of each day, Dratel also mailed the original FiNet order tickets to the New York City office for records maintenance.

[19] Dratel never entered trades or allocations into the OMS or FiNet systems himself.

[20] Dratel insisted that he faxed allocation instruction sheets to the New York City office throughout the day. The vast majority of allocation instruction sheets entered into the record, however, indicate that they were faxed at or near the close of the market or later. This is consistent with PH's testimony as to the allocation sheets that she located on site at DGI. *See* Section III.A.2, *supra*.

[21] Dratel's testimony on this point was inconsistent. Dratel testified that, when he directed the New York City office staff to time stamp several FiNet tickets for subsequent allocation, he would not tell them the names of the customers and would provide allocation information later in the day. Dratel also testified that, for bunched trades, he sometimes time stamped blank FiNet tickets that he later mailed to the New York City office for the office staff to complete. Either way, DGI routinely time stamped blank FiNet tickets.

[22] Dratel testified that he advised the New York City office staff when he was done purchasing for the day but that sometimes he did not know he was done buying until he sold the positions. He testified also that, if he did not advise the New York City office staff that he was done adding to a position, the staff would hold off processing allocations because they expected Dratel to add to the position. He also testified, however, that he did not communicate the allocation information to the New York City office staff until later in the day.

Dratel also testified that the New York City office would sometimes "get rid of" stamped FiNet tickets before they were input into the system. He testified that, after he called the New York City office to purchase stock in the Firm Account, the staff would time stamp blank FiNet tickets. But if he directed the New York City office staff to buy additional shares of the same stock later in the day, he would direct them to prepare and time stamp new blank FiNet tickets, and they would discard the old time-stamped, blank FiNet tickets. He testified that, if he bought a third time, he would direct the staff to destroy the second set of time-stamped, blank FiNet tickets as well. Dratel explained that, because the tickets are time stamped blank and are not numbered or coded to indicate a break in the chain of tickets, a discarded FiNet ticket would not result in a cancel and rebill, and tickets could be discarded and recreated without detection. Dratel testified similarly regarding bunched trades. He stated that he sometimes faxed allocation instructions at one point during a trading day, and then decided to purchase additional shares of the same stock later in the day. When this occurred, he would direct the New York City office to discard the original faxed allocation instruction sheet, and maintain in DGI's records only the second allocation instruction sheet that he faxed later in the day.[23]

Dratel testified that, notwithstanding the timing of the New York City office's receipt of allocation instructions or input of allocations into FiNet, he made all allocation decisions before he purchased any stock and maintained a running allocation list on his desk. The Extended Hearing Panel did not credit Dratel's assertion. The credibility findings of the initial fact finder are entitled to considerable weight and deference particularly where, as here, they are supported by record evidence. *Manoff*, 55 S.E.C. at 1161-62 & n.6. First, VP and AL testified that Dratel generally did not communicate allocation instructions until after closing out positions. Second, Dratel time stamped blank FiNet order tickets and did not identify customer names when he placed orders in the Firm Account. Third, he admitted to sometimes discarding tickets and creating new tickets. Fourth, the evidence included several examples of FiNet order tickets with altered or incorrect time stamps, suggesting that the tickets that did identify customer names were completed after the fact. Additionally, for the majority of trades, Dratel was unable to produce a copy of a running list that he maintained for any trading day.

4. *Legal Conclusions*

Exchange Act Section 10(b) and Exchange Act Rule 10b-5 prohibit fraudulent and deceptive acts and practices in connection with the purchase or sale of a security.[24] NASD Rule

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[23] OD, DGI's recordkeeping clerk, denied that she ever intentionally discarded firm records, but neither she nor VP were specifically asked about Dratel's claim to have discarded order tickets and allocation sheets if he purchased additional shares of stock.

[24] Exchange Act Section 10(b) makes it unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange to use or employ, in connection with the purchase or sale of any security, any manipulative or deceptive device or contrivance. 15 U.S.C. § 78j(b). Exchange Act Rule 10b-5 makes it unlawful for any person, directly or indirectly, (a) to employ any device, scheme, or artifice to defraud; (b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; or (c) to engage in any act, practice,

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2120 (now FINRA Rule 2020) is FINRA's anti-fraud rule. It is similar to Rule 10b-5 and provides that no member shall effect any transactions, or induce the purchase or sale of any security, by means of any manipulative, deceptive or fraudulent device.[25] The Commission's and FINRA's anti-fraud rules are designed to ensure that members of the securities industry fulfill their obligations to the public to be complete and accurate when making statements about securities and to refrain from engaging in manipulative or deceptive conduct.

In nearly every conceivable way, a cherry-picking scheme operates as a "device, scheme, or artifice to defraud" and "as a fraud or deceit upon" investors. *SEC v. K.W. Brown and Co.*, 555 F. Supp. 2d 1275, 1303 (S.D. Fla. 2007). "By its very nature, [a] cherry-picking scheme operate[s] as a fraud on . . . clients, which is prohibited under [Exchange Act Rule] 10b-5(a) and (c)." *Id.* at 1304. Furthermore, a registered person and member firm who engage in an undisclosed fraudulent cherry-picking scheme also violate Exchange Act Rule 10b-5(b) and FINRA's anti-fraud rule by making omissions of material facts in connection with the purchase or sale of securities. *Id.*; *see also Basic Inc. v. Levinson*, 485 U.S. 224, 235, n.13 (1988) (finding that the Commission may prove fraud by demonstrating that the respondent made a material misrepresentation or omission and acted with scienter, in connection with the purchase or sale of a security, and while using the facilities of interstate commerce).

We find that Dratel and DGI willfully engaged in a fraudulent allocation or "cherry picking" scheme. We also find that they failed to disclose material facts in connection with purchases and sales of securities by failing to disclose to the Discretionary Customers that Dratel traded his personal account side by side with the Discretionary Customers' accounts and favored his account over theirs.[26]

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or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security. 17 C.F.R. § 240.10b-5.

[25] Conduct that violates Commission rules or FINRA rules is inconsistent with high standards of commercial honor and just and equitable principles of trade and therefore also violates NASD Rule 2110 (now FINRA Rule 2010). *Joseph Abbondante*, 58 S.E.C. 1082, 1103 (2006), *aff'd*, 209 F. App'x 6 (2d Cir. 2006). "Misrepresentations also are inconsistent with just and equitable principles of trade and violate NASD . . . Rule 2110." *Dane S. Faber*, 57 S.E.C. 297, 306 (2004); *see also Keith Springer*, 55 S.E.C. 632 (2002) (finding that representative who effected post-execution trade allocations and allocated trades with better executions to his personal account violated just and equitable principles of trade).

[26] Based on Dratel's conduct, ownership and control of DGI, and his position as the only registered person conducting securities business at the firm, we hold both Dratel and DGI responsible under causes one, two, and three. *Kirlin Sec., Inc.*, Exchange Act Release No. 61135, 2009 SEC LEXIS 4168, at *59 (Dec. 10, 2009) (holding that a firm may be held accountable for the misconduct of its associated persons).

a. Respondents Engaged in a Fraudulent Scheme

The preponderance of the evidence demonstrates that Dratel orchestrated a fraudulent allocation scheme.[27] We find compelling the evidence that Dratel executed increasingly more day trades in 2006 and generated outrageously large profits for his personal account while the Discretionary Customers lost significant amounts of money in day and overnight trading, often in the same securities. The evidence demonstrates that Dratel often traded the same securities in his account and the Discretionary Customers' accounts, but that his trades were far more profitable or less unprofitable. Furthermore, Dratel exercised discretionary authority in the Discretionary Customers' accounts without supervision, used an omnibus account for his personal and customer trades, and allocated trades only after observing the security's performance. He waited until he could discern how the stock would perform before allocating all or some of these positions from the Firm Account to individual customers or himself. He accomplished this, in part, by falsifying order tickets and failing to complete them at the time of execution, and he favored his account over the accounts of the Discretionary Customers. Taken together, the evidence supports our finding of a fraudulent day-trading scheme.[28]

<u>(1) Dratel Exercised Discretionary Authority and Was Not Supervised.</u> At the outset, we note that Dratel operated a single-person firm where he was the only registered person and sole principal. He was not subject to supervision or oversight, and he alone made all trading decisions at DGI. This enabled Dratel to orchestrate a cherry-picking scheme without detection or intervention by another registered person or supervisor. *Cf. K.W. Brown*, 555 F. Supp. 2d at 1283-84 (finding cherry picking where two individual respondents controlled virtually every aspect of firm's operations and were the only principals reviewing account activity); *Melhado, Flynn & Assocs. Inc.*, Exchange Act Release No. 64467, 2011 SEC LEXIS 1662, at *5 (May 11, 2011) (finding fraudulent cherry-picking scheme furthered by fact that chief executive officer was only firm employee who executed day trades). Dratel also exercised discretionary trading authority over the 25 Discretionary Customers' accounts. This provided him with the unique opportunity and ability to determine which securities to purchase and which accounts would receive profitable and losing trades, without discussing the trades in advance with the customers.

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[27] The Extended Hearing Panel confined its findings of violation under cause one to 2006. It found that Dratel's personal account and the discretionary customers' accounts generated nearly the same amount of profit for day and overnight trading during the last quarter of 2005. Their profitability diverged dramatically in early 2006. The Extended Hearing Panel therefore found violations under cause one during 2006 only. We confine our findings of violation under cause one to 2006 as well.

[28] We are mindful that the dissenting Extended Hearing Panel member expressed unwillingness to rely substantially on circumstantial evidence to reach this conclusion. Circumstantial evidence, however, can be sufficient to prove a violation of the securities laws and to demonstrate scienter in fraud cases. *See Herman & MacLean v. Huddleston*, 459 U.S. 375, 390-91 n.30 (1983) (holding that proof of scienter may be "a matter of inference from circumstantial evidence"); *Terrance Yoshikawa*, Exchange Act Release No. 53731, 2006 SEC LEXIS 948, at *17 (Apr. 26, 2006) ("Proof of scienter may be inferred from circumstantial evidence.").

The exercise of discretionary trading authority is also a common characteristic of cherry picking. *See Gerson Asset Mgmt., Inc.*, Exchange Act Release No. 52880, 2005 SEC LEXIS 3120, at *6 (Dec. 2, 2005) (finding that cherry-picking respondent exercised discretionary authority over injured customers' accounts); *Springer*, 55 S.E.C. at 635 (finding that cherry-picking respondent managed discretionary customer accounts).

<u>(2) Dratel Traded Exclusively Through an Omnibus Account.</u> Dratel originated all day and overnight trades for the Discretionary Customers' accounts and his personal account in the Firm Account without identifying the intended customer. The OMS order tickets that DGI used to place market orders did not require that Dratel identify customers to execute trades. DGI needed to enter only the Firm Account number into the OMS system to execute a trade. This enabled Dratel to hold each stock position in the Firm Account, assess its performance, and execute the other side of the trade before allocating the trade to his or a Discretionary Customer's account. Dratel's use of the Firm Account for all trading also supported respondents' cherry-picking scheme.[29] *See MiddleCove Capital, LLC*, Exchange Act Release No. 68669, 2013 SEC LEXIS 162, at *6 (Jan. 16, 2013) (finding cherry-picking scheme where respondent used a master account for block purchases of securities that he allocated to personal and client accounts); *Gerson Asset Mgmt.*, 2005 SEC LEXIS 3120, at *6 (finding that perpetrator of cherry-picking scheme used an omnibus account to place orders for his own and clients' transactions).

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[29] Dratel denied that he executed all trades through the Firm Account as a means of cherry picking. He testified that he traded, even for his own account, through the Firm Account because it was simpler, more convenient, and how DGI had always handled trading. He also stated that, at the start of each trading day, he never knew how much of any particular stock he would accumulate that day and, in order to save on ticket charges, he would build positions in the Firm Account before allocating it to his personal account or a Discretionary Customer's account. He contended that, by doing so, he provided customers with an average price. Dratel's claims are not supported by the evidence.

The charge for each purchase into, and sale from, the Firm Account was $8.75. Each trade in or out of a Discretionary Customer's account or Dratel's personal account cost $17.50. Given the mechanics of executing Dratel's personal trades or a Discretionary Customer's trades through the Firm Account, Dratel conceded that a single trade executed in this manner would cost $35 ($8.75 to purchase in the Firm Account, plus $8.75 to sell from the Firm Account, plus $17.50 to purchase in Dratel's personal account or a Discretionary Customer's account) and that the same trade executed directly in his personal account or a Discretionary Customer's account (without use of the Firm Account) would cost only $17.50. PH testified that, if Dratel's personal account or the Discretionary Customers' accounts acquired stock that was purchased into the Firm Account in three lots on one day, they could break even. Only if it was acquired in four or more lots would they save money on the purchases by having used the Firm Account. PH also testified that she reviewed the 2005 and 2006 profit and loss blotters for Dratel's personal account, and that she saw no instances in which Dratel purchased stock through the Firm Account in four or more lots in one day. *Cf. K.W. Brown*, 555 F. Supp. 2d 1275, 1302 (finding, in cherry-picking case, that there was no good explanation for representative's use of bunched trade account to execute customer and firm trades). We do not credit Dratel's explanation for his use of the Firm Account.

(3) Dratel Executed Trades without Identifying Customers. Dratel's allocation process also demonstrates cherry picking. His process involved faxing allocation instructions to the New York City office well after the staff had executed the trades in the Firm Account. Through DGI's use of FiNet for allocations, DGI's staff manually input allocations after the fact and sometimes even after the markets closed. Dratel used his ability to delay allocation, often until the end of the day or after the market closed, to accomplish cherry picking.[30] In effect, Dratel would determine how a stock performed before he decided whether to allocate trades to his personal account or to Discretionary Customers' accounts.[31] *See, e.g., Melhado, Flynn*, 2011

[30] Certain trades highlight Dratel's successful cherry picking. On May 22, 2006, Dratel purchased three similar NASDAQ stocks during a six-minute window at the start of the day. At the end of the day, he sold all shares during another six-minute window. Two stocks sold for a loss. Dratel allocated those trades to two Discretionary Customers. One stock sold at a profit. Dratel allocated that trade to his personal account. Similarly, on October 3, 2006, Dratel opened two positions, one long and one short, before 9:30 a.m. in the Firm Account. During the hour before the markets closed, Dratel covered the short position at a loss and sold the long position for a profit. He allocated the short position to a Discretionary Customer account and the long position to his personal account. Again, on May 9, 2006, Dratel began accumulating positions in the Firm Account in four stocks, MIDD, HANS, AAP, and CNW, when the market opened. Before 10:00 a.m., he sold the entire position of MIDD stock in his personal account for a profit of $1,497. As the morning progressed, Dratel purchased two additional stocks, WCG and MRVL, in the Firm Account. Dratel allocated $302,831 in purchases to his personal account, which held only $41,906 in cash and no securities. He sold four additional positions during the day from his personal account at a profit of $5,460. Near 4:00 p.m., he sold the remainder of the stock that he had allocated to six Discretionary Customers for a net loss of $1,312. One customer earned a profit of $923.25.

[31] This finding is supported by the facsimile times indicated on Dratel's faxed allocation instruction sheets and faxed FiNet tickets, PH's testimony regarding the trading records that she discovered at DGI, and VP's testimony that she did not receive allocation instructions until after Dratel closed out positions, generally at approximately 4:00 p.m. Furthermore, the record included numerous day and overnight trades that DGI executed on an "as of" basis. Respondents argue that the existence of "as of" trades do not prove cherry picking. While it is true that "as of" trading alone does not definitively prove cherry picking, here it is but one of many factors that we have considered. Indeed, cases involving fraudulent allocation schemes often include allocations from an omnibus account to customer accounts the following day on an "as of" basis because "as of" trading enables a day trader to determine the profitability of a trade before allocating it from an omnibus account to a customer. *See, e.g., MiddleCove Capital*, 2013 SEC LEXIS 162, at *6-7 (finding that 65% of the purchases that cherry-picking respondent allocated to customers were not allocated until after 4:00 p.m. on the day of purchase or the next day and marked "as of").

The dissenting member of the Extended Hearing Panel found that DGI's "as of" trades were unrelated to Dratel's cherry picking. We do not agree. While not all of the "as of" trades that DGI executed were part of Dratel's cherry picking, some were in fact part of the scheme.

SEC LEXIS 1662, at *6 (finding that respondent effectuated fraudulent cherry-picking scheme by submitting equity buy orders to the trading desk in the morning without indicating the accounts to which the purchases would be allocated and providing allocation instructions much later in the day, "often shortly before the close of the market"); *Ark Asset Mgmt. Co., Inc.*, Investment Advisers Act Release No. 3091, 2010 SEC LEXIS 3233, at *5 (Sept. 29, 2010) (finding that respondent "accomplished this cherry-picking by placing orders for securities, but delaying allocation of the purchases and sales until after the orders had been filled and the price of the security had been obtained"); *Gerson Asset Mgmt.,* 2005 SEC LEXIS 3120, at *6 (finding that respondent in cherry-picking case purchased securities early in the day and waited until the end of the day to allocate stock to individual accounts).

(4) Dratel's Level of Day Trading Increased Dramatically. Dratel's increased level of trading activity is another indication of respondents' cherry picking.[32] Between January and September 2005, Dratel executed an average of only 19.2 day and overnight trades per month in the Discretionary Customers' accounts. Beginning in October 2005, Dratel became significantly more active day and overnight trading in the Discretionary Customers' accounts. Between October 1, 2005, and December 31, 2006, Dratel's day and overnight trading in the Discretionary Customers' accounts increased dramatically to an average of 82.9 trades per month. Similarly, between January and September 2005, Dratel executed an average of 2.7 day and overnight trades per month in his personal account. That also changed in October 2005. Between October 1, 2005, and December 31, 2006, Dratel executed an average of 33.4 day and overnight trades in his personal account. We find that respondents' increase in day and overnight trading late in 2005 signified the start of Dratel's cherry picking, which occurred with intensity throughout 2006. *See MiddleCove Capital*, 2013 SEC LEXIS 162, at *6-7 (finding that respondent's cherry picking corresponded with a surge in his day trading).

(5) Dratel Traded the Same Stocks for Himself and His Customers with Better Results for Himself. Another clear indication of the existence of a cherry-picking scheme is that, in 27 instances in 2006, Dratel day and overnight traded the same stock on the same day in his personal account and in the accounts of Discretionary Customers. This is a common element often found in fraudulent allocation cases. Dratel testified that, when he traded the same stock in his personal account and the account of a Discretionary Customer, his customer always received

[32] The Extended Hearing Panel relied upon an analysis of Dratel's day and overnight trading prepared by Enforcement's expert witness, Kenneth D. Collier ("Collier"). Collier is the president of Collier Consulting, Inc., a provider of litigation consulting services and securities continuing education.

The dissenting member of the Extended Hearing Panel objected to the Extended Hearing Panel's reliance on Collier's analysis. He concluded that Collier's sample size was too small and arbitrarily manipulated, the length of the Cause One Review Period was too short and arbitrarily established, the methodology for measuring trades was not adequate, and the length of the period used for comparison was inadequate. He also contended that he was not satisfied that Collier's calculations were reliable and that the Extended Hearing Panel should consider the Discretionary Customers' overall account profitability, not just the profits that they earned on day and overnight trading. We address each of these issues below.

the same or better execution prices. While individual prices per share may be comparable in some instances, in 2006 Dratel generally allocated positions from the Firm Account so as to provide the greatest profit or least loss to his personal account in 21 of the 27 instances in which he traded the same stock on the same day. Indeed, Dratel's personal account often received more favorable prices than the Discretionary Customers' accounts for the same stocks.[33] *See K.W. Brown*, 555 F. Supp. 2d at 1290 (finding as evidence of cherry picking that firm account and customers' accounts purchased or sold the same securities on the same day and that the customers consistently received the less favorable execution prices); *MiddleCove Capital*, 2013 SEC LEXIS 162, at *8-9 (finding that cherry-picking respondent often allocated the same security to his personal account and customer accounts on the same or different days and disproportionately made money on those allocations); *Ark Asset Mgmt.*, 2010 SEC LEXIS 3233, at *5 (finding that cherry-picking respondent's proprietary account and customers' accounts often traded the same securities).[34]

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[33] For instance, on April 10, 2006, Dratel purchased 1,000 shares of PLCE stock at $59.35 per share, which he allocated to his personal account, and an additional 1,500 shares of PLCE stock at $60.02 per share, which he allocated to Discretionary Customers' accounts. Dratel sold his shares that day and realized a $1,514 gain, and he sold the customers' shares the same day for a $1,643 loss. Other instances exist. On November 20, 2006, Dratel bought and sold 1,000 shares of X stock in his personal account and generated a $1,917.66 profit. On the same day, he bought and sold 1,000 shares of X stock in the account of a Discretionary Customer and generated an $882.24 loss. Similarly, on November 16, 2006, he purchased and sold 1,000 shares of BIG stock in his personal account and earned a profit of $1,809.20 while, on the same day, he bought and sold 1,000 shares of BIG stock each in the accounts of two Discretionary Customers at a loss of $750.72 per account. Dratel bought all of these securities through the Firm Account.

Even in instances in which Dratel suffered a loss, the loss in his personal account was often less than the Discretionary Customers' losses. For instance, on October 3, 2006, he allocated to his personal account 1,000 shares of HLX stock at a loss of $590.88. On the same day, he allocated purchases and sales of 1,000 shares of HLX stock to a Discretionary Customer's account at a $620.88 loss and 2,000 shares to another Discretionary Customer's account at a $1,141.76 loss. On July 17, 2006, Dratel allocated to his personal account a purchase and sale of 400 shares of MWRK stock at a loss of $466.40, while he allocated to two Discretionary Customers purchases and sales of 500 shares of MWRK stock at losses of $580.50 per customer and allocated to a third Discretionary Customer a purchase and sale of 600 shares of MWRK stock at a loss of $694.60.

Dratel argued that he traded the same stock on the same day as Discretionary Customers infrequently and that any conflict of interest therefore was negligible. This argument is beside the point. Dratel's trading of the same stock on the same day as Discretionary Customers, while directing the more profitable or less unprofitable trades to himself, is strong evidence to support our finding of cherry picking. Although Dratel did not engage in this conduct every trading day, the fact that it occurred at all supports our findings.

[34] During 2006, Dratel also day and overnight traded the same stocks as customers on different days and allocated the more profitable or least unprofitable transactions to his personal

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<u>(6) Dratel Generated Significant Profits for Himself.</u> Overall, Dratel's day and overnight trading in 2006 was far more successful in his personal account than in the accounts of the 25 Discretionary Customers. This also demonstrates that respondents cherry picked profitable trades.[35] Indeed, Dratel's day and overnight trading in 2006 resulted in cumulative profits in Dratel's personal account of $489,701 and cumulative losses in the Discretionary Customers' accounts of $228,163.[36] During the nine months preceding the Cause One Review Period, 46%

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account. For example, between January 19 and October 19, 2006, Dratel executed 20 day and overnight trades in CTXS stock. Dratel allocated seven of the trades to his account and generated a profit of $14,755.88 on CTXS stock in his account. He allocated 13 of the CTXS trades to Discretionary Customers' accounts, only one of which was profitable. The remainder resulted in total losses to the Discretionary Customers of $8,462.36.

[35] Dratel argued that it was unfair that Collier calculated profits in the Discretionary Customers' accounts only in day and overnight trading and did not consider the overall performance of the Discretionary Customers' accounts. We reject Dratel's argument. Even were we to assume that the Discretionary Customers' accounts profited overall, that does not mean that Dratel did not engage in a fraudulent allocation scheme with respect to day and overnight trades. Customers who are the victims of fraudulent allocation schemes are damaged by the trades that they never received because the perpetrator allocates the favorable trades to himself. Profits derived from investments that were not day and overnight trades are not relevant as to whether the respondent fraudulently allocated day and overnight trades. Thus, regardless of whether the Discretionary Customers' accounts performed well overall, customers who are victims of cherry picking never receive the benefit of winning allocations, and under regular market forces, their accounts may have performed better. If we followed Dratel's suggestion and considered only overall account performance, a registered person involved in a cherry-picking scheme could rely on the positive performance of customers' long-term investments to conceal cherry picking in short-term trades. *Cf. MiddleCove Capital*, 2013 SEC LEXIS 162, at *11-12 (comparing performance only of allocated trades in respondent's personal account and customers' accounts); *Ark Asset Mgmt.*, 2010 SEC LEXIS 3233, at *6-7 (comparing profitability of cherry-picked trades to profitability of trades allocated to customers rather than overall account performance); *K.W. Brown*, 555 F. Supp. 2d at 1299 (same).

[36] Broken down by quarter, a review of Collier's calculations of the gains and losses from day and overnight trading in Dratel's personal account and the accounts of the Discretionary Customers demonstrates that a significant disparity developed and persisted throughout 2006:

	Dratel	25 Customers
Oct.-Dec. 2005	$45,078	$42,415
Jan.-Mar 2006	$136,428	$66,011
Apr.-June 2006	$140,499	$(52,962)
July-Sept. 2006	$147,813	$(92,755)
Oct.-Dec. 2006	$64,961	$(148,457)

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of the Discretionary Customers' day and overnight trades were profitable and 54% lost an average of $756 per trade. The Discretionary Customers' average per trade profit for day and overnight trades was $1,546.[37] During the Cause One Review Period, however, only 28% of the Discretionary Customers' day and overnight trades were profitable and 72% were unprofitable. During this period, the Discretionary Customers' accounts earned an average profit in day and overnight trading of $1,318 per trade and lost an average of $733 per trade. Conversely, during the nine months preceding the Cause One Review Period, 40% of Dratel's day and overnight trades in his personal account were profitable and 60% were unprofitable. Between October 1, 2005, and December 31, 2006, however, an overwhelming 83% of Dratel's day and overnight trades were profitable with an average per trade profit of $1,374 per trade. At the same time, only 17% of Dratel's day and overnight trades were unprofitable and generated an average per trade loss of $413. Significantly, Dratel's personal account went from earning an average of $402 per profitable trade during the nine months preceding the Cause One Review Period to earning an average of $1,300 per profitable trade by the end of the Cause One Review Period. Dratel's average account equity during the 15-month Cause One Review Period was $34,438. During that same time, Dratel withdrew approximately $706,000 in cash from his account.[38]

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Dratel objected to Collier's failure to include in his calculations Dratel's discretionary customer accounts that had two or fewer day and overnight trades during the review period. Collier indicated in his report that the impact of these few trades would have been immaterial to the overall result. We rely on Collier's assessment and reject Dratel's argument.

[37] Dratel and DGI objected to Collier's use of a nine-month period for comparison to the Cause One Review Period, and they contended that he should have reviewed profits and losses in Dratel's personal account and the Discretionary Customers' accounts during a longer period of time, such as the entire lives of the accounts. Dratel offered summaries of trading data that showed that the accounts of the Discretionary Customers profited between 1999 and 2005 and that the Discretionary Customers' accounts made more money during that time than his personal account, which often lost money. We do not agree that Collier should have used a longer period of time for comparison. First, many of the losses that Dratel incurred in his personal account in 2004 and 2005 resulted from voluntary cross trades that Dratel willingly executed between his personal account and the accounts of Discretionary Customers at above market prices to generate profits for the Discretionary Customers. The losses or lesser profits in Dratel's personal account, therefore, were not attributable to regular market forces, but rather to his efforts to cover his customers' losses. *See infra* Section III.A.4.c. Additionally, even if the Discretionary Customers' accounts were more profitable than Dratel's personal account during the period prior to 2006, that does not counteract the extreme nature of the reversal that occurred in 2006 and the extent of the differences in 2006 between the performance of day and overnight trading in Dratel's personal account and day and overnight trading in the Discretionary Customers' accounts, particularly given that Dratel and the customers often traded the same or similar securities.

[38] Dratel argued that the Cause One Review Period, October 2005 through December 2006, was established arbitrarily and unfairly. We disagree. Collier found that Dratel significantly increased the amount of day trades that he executed in his own account in October 2005 and that

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Collier also calculated and compared win/loss ratios in the 25 Discretionary Customers' accounts and Dratel's personal account on a quarterly basis. During the Cause One Review Period, Dratel's win/loss ratio in his personal account improved dramatically. Between October and December 2005, the win/loss ratio in Dratel's personal account was 83%-17%; between January and March 2006, it was 81%-19%; between April and June 2006, it was 82%-18%; between July and September 2006, it was 86%-14%; and between October and December 2006, it was 85%-15%. The Discretionary Customers' accounts, conversely, did not fare as well. Between October and December 2005, their win/loss ratio was 53%-47%; between January and March 2006, it was 51%-49%; between April and June 2006, it dropped to 29%-71%; between July and September 2006, it dropped further to 22%-78%; and between October and December 2006, it dropped still further to 21%-79%. Collier found that, between January 2005 and December 2006, Dratel's success rate (day and overnight trading in the Discretionary Customers' accounts and his account) was 44% overall. In his personal account, however, his day and overnight trading success rate during the two-year period was an astounding 81%, and his success rate in the Discretionary Customers' accounts day and overnight trading was only 31%.[39] Dratel's dramatic increase in profitability in his own account provides clear evidence of the existence of a cherry-picking scheme.[40] *See Melhado, Flynn*, 2011 SEC LEXIS 1662, at *7

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his profits increased dramatically while his customers' day-trading profits dropped precipitously. We find that Enforcement's focus on this period of time was reasonable and not arbitrary.

[39] These statistics are compelling. Broken down by calendar quarter, Dratel's personal account faired significantly better than the Discretionary Customers' accounts during 2006. Between January and March 2006, Dratel's day and overnight trading success rate was 67% for all accounts that he controlled, but for his personal account, it was 81%. Similarly, between April and June 2006, Dratel's day and overnight trading success rate for all accounts that he controlled was 49%, but for his personal account, it was 82%. Between July and September 2006, Dratel's day and overnight trading success rate for all accounts that he controlled dropped to 35%, but in his personal account, it rose to 86%. Between October and December 2006, Dratel's day and overnight trading success rate for all accounts that he controlled dropped still further to 28%, but in his personal account, it was 85%.

[40] Respondents admitted that Collier correctly concluded that the Discretionary Customers lost money in day and overnight trading in 2006 and Dratel's personal account earned day and overnight trading profits of $489,000. The Discretionary Customers lost approximately $228,163 from day and overnight trading during that same period. Dratel and DGI objected to Collier's methodology for counting trades and argued that the trades should be counted on a per stock basis rather than on a per customer basis as Collier did. They argued that Collier's counting methods skewed the profit/loss ratios. Like the Extended Hearing Panel, we reject respondents' argument. Under respondents' methodology, a bunched trade for four customers would be considered one trade as opposed to four. This method of calculating profits and losses does not allow for accurate comparison between Dratel's losses and profits and the Discretionary Customers' losses and profits because often Dratel's personal account was one of the customer accounts that participated in bunched trades, and his account often profited. We find Collier's

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(finding cherry picking where nearly every trade allocated to the firm's proprietary account appreciated in value, resulting in 98% profitability); *Ark Asset Mgmt.*, 2010 SEC LEXIS 3233, at *6-7 (finding that cherry-picked accounts were 68% profitable on the day of allocation while customer accounts were 37% profitable, and that favored accounts' long day trades were 75% profitable while long day trades in customer accounts were only 37% profitable); *James C. Dawson*, Investment Advisers Act Release No. 3057, 2010 SEC LEXIS 2561, at *4 (July 23, 2010) (finding cherry picking where, of 400 trades that respondent allocated to his personal account, 98.3% were profitable and, of the 2,880 trades that he allocated to customers, 51.7% were profitable); *Gerson Asset Mgmt.*, 2005 SEC LEXIS 3120, at *7 (finding that respondent's day trades were disproportionately more profitable than customers' day trades and that this supported finding of cherry picking).

<u>(7) Dratel's Account Equity Was Low.</u> The sizeable profits that Dratel generated in his personal account are all the more noteworthy given that the equity in Dratel's account remained relatively low. Indeed, his average monthly equity was approximately $27,868.[41] Collier opined that Dratel purchased stock in the Firm Account using the combined equity in the Discretionary Customers' accounts and without assuming risk in his account because he did not allocate securities until he had observed how prices moved intra-day. Dratel admitted that he maintained a close watch on the buying power in the Discretionary Customers' accounts. Collier calculated that, on average, equity in Dratel's personal account between October 2005 and December 2006

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method of counting trades per customer rather than per security to be a reliable indication of profit and loss. *See, Melhado, Flynn*, 2011 SEC LEXIS 1662, at *7-8 (assessing profitability in cherry picking case by counting trades per allocation to customer, not per security); *Ark Asset Mgmt.*, 2010 SEC LEXIS 3233, at *6-7 (calculating profitability in cherry picking case on a per customer basis rather than per security basis); *K.W. Brown*, 555 F. Supp. 2d at 1299 (relying on expert analysis of profitability on a per customer basis rather than per security).

In any event, even respondents' proposed methodology for counting trades per security rather than per customer demonstrates that Dratel's trading in his personal account out-performed his trading in the Discretionary Customers' accounts. Based on Dratel's computations, 82% of the day and overnight trades in his personal account in 2006 were profitable. His computations also indicate that, in 2006, he executed 633 day and overnight trades in the Discretionary Customers' accounts, of which 252 were profitable single-customer trades and only 25 were profitable multiple-customer trades. Dratel's success rate in customer accounts therefore was only 12%.

[41] Collier testified that, unless granted an exemption by DGI's clearing firm, the maximum amount of stock that Dratel or any DGI customer could have purchased in a standard customer account was four times the cash value of the account. Collier calculated the daily account value of Dratel's personal account for the month of May 2006. On 13 of the 22 settlement dates that month, Dratel's purchases far exceeded more than four times the available cash in is account.

was $34,437, yet Dratel realized day and overnight trading profits of $542,339 or 1,260% over 15 months.[42]

In further support of our finding that respondents cherry picked, the record included evidence of Dratel's sales of securities from his personal account before allocation from the Firm Account to his account. Additionally, the evidence discussed in Sections III.A.2 & 3 *supra* unequivocally demonstrated that DGI's order tickets were altered, time-stamped blank, and backdated. Both occurrences further support our finding of cherry picking. *See Melhado, Flynn*, 2011 SEC LEXIS 1662, at *3 (finding that respondent altered trade tickets in an effort to cover up fraudulent allocation scheme); *Ark Asset Mgmt.*, 2010 SEC LEXIS 3233, at *8-9 (finding that respondent's failure to ensure that order tickets timely reflected allocation determinations supports a finding of cherry picking).

<u>(8) Respondents' Defenses Are Not Persuasive.</u> Respondents argued that the differences between the profitability of day trading in Dratel's personal account and day trading in the Discretionary Customers' accounts were due to market forces and the different trading strategies he employed. He stated that his trading was significantly more aggressive in his account and less so in the Discretionary Customers' accounts.[43] Dratel entered into evidence 28 examples of day trading in his personal account and the Discretionary Customers' accounts that he randomly selected purportedly to illustrate his trading strategy and his reliance on information reported on subscription stock research services. The trades that Dratel entered into evidence, however, only

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[42] Collier also reviewed Dratel's personal account purchase volume and average account equity on a monthly basis going back to 1999. In 2006, Dratel's personal account held, on average, monthly account equity of less than $50,000 and often $20,000 or less. His purchase volume per month in 2006, however, well exceeded $1 million in all but two of the months, exceeded $2 million six of the months, and even exceeded $3 million for two months in 2006. By contrast, between 1999 and 2002, the average equity in Dratel's account was well over $300,000 per month and often over $500,000. His average account equity in 2003 was $132,325 per month and in 2004 was $152,203 per month. During the last three months of 2005, Dratel's average monthly account equity dropped to $60,718, and in 2006, his average account equity was $27,868 per month. The drop in account equity notwithstanding, Dratel's average purchase volume in his personal account in 2006 rose dramatically to $1,990,678 per month.

[43] Enforcement disputed this claim. Enforcement read excerpts from Dratel's on-the-record testimony in which he indicated that his strategies for day and overnight trading for his and his customers' accounts were essentially the same. Enforcement quoted Dratel's statement that "day trading is day trading." Respondents' counsel, however, argued that Dratel also stated during on-the-record testimony that he generally traded in a more aggressive fashion in his personal account and took more risks in that account than he took in customer accounts. Even if, as respondents' counsel contends, Dratel traded more aggressively in his own account, a fact that is not proven by this record, that still would not explain the breadth of difference in profitability between Dratel's personal account and the Discretionary Customers' accounts. Furthermore, Dratel also testified that, on the days when he traded the same stock in his personal account that he traded in a Discretionary Customer's account, he did in fact follow the same day trading strategy for himself and his customers.

partially accounted for trading on those days and failed to address other trades that he executed on the same days. For example, on February 27, 2006, Dratel traded AMT stock for Discretionary Customers, which he stated had a strong recommendation on an on-line subscription research service. He claimed to have purchased it for Discretionary Customers because of the recommendation, but the stock lost money. That same day, Dratel executed two day trades for himself in HURC and NFI stock, both of which were profitable. Dratel provided no explanation for why he picked those stocks for himself and no comparison of the stocks to show how the securities that he picked for his own account were riskier than those that he allocated to Discretionary Customers' accounts. Similarly, Dratel acknowledged that holding stock overnight was riskier than ending the day flat.[44] In 2006, however, approximately 323 of the 1,164 day and overnight trades that Dratel executed in the Discretionary Customers' accounts were held overnight. This equals approximately 27%. Conversely, Dratel held only 21 of his personal day trades overnight in 2006. This equals only five percent of the 423 day and overnight trades that he allocated to his personal account in 2006. We find that Dratel failed to establish a meaningful difference in his trading strategies for his personal account and the Discretionary Customers' accounts to explain the vast differences in performance.

We find no purpose for Dratel's actions other than the execution of a fraudulent allocation or cherry picking scheme. The types of securities, the sizes of the trades, and the purportedly different trading strategies provide no explanation. *Cf. Dawson*, 2010 SEC LEXIS 2561, at *4 ("Neither the size of the trades, nor differing trading strategy, nor any factor other than profitability explained Dawson's allocations."). We therefore affirm the Extended Hearing Panel's findings that DGI and Dratel engaged in a fraudulent cherry-picking scheme.

b. Respondents Failed to Disclose Material Information

In addition to finding that Dratel and DGI executed a fraudulent scheme, we also affirm the Extended Hearing Panel's findings that DGI and Dratel perpetrated a fraud by failing to disclose material information to DGI's customers. The creation of a misrepresentation by omission "can encompass participating in a course of business that operates as a fraud on the buyers or sellers of stock." *K.W. Brown*, 555 F. Supp. 2d at 1304 (*citing SEC v. Zanford*, 535 U.S. 813, 819-22 (2002); *see also Affiliated Ute Citizens of Utah v. U.S.*, 406 U.S. 128, 152-53 (1972) (finding fraudulent omission where defendants induced sellers of stock to dispose of shares without disclosing to them material facts that reasonably could have been expected to influence their decision to sell). To establish that Dratel and DGI omitted information that they had a duty to disclose, in violation of Exchange Act Section 10(b) and Rule 10b-5 thereunder, it is necessary that Enforcement prove by a preponderance of the evidence that they omitted material information in connection with the purchase and sale of a security and that they acted

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[44] The Commission has similarly acknowledged the risk associated with holding stock positions overnight. *See Day Trading: Your Dollars at Risk*, at 1, *available at* http://www.sec.gov/investor/pubs/daytips.htm ("True day traders do not own any stocks overnight because of the extreme risk that prices will change radically from one day to the next, leading to large losses.").

with scienter.[45] *SEC v. First Jersey Sec., Inc.*, 101 F.3d 1450, 1467 (2d Cir. 1996); *Dep't of Enforcement v. Gonchar*, Complaint No. CAF040058, 2008 FINRA Discip. LEXIS 31, at *27 (FINRA NAC Aug. 26, 2008), *aff'd*, Exchange Act Release No. 60506, 2009 SEC LEXIS 2797 (Aug. 14, 2009).

Liability for failing to disclose material information is "premised upon a duty to disclose arising from a relationship of trust and confidence between parties to a transaction." *Chiarella v. U.S.*, 445 U.S. 222, 230 (1980). Federal courts, the Commission, and FINRA have held that a registered representative has a duty to disclose material information fully and completely when recommending an investment. *See De Kwiatkowski v. Bear, Stearns & Co.*, 306 F.3d 1293, 1302 (2d Cir. 2002) (a broker "is obliged to give honest and complete information when recommending a purchase or sale"); *Hanly v. SEC*, 415 F.2d 589, 596-97 (2d Cir. 1969); *SEC v. Hasho*, 784 F. Supp. 1059, 1106 (S.D.N.Y. 1992); *Richard H. Morrow*, 53 S.E.C. 772, 781 (1998); *Dep't of Mkt. Regulation v. Field*, Complaint No. CMS040202, 2008 FINRA Discip. LEXIS 63, at *32-33 (FINRA NAC Sept. 23, 2008). This duty is derived from the broker's "special relationship" to an investor. *Hanly*, 415 F.2d at 596. A broker's duty is to link his recommendation with any additional significant facts necessary for an investor to assess the nature and reliability of that recommendation. *See Morrow*, 53 S.E.C. at 781 (requiring broker who recommends a security to disclose "material adverse facts"); *Dep't of Enforcement v. Cipriano*, Complaint No. C07050029, 2007 NASD Discip. LEXIS 23, at *27 (NASD NAC July 26, 2007).

Furthermore, Dratel created a relationship of trust and confidence with his customers when they granted him discretionary authority over their accounts. *See U.S. v. Szur*, 289 F.3d 200, 211 (2d Cir. 2002) (finding that a duty to disclose arises because of the relationship of trust and confidence between a broker and a customer with respect to those matters that have been entrusted to the broker); *U.S. v. Wolfson*, 642 F.3d 293, 295 (2d Cir. 2011) (finding that the presence of a discretionary account automatically implies a general fiduciary duty between a broker and customer). By exercising discretionary authority in the Discretionary Customers' accounts, Dratel had an affirmative duty to disclose to the Discretionary Customers material facts related to his trading in their accounts. *See Dawson*, 2010 SEC LEXIS 2561, at *8 ("As a fiduciary, Dawson owed 'an affirmative duty of utmost good faith, and full and fair disclosure of all material facts, as well as an affirmative obligation to employ reasonable care to avoid misleading clients.'") (*citing Michael Batterman*, 57 S.E.C. 1031, 1043 (2004), *aff'd*, 121 F. App'x 410 (2d Cir. 2005)); *Leib v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 461 F. Supp. 951, 953 (E.D. Mich. 1978) (holding that a broker who has discretion must explain forthrightly the practical impact and potential risks of the course of dealing in which he is engaged); *Mason, Moran & Co.*, 35 S.E.C. 84, 90 (1953) (finding that it is the duty of a fiduciary to "make full and

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[45] In addition, there must also be proof that 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. Respondents do not dispute that they communicated through telephone calls or the U.S. mail service, thereby satisfying the interstate commerce requirement. *See SEC v. Softpoint, Inc.*, 958 F. Supp. 846, 865 (S.D.N.Y. 1997) (determining that the jurisdictional requirements of the federal antifraud provisions are interpreted broadly and are satisfied by intrastate telephone calls or the use of the U.S. mail), *aff'd*, 159 F.3d 1348 (2d Cir. 1998).

effective disclosure to the customer of all material facts likely to have a bearing on the desirability of the transaction from the customer's point of view, including information about registrant's own interest in the transaction").

Dratel should have disclosed to the Discretionary Customers his self interest in the trading that he conducted in the Discretionary Customers' accounts and the conflict of interest that resulted. He did not advise the Discretionary Customers that he was day trading for his personal account at the same time and with some of the same securities that he was day trading in their accounts.[46] He also failed to tell the Discretionary Customers that he had fraudulently allocated more profitable trades to his personal account and less profitable or losing trades to their accounts. Dratel failed to disclose all of this information to the Discretionary Customers.

The information that Dratel failed to disclose is material. The test of materiality is whether a reasonable investor would consider the information significant. *See Basic Inc.*, 485 U.S. at 231-32. A misstated or omitted fact is material if a reasonable investor would have viewed the fact as having significantly altered the "total mix" of information made available. *See TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976). The "reasonable investor" standard is an objective one. *Id.* at 445; *accord Dept. of Enforcement v. Reynolds*, Complaint No. CAF990018, 2001 NASD Discip. LEXIS 17, at *28 (NASD NAC June 25, 2001). By day trading the same stocks side-by-side with the Discretionary Customers and intentionally allocating profitable or less unprofitable trades to himself, Dratel favored his account over the Discretionary Customers' accounts. A reasonable investor surely would find material Dratel's subordination of discretionary customers' interests to his personal interests. *See K.W. Brown*, 555 F. Supp. 2d at 1280 (finding material investment advisor's allocation scheme that benefitted the firm's account over the customers' accounts and which the advisor failed to disclose to customers); *cf. Affiliated Ute Citizens of Utah*, 406 U.S. at 153 (holding that the securities holders "had the right to know that the defendants were in a position to gain financially from their sales"); *Kevin D. Kunz*, 55 S.E.C. 551, 564 (2002) (holding that a broker-dealer's self interest in serving an issuer is material and must be disclosed), *aff'd*, 64 F. App'x 659 (10th Cir. 2003); *Paulson Inv. Co.*, 47 S.E.C. 886, 888 (1983) (noting materiality of a broker's recent personal purchase at one-third the price of stock also recommended and sold to customers); *Dep't of Enforcement v. Donner Corp. Int'l*, Complaint No. CAF020048, 2006 NASD Discip. LEXIS 4, at *36 n.29 (NASD NAC Mar. 9, 2006) (holding that a broker's self interest in promoting an issuer is material), *remanded on other grounds,* Exchange Act Release No. 55313, 2007 SEC LEXIS 334 (Feb. 20, 2007).

We also find that respondents' omissions were in connection with the purchase or sale of a security. The Supreme Court has construed the "in connection with" requirement broadly. *See SEC v. Zanford*, 535 U.S. at 819 (holding that the "in connection with" language in Section 10(b)

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[46] Dratel admitted that he did not disclose this to the Discretionary Customers, contending that he did not feel that it presented any conflict of interest. Dratel argued that he "rarely" day and overnight traded the same stock on the same day as the Discretionary Customers. In 2006, however, he executed approximately 27 day and overnight trades in which he traded the same stock in his personal account and the account of one or more Discretionary Customers on the same day.

"should be construed not technically and restrictively, but flexibly to effectuate [the law's] remedial purposes"); *Superintendent of Ins. of N.Y. v. Bankers Life & Cas. Co.*, 404 U.S. 6, 12 (1971) (same). The cherry-picking scheme in this case satisfies this requirement in that Dratel placed numerous orders to buy and sell securities as part of his fraudulent allocation process. *See K.W. Brown*, 555 F. Supp. 2d at 1306 (finding that fraudulent allocation scheme satisfies "in connection with" requirement); *SEC v. Rana Research, Inc.*, 8 F.3d 1358, 1362 (9th Cir. 1993) (holding that "in connection with" requirement met if the fraud touches upon or has some nexus with a securities transaction).

We conclude that respondents had a duty to disclose and failed to disclose material information to the 25 Discretionary Customers in connection with Dratel's 2006 day and overnight trades.

c. Respondents Acted with Scienter

We find, by a preponderance of the evidence, that Dratel acted with scienter.[47] Scienter is defined as "a mental state embracing intent to deceive, manipulate, or defraud." *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12 (1976). Scienter is established if a respondent acted intentionally or recklessly. *See Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 319 n.3 (2007); *Irfan Mohammed Amanat*, Exchange Act Release No. 54708, 2007 SEC LEXIS 2558, at *35 (Nov. 3, 2007), *aff'd*, 269 F. App'x 217 (3d Cir. 2008). Reckless conduct includes "a highly unreasonable omission, involving not merely simple, or even inexcusable negligence, but an extreme departure from the standards of ordinary care, and which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it." *Sundstrand Corp. v. Sun Chem. Corp.*, 553 F.2d 1033, 1045 (7th Cir. 1977) (internal quotation omitted); *see also Meadows v. SEC*, 119 F.3d 1219, 1226 (5th Cir. 1997).

Proof of scienter may be "a matter of inference from circumstantial evidence." *Herman & MacLean*, 459 U.S. at 390-91 n.30 (1983). It is clear from Dratel's conduct and the facts of this case that Dratel knowingly placed his own interests before the interest of the 25 Discretionary Customers with respect to day and overnight trading decisions. Dratel had sole and exclusive authority over all trading decisions in his account and the Discretionary Customers' accounts. The allocation instruction sheets and FiNet tickets that Dratel faxed to the New York City office displayed facsimile times that were well after the execution of the trades at issue, and the New York City office staff corroborated what the documents indicate – that Dratel regularly communicated allocation instructions after DGI closed out positions in the Firm Account. PH's testimony regarding the documentation that she found at the New York City office also supported this conclusion. The time lag between order execution and allocation enabled Dratel to assess profitability on a trade-by-trade basis, and cherry pick the better trades

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[47] Based on Dratel's conduct, sole ownership of DGI, control over the firm, and position as the only registered person conducting a securities business at DGI, we attribute Dratel's mental state to DGI and find that DGI acted with scienter. *See Kirk A. Knapp*, 50 S.E.C. 858, 860 n.7 (1992) (noting that NASD properly attributed scienter of firm's owner to firm); *SEC v. Blinder, Robinson & Co.*, 542 F. Supp. 468, 477 (D. Colo. 1982) (holding, for purposes of establishing scienter, that president and principal shareholder's mental state is imputed to the firm).

for his own account. Dratel's method of handling trading in his and the Discretionary Customers' accounts proceeded as a well-executed cherry-picking scheme, which Dratel was able to conceal from the Discretionary Customers because many of their long-term investments maintained overall profitability in their accounts. Because Dratel alone controlled all of the trading and allocation decisions, he had to have actively perpetrated the scheme or was, at the least, reckless in his conduct. *See K.W. Brown*, 555 F. Supp. 2d at 1307 (finding scienter where respondent prepared allocation sheets that did not identify customer accounts until well after trade execution).

Respondents contended that the Discretionary Customers were friends, family members, and long-time customers of DGI, with whom Dratel has enjoyed a lengthy and close relationship. They argued that the Discretionary Customers included some of the same customers to whom Dratel voluntarily paid cash to cover losses in 2007 or with whom Dratel engaged in cross trades at above-market prices in 2004 and 2005. Respondents argued that these facts undercut a finding of scienter.[48] We do not agree. We note that many of the Discretionary Customers' accounts at issue also engaged in long-term trading and that, overall, their accounts may have profited in 2006 because of the other types of trading in their accounts. This provided Dratel with the perfect opportunity to camouflage this fraudulent allocation scheme and direct day and overnight trading profits to his personal account while avoiding detection because of profitable long-term trading in the Discretionary Customers' accounts. Indeed, friends and family members have been the targets of other unscrupulous brokers' and registered investment advisers' cherry-picking schemes. *See, e.g., James C. Dawson*, Initial Decisions Release No. 392, 2009 SEC LEXIS 4143, at *4 (Dec. 18, 2009), *aff'd*, 2010 SEC LEXIS 2561 (July 23, 2010); *K.W. Brown*, 555 F. Supp. 2d at 1280.

Furthermore, Dratel's financial situation was strained during the years leading up to 2006, providing incentive for his execution of a cherry-picking scheme.[49] We find that Dratel's

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[48] The dissenting member of the Extended Hearing Panel also believed that the fact that the Discretionary Customers were friends and family members undercut a finding of scienter.

[49] In 2002 and 2003, Dratel realized losses of $252,173 in his IRA accounts and $34,439 in his personal account. In 2004 and 2005, Dratel realized losses of $144,981 in his personal account and $115,509 in his IRA accounts. He and DGI also settled customer arbitrations totaling $233,000. In 2004 and 2005, Dratel executed internal cross trades between his personal account at DGI and customer accounts, including accounts belonging to the Discretionary Customers, whereby he purchased stock from customers at above-market prices to compensate the customers for losses that they incurred through his management of their accounts. As a result of these cross trades, Dratel incurred total losses of approximately $302,040 in 2004 and 2005. Indeed, as of April 2005, the month-end value of Dratel's personal account was $(5,819). In the fall of 2005, Dratel held a $4.2 million mortgage on his home, which he attempted to sell to downsize. Dratel was not able to sell his home and, eventually, the bank foreclosed on Dratel's home. In July 2006, Dratel borrowed $434,000 from a customer, purportedly to purchase a new home. Dratel also paid various customers, including many of the Discretionary Customers, between January 1, 2008 and February 17, 2011, a total of $156,575 to assist them after they suffered losses in December 2007 and in the market downturn in 2008. Dratel stated that this was his method of correcting his mistakes.

financial situation provided a motive for Dratel to execute a fraudulent cherry-picking scheme and generate profits in his personal account at the expense of the Discretionary Customers. *See K.W. Brown*, 555 F. Supp. 2d at 1289 (finding that broker-dealer's losses provided incentive for respondents to undertake fraudulent allocation scheme).

Moreover, where, as here, the case also involves a material omission, scienter is established where the respondent was aware of the material information. *Kenneth R. Ward*, 56 S.E.C. 236, 259-60 (2003) (finding scienter established when representative was aware of material information and failed to make appropriate disclosures to customers), *aff'd*, 75 F. App'x 320 (5th Cir. 2003); *Field*, 2008 FINRA LEXIS 63, at *33-34 (finding scienter established where representative was aware of substantial risks associated with bonds and failed to disclose risks to customers). Dratel made the conscious decision to day trade his personal account alongside the accounts of Discretionary Customers through the Firm Account and to share in stock purchases and sales with them. Yet he chose not to disclose this potential conflict of interest to them. He also knew that he favored his personal account over the Discretionary Customers' accounts when he made allocation decisions, but this too he chose not to disclose. Most of the Discretionary Customers were long-term customers of DGI, elderly individuals who knew his father, and close personal friends. These factors, however, did not deter him from concealing material information from them at the same time that he controlled their securities accounts. We find that Dratel acted with scienter.[50]

d. Respondents Willfully Maintained Order Tickets Inaccurately and Delayed Identifying Customers on Order Tickets

We further find that, between October 1, 2005, and December 31, 2006, Dratel and DGI willfully maintained the firm's order tickets inaccurately, falsified order tickets, time stamped blank order tickets, back-dated time stamps on order tickets, and delayed identifying customer names on order tickets. We find that DGI willfully violated Section 17(a) of the Exchange Act, 15 U.S.C § 78q-1(a), and Exchange Act Rules 17a-3(a)(6) and (7), and that DGI and Dratel violated NASD Rules 3110 and 2110.

NASD Rule 3110(a) states that FINRA members must make and preserve books, accounts, records, memoranda, and correspondence in conformity with all rules and regulations, as prescribed by Exchange Act Rule 17a-3. NASD Rule 3110(j) states that before any customer order is executed, the name or designation of the account for which the order is to be executed must be placed on the order ticket.[51] Exchange Act Rules 17a-3(a)(6) and (7) require, among many disclosures, that every member firm indicate on every order ticket the account for which the order is entered, the time the order was received, the time of entry, the time of execution, and whether the order was entered pursuant to an exercise of discretionary authority. Rule 2110

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[50] We address our finding that Dratel willfully violated the Exchange Act and Exchange Act Rules below in Section III.A.4.d *infra*.

[51] Respondents' practice of allocating trades after closing out positions does not implicate the order-ticket exception currently contained in supplementary material .01 to FINRA Rule 4515.

requires observance of high standards of commercial honor and just and equitable principles of trade.[52]

Both Dratel and the New York City office staff testified that they time stamped blank FiNet order tickets to ensure that the allocation tickets bore the same time stamps as the OMS tickets. The New York City office staff acted at Dratel's direction. Thus, in many instances, at the time of execution, the FiNet order tickets did not bear the customer name or account number as required by the Exchange Act, Exchange Act Rule 17a-3, and NASD Rule 3110.[53] Additionally, PH testified that DGI produced order tickets that had been altered, as compared to tickets for the same trades that she located during her on-site investigation.[54] The record evidence corroborated PH's testimony and demonstrated that some time stamps had been altered manually and others were for times that were in the middle of the night. *See supra* Section III.A.2. Additionally, VP credibly testified that she regularly rolled back the time stamp machine so that time stamps on FiNet tickets matched time stamps on OMS tickets. *See supra* Section III.A.3. The record demonstrates that Dratel and the New York City office manipulated and

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[52] "It is well established that a violation of other NASD rules or securities laws or regulations also constitutes a violation of Rule 2110." *Kirlin Sec.*, 2009 SEC LEXIS 4168, at *65.

[53] In some cases, blank, time-stamped FiNet order tickets were mailed from the East Hampton office to the New York City office, so the customer names and account numbers were not added until days after execution.

[54] For example, in March 2006, DGI produced to FINRA a series of trade tickets and confirmations for NDSN trades "as of" December 14, 2005. The confirmations indicated that the Firm Account sold 2,000 shares of NDSN stock on December 16, 2005, "as of" December 14. The trade tickets indicated that 1,000 of the shares were sold to five customers. The time stamps on the customers' order tickets all indicated December 14, 2005 at 12:46 a.m. In March 2007, Enforcement received additional order tickets regarding December 14, 2005 trading in NDSN. These order tickets indicated that the Firm Account purchased 1,000 shares of NDSN at 11:46 a.m. and 1,000 shares at 12:48 p.m., and sold 2,000 shares at 12:48 p.m. on December 14, 2005. None of these tickets indicated that the trades occurred on December 16 "as of" December 14, 2005. Additional tickets produced in March 2007 showed that 1,000 NDSN shares were sold to the same five customers indicated on the tickets produced in March 2006, but these tickets contained a different time stamp – 12:48 p.m. Other tickets produced in March 2007 showed that the other 1,000 shares of NDSN stock were sold from the Firm Account to four other customers. These tickets were not marked as "as of" trades and were time stamped December 14, 2005 at 12:48 p.m. Similarly, DGI produced tickets that indicated that Dratel purchased, through the Firm Account, 3,000 shares of CYNO stock in his personal account at 10:28 a.m. on December 9, 2005. (He sold it at a profit on December 13, 2005.) The time stamps on DGI's trade tickets, however, indicated that the Firm Account sold 3,000 shares of CYNO at 10:28 a.m. on December 8, 2005. The trade tickets for three purchases of 1,000 shares each of CYNO into the Firm Account are time stamped December 9, 2005 at 10:21, 10:23, and 10:28 a.m. These tickets suggested that DGI's records were not reliable in that they appeared to have incorrect date and time stamps.

falsified time stamps on DGI's order tickets. In all, the record is replete with examples of DGI's failure to complete and maintain its order tickets in compliance with NASD Rule 3110 and Exchange Act Rule 17a-3(a).

We also find that respondents' misconduct under causes one and two was willful. The term "willful" need not connote that respondents intended to violate FINRA and Commission rules and federal statutes. *See Arthur Lipper Corp. v. SEC*, 547 F.2d 171, 180 (2d Cir. 1976) (holding that the term "willfully" does not require proof of evil intent). "A willful violation under the federal securities laws simply means 'that the person charged with the duty knows what he is doing.'" *Robert D. Tucker*, Exchange Act Release No. 68210, 2012 SEC LEXIS 3496, at *41 (Nov. 9, 2012) (*citing Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000)). Dratel was an experienced member of the securities industry and a registered principal. He is presumed to have known and understood the rules and laws that govern this industry. *Carter v. SEC*, 726 F.2d 472, 474 (9th Cir. 1983). Furthermore, Dratel admitted that he chose not to disclose that he traded his personal account side-by-side with Discretionary Customers' accounts because he concluded that there was no conflict. He also admitted to having time stamped blank order tickets and directing his staff to do the same and to add customer names to order tickets after execution. We find, by a preponderance of the evidence, that Dratel acted willfully. Based on Dratel's conduct, sole ownership of DGI, control over the firm, and position as the only registered person conducting a securities business at DGI, we attribute Dratel's willfulness to DGI and find that the firm also acted willfully.[55]

We also find that Dratel caused DGI to violate Section 17(a) of the Exchange Act and Exchange Act Rule 17a-3. Dratel is DGI's sole owner and its only principal. He is DGI's designated FINOP and chief compliance officer, and he alone handled all of DGI's trading. He also testified that he, along with the New York City office staff, completed all of the order tickets and that the New York City office staff acted at his direction. As such, we hold Dratel responsible for DGI's recordkeeping-related violations.

Dratel argued that the Extended Hearing Panel erred in holding him responsible for the firm's violations of NASD Rule 3110 and Exchange Act Rule 17a-3(a) because only broker-dealer firms, not individuals, can violate Rule 17a-3.[56] We do not agree. First, like the Extended Hearing Panel, we hold Dratel responsible for DGI's violations of NASD Rule 3110. Although NASD Rule 3110 establishes specific requirements for member firms, not registered individuals,

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[55] Under Section 3(a)(39) of the Exchange Act, 15 U.S.C § 78c(a)(39), a person or entity is subject to statutory disqualification if he has willfully violated the Exchange Act.

[56] Dratel also argued that his violations should be excused because they occurred in an inconsequential number of tickets as compared to the thousands of tickets that DGI prepared in a year. Additionally, he argued that he was a busy one-man firm and should not be held responsible for his staff's errors because they too were very busy entering many trades. We reject these arguments. "Firms are not exempt from the recordkeeping requirements when compliance would inconvenience them or interfere with their trading." *Dep't of Mkt. Regulation v. Ko Sec.*, Complaint No. CMS000142, 2002 NASD Discip. LEXIS 18, at *24 (NASD NAC Nov. 13, 2002), *aff'd*, 56 S.E.C. 44 (2003). The fact that DGI and Dratel maintained some, but not all, trade tickets inaccurately, and the firm's busy schedule, do not excuse their violations.

FINRA Rule 0140 (formerly NASD Rule 115) indicates that all of FINRA's rules shall apply equally to members and associated persons and that associated persons shall have the same duties and obligations as member firms. We also hold Dratel responsible for causing DGI to violate Exchange Act Rule 17a-3. In prior decisions, we have held that associated persons who create inaccurate books violate NASD Rules 3110 and 2110 by causing their firms to violate Exchange Act Rule 17a-3. *See Dep't of Enforcement v. Cohen*, Complaint No. EAF0400630001, 2010 FINRA Discip. LEXIS 12, at *35 (FINRA NAC Aug. 18, 2010), *aff'd*, Exchange Act Release No. 65347, 2011 SEC LEXIS 3225 (Sept. 16, 2011). In this respect, we followed Commission precedent. *See Davrey Fin. Servs., Inc.*, 58 S.E.C. 474, 481 n.3 (2005).

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DGI and Dratel employed a fraudulent allocation or cherry-picking scheme that enabled Dratel to allocate profitable trades to Dratel's personal account and unprofitable or less profitable trades to the Discretionary Customers' accounts. In furtherance of the scheme, Dratel and DGI altered or manipulated DGI's trading tickets by time stamping blank tickets, time stamping tickets inaccurately, altering time stamps, and time stamping order tickets without identifying customer names. This conduct furthered their fraudulent allocation scheme. DGI and Dratel also fraudulently failed to disclose material information regarding Dratel's trading practices and the fraudulent scheme to the Discretionary Customers. We find that, in so doing, Dratel and DGI willfully violated Section 10(b) of the Exchange Act, Exchange Act Rule 10b-5, and NASD Rules 3110, 2120, and 2110. We also find that DGI willfully violated Section 17(a) of the Exchange Act and Exchange Act Rules 17a-3(a)(6) & (7).

B. Cause Five – Failing to Establish, Maintain, and Enforce Adequate Supervisory Procedures

The complaint alleged, and the Extended Hearing Panel found, that between January 2005 and December 2007 DGI and Dratel failed to establish, maintain, and enforce adequate supervisory procedures, in contravention of NASD Rules 3010(a) and (b) and 2110. We affirm the Extended Hearing Panel's findings.

NASD Rule 3010(a) states that each member must establish and maintain a system to supervise the activities of each registered representative and associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations and FINRA's rules. NASD Rule 3010(b) states that each member shall establish, maintain, and enforce written procedures to supervise the types of business in which it engages and supervise the activities of registered and associated persons that are reasonably designed to achieve compliance with applicable securities laws and regulations and FINRA's rules. NASD Rule 2110 requires that member firms and associated persons observe high standards of commercial honor and just and equitable principles of trade.

The record included DGI's September 2004 written supervisory procedures and January 24, 2007 written supervisory procedures.[57] Neither version of DGI's written supervisory

[57] Respondents also entered into the record DGI's September 15, 2010 written supervisory procedures. Cause five alleged misconduct during the period of January 2005 through December

[Footnote continued on next page]

procedures addressed trade aggregation and allocation with respect to discretionary accounts and the manner in which trades must be executed. Nor did DGI have in place practical procedures to ensure that Dratel properly aggregated and allocated trades for discretionary accounts. The topics of aggregation and allocation of trades were particularly important, given that Dratel executed all customer trades and trades in his personal account through the Firm Account, often as batched trades. DGI's supervisory procedures also did not address and establish standards for the proper completion of order tickets and there were no daily processes at DGI to provide for this. *See, e.g.*, *Kemper Fin. Servs. Inc.*, 51 S.E.C. 715, 718 (1993) (finding inadequate supervisory procedures where procedures failed to address time stamping order tickets and allocating orders among accounts). DGI updated the September 2004 supervisory procedures in January 2007. The January 2007 updates, however, remained deficient in that they failed to specify that allocation instructions must be formulated before a trade is executed and that customer account names must be designated on order tickets before customer trades are executed.

Dratel was the only registered person at DGI and was designated as DGI's chief compliance officer, AML officer, and FINOP. Furthermore, he was identified in DGI's written supervisory procedures as DGI's only designated supervisor and principal. Dratel therefore was responsible for DGI's supervisory lapses.[58]

We find that Dratel and DGI violated NASD Rules 3010(a) and (b) and 2110, as alleged in cause five of the complaint.

C. Cause Six – Willfully Failing to Update Customer Account Information

The complaint alleged, and the Extended Hearing Panel found, that between November 2004 and January 2008, DGI willfully violated Section 17(a) of the Exchange Act and Exchange Act Rule 17a-3(a)(17)(i), and DGI and Dratel violated NASD Rules 3110(a) and 2110 by failing

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[Cont'd]

2007. DGI's September 15, 2010 revisions to the written supervisory procedures therefore are irrelevant to our consideration.

Respondents argued that FINRA impliedly approved DGI's 2007 procedures by not objecting to them when DGI provided FINRA with a copy. We do not agree. Member firms and registered persons are charged with knowing the applicable regulations and cannot shift their responsibility for rule compliance to FINRA. *See Pennmont Sec.*, Exchange Act Release No. 54434, 2006 SEC LEXIS 2048, at *20 (Sept. 13, 2006); *cf. Castle Sec. Corp.*, 58 S.E.C. 826, 834 (2005) (rejecting respondent's effort to shift blame to NASD for not apprising it sooner of OATS failures).

[58] We hold Dratel responsible both for the underlying misconduct and the lax supervisory and compliance structure at DGI. *See John Montelbano*, 56 S.E.C. 76, 93 (2003) (finding a respondent both substantively responsible and a deficient supervisor with respect to the same misconduct).

to update periodically account information for 42 customers. We affirm the Extended Hearing Panel's findings under cause six.

NASD Rule 3110(a), now FINRA Rule 4511, states that FINRA members must make and preserve books, accounts, records, memoranda, and correspondence in conformity with all rules and regulations, as prescribed by Exchange Act Rule 17a-3. Exchange Act Rule 17a-3(a)(17)(i) states that, for each customer account, a member firm shall make and keep an account record including the customer's name, tax identification number, address, telephone number, date of birth, employment status, annual income, net worth, and account's objectives, and must supply the information to the customer and provide the customer with an opportunity to update the information as necessary at 36-month intervals. NASD Rule 2110 requires that member firms and associated persons observe high standards of commercial honor and just and equitable principles of trade.

Rule 17a-3(a)(17)(i) ensures that customers have the opportunity periodically to update their account information by requiring firms to provide customers with the information the firm has and the opportunity to update it. Dratel acknowledged that DGI did not furnish each of its customers periodically with a statement of customer information. He contended that DGI relied on Oppenheimer for compliance. Dratel contended that Oppenheimer's monthly account statements included a customer account verification form and provided customers with the opportunity to update account information. The Oppenheimer forms, however, are blank and therefore do not provide customers with the information that DGI already has. Respondents made no effort to supply this information to its customers and did not comply with the requirements of Exchange Act Rule 17a-3(a)(17)(i).

Dratel was DGI's chief compliance officer, AML officer, and FINOP, and he was designated in DGI's written supervisory procedures as DGI's only supervisor and principal. We therefore hold Dratel responsible for DGI's violations, find that Dratel caused DGI's violations, and find that Dratel's actions were willful. As we stated above in section III.A.4.d *supra*, a finding that a violation of the federal securities laws is willful means that the person or entity charged with the duty knows what he is doing. Dratel made no effort to ensure that he or any of his staff provided DGI's customers with an opportunity to review the customer account information that DGI possessed and update that information as necessary. Dratel did not even ensure that Oppenheimer, upon whom he purportedly relied for DGI's compliance with the rule, provided customers with this information. He simply ignored the requirement and assumed that Oppenheimer had covered DGI's responsibilities. We find that his misconduct was willful. Based on Dratel's conduct, sole ownership of DGI, control over the firm, and position as the only registered person conducting a securities business at DGI, we attribute Dratel's willfulness to DGI and find that DGI willfully violated Section 17(a) of the Exchange Act and Exchange Act Rule 17a-3(a)(17)(i), and that Dratel and DGI violated NASD Rules 3110(a) and 2110, as alleged under cause six.

D. <u>Cause Seven – Failing to Comply with Anti-Money Laundering Requirements</u>

Cause seven alleged, and the Extended Hearing Panel found, that DGI opened 11 new customer accounts without requiring photographic identification during the period between August 2006 and January 2008. Additionally, cause seven alleged, and the Extended Hearing

Panel found, that DGI failed in 2006 and 2007 to independently test its AML program, in violation of NASD Rules 3011(b) and (c), now FINRA Rule 3310, and NASD Rule 2110.

NASD Rule 3011(b) required each member to establish and implement a written AML program reasonably designed to achieve and monitor the member's compliance with the requirements of the Bank Secrecy Act, and its implementing regulations, including 31 C.F.R. § 103.22 (Customer Identification Programs for Broker-Dealers). This regulation required broker-dealers to establish a written customer identification process as part of the broker-dealer's AML program. The regulation required that customer identification programs include procedures for verifying the identity of each customer within a reasonable time of opening an account. The regulation indicated that identity verification through documents, for an individual, must include an unexpired government-issued identification evidencing nationality or residence and bearing a photograph, such as a driver's license or passport. NASD Rule 3011(c) required that member firms provide for annual independent testing for compliance on a calendar year basis.[59] *See NASD Notice to Members 06-07*, 2006 NASD LEXIS 10, at *3 (Feb. 2006) (explaining the requirements for independent AML testing).

DGI's own customer identification program required verification of customer identification through documents, except in circumstances that are not applicable to this case, such as a valid driver's license or passport. Between August 2006 and January 2008, DGI opened 11 new accounts for customers without timely obtaining photographic identification.

DGI conducted independent testing of its 2006 and 2007 AML compliance programs in 2008. DGI did not, however, conduct independent testing in calendar years 2006 and 2007, as required by NASD Rule 3011.

We find that DGI violated NASD Rules 3011(b) and (c) and 2110 as alleged in cause seven.

E. Procedural Arguments

Respondents raised several procedural arguments. They argued that: (1) the Hearing Officer's July 28, 2011 pre-hearing evidentiary rulings were prejudicial; (2) the Hearing Officer's February 16, 2012 post-hearing evidentiary ruling denied them an opportunity to defend themselves fully; and (3) they were prejudiced by unfair and unreasonable delay in these proceedings. We evaluate these arguments to determine if the Hearing Panel met the obligations of Section 15A(b)(8) of the Exchange Act, 15 U.S.C § 78o-3(b)(8), which requires FINRA to provide respondents with a "fair procedure" and to "bring specific charges, notify [respondents],

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[59] The complaint alleged violations of NASD Rule 3110, but Enforcement corrected the complaint's reference to Rule 3110 during the proceeding. Enforcement's prehearing brief noted the error and identified the allegation as an alleged violation of Rule 3011, not Rule 3110, and the Extended Hearing Panel found a violation of Rule 3011. We find that respondents were adequately aware of the violations alleged and had an adequate opportunity to respond and defend themselves. *See William C. Piontek*, 57 S.E.C. 79, 90-91 (2003) (finding that a party who understood the issues and had an opportunity to defend had sufficient notice of allegations against him).

and give [them] an opportunity to defend against, such charges." We find that the Extended Hearing Panel complied with the Exchange Act.

1. The Hearing Officer's July 28, 2011 Pre-Hearing Evidentiary Rulings Were Fair

Respondents argued on appeal that the Hearing Officer's July 28, 2011 pre-hearing order was prejudicial because Collier was not qualified to act as an expert, and the Hearing Officer improperly excluded respondents' exhibits. We do not find any evidence of prejudice and reject these arguments.

We turn first to respondents' argument that the Hearing Officer improperly excluded evidence. In the July 28, 2011 order, the Hearing Officer did not reject any of respondents' proposed exhibits. Rather, the Hearing Officer deferred ruling on all witness and exhibit objections until after both parties briefed the issues.[60] Ultimately, the Hearing Officer excluded respondents' proposed exhibits 2, 3, 5 (pages 5-8), and 6 (pages 3 and 4) from the record. We address the excluded exhibits here.

Respondents' proposed exhibit 2 contains charts that compare the overall performance of all DGI customer accounts (not just the Discretionary Customers' accounts) to the performance of major stock indices during the review period and other time periods. Respondents' proposed exhibit 3 contains a listing of all DGI customer accounts (not just the Discretionary Customers' accounts) and indicates the change in account equity between October 1, 2005, and December 31, 2006. Pages one through four of respondents' proposed exhibit 5 were entered into the record as RX 5 and pages one and two of respondents' proposed exhibit 6 were entered into the record as RX 6.[61] Pages five through eight of respondents' proposed exhibit 5 contain change in account equity figures for the 25 Discretionary Customers for time periods outside the Cause One Review Period. Pages three and four of respondents' proposed exhibit 6 contain change in account equity figures for the nine customers that Collier identified as having lost the most in day and overnight trading for time periods outside the Cause One Review Period. The Hearing Officer excluded these proposed summary exhibits because they were overly inclusive. They included time periods outside the Cause One Review Period and included information regarding customers other than the 25 Discretionary Customers or the 40 discretionary customers that engaged in day and overnight trading. The excluded exhibits also included account performance

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[60] Subsequently, the Hearing Officer issued a September 27, 2011 order that rejected respondents' proposed exhibits 1, 2, 3, 5, and 6 and deferred ruling on respondents' proposed exhibit 53 because respondents indicated that they may not choose to offer the exhibit into evidence. At a pre-hearing conference on December 6, 2011, the Hearing Officer indicated that respondents could renew their requests to admit these exhibits at the hearing. At hearing, respondents' proposed exhibits 1, 5 (pages 1-4), and 6 (pages 1-2) were admitted into evidence as Respondents' Exhibits ("RX") 1, 5, and 6.

[61] RX 5 contains information regarding changes in account equity for the 40 discretionary customers that engaged in day and overnight trading during the Cause One Review Period. RX 6 contains the same information for the nine customers that Collier identified as having lost the most in day and overnight trading.

information for long-term trading unrelated to day and overnight trading in the Discretionary Customers' accounts.

Pursuant to FINRA Rule 9263(a), the Hearing Officer shall receive relevant evidence, and may exclude all evidence that is irrelevant, immaterial, or unduly prejudicial. Under FINRA Rule 9263(a), the Hearing Officer has broad discretion to accept or reject evidence, and we review the exclusion of evidence only for an abuse of discretion. *Dep't of Enforcement v. Strong*, Complaint E8A2003091501, 2008 FINRA Discip. LEXIS 19, at *17-18 (FINRA NAC Aug. 13, 2008). "Because this discretion is broad, the party arguing abuse of discretion assumes a heavy burden that can be overcome only upon showing that the Hearing Officer's reasons to admit or exclude the evidence were 'so insubstantial as to render . . . [the admission or exclusion] an abuse of discretion.'" *Id.* (citing *Omnipoint Corp. v. FCC*, 213 F.3d 720, 723 (D.C. Cir. 2000)). Respondents have made no such showing here. Respondents' proposed exhibit 2 contains a comparison of the overall performance of DGI's customer accounts, not just the performance of the customers' day and overnight trading and not just the Discretionary Customers, to major stock indices. The comparison reaches beyond the trades that are our focus here and is neither relevant nor material to a determination as to whether respondents engaged in a cherry-picking scheme in 2006. Similarly, proposed respondents' exhibits 3, 5, and 6 include extraneous information that relates to periods other than the period under review and to customers other than the Discretionary Customers at issue in this case. They also include overall account performance figures, not just performance figures related to day and overnight trading, and therefore are irrelevant to the cherry-picking allegations. The Hearing Officer properly rejected these exhibits. *See Robert J. Prager*, 58 S.E.C. 634, 664 (2005) (noting that it is proper for a Hearing Officer to reject proposed exhibits relating to events after the period at issue in the complaint); *Dep't of Enforcement v. FCS Sec.*, Complaint No. 2007010306901, 2010 FINRA Discip. LEXIS 9, at *22-23 (FINRA NAC July 30, 2010) (rejecting proposed exhibits that respondents failed to demonstrate were relevant to the narrow issues of the case), *aff'd*, Exchange Act Release No. 64852, 2011 SEC LEXIS 2366 (July 11, 2011).

We turn now to respondents' arguments regarding Collier. Respondents objected to the Extended Hearing Panel's reliance on Collier's report and its designation of Collier as an expert. The Extended Hearing Panel accepted Collier's report and testimony and stated that, in the context of this proceeding, it would assess the reliability of his methodology and determine the appropriate weight to give his report and testimony. "[T]he Hearing Officer's discretion to accept or reject expert testimony is particularly broad." *Dep't of Enforcement v. Fiero*, Complaint No. CAF980002, 2002 NASD Discip. LEXIS 16, at *89 (NASD NAC Oct. 28, 2002). We find that the Extended Hearing Panel acted properly, and we affirm its determination to admit Collier's report and testimony. "[W]here the gatekeeper and the fact finder are the same, the [fact finder] does not err in admitting the evidence subject to the ability later to exclude it or disregard it" if it is not reliable. *In re Maurice J. Salem*, 465 F.3d 767, 777 (7th Cir. 2006).

After the Extended Hearing Panel admitted Collier's analysis into evidence, the Extended Hearing Panel relied on Collier's calculations in making its findings. The opinions that Collier provided involved mathematical analyses of numbers related to Dratel's trading activities in his and the Discretionary Customers' accounts. Collier has degrees in accounting and finance and experience as a certified public accountant and a registered person in the securities industry. He has consulted on more than 1,800 securities cases and provided securities-related expert opinions and testimony in more than 250 trials and arbitrations. Collier also qualified as an expert in the

United States District Court for the Southern District of Florida on behalf of the Securities and Exchange Commission in *SEC v. K.W. Brown and Co.*, 555 F. Supp. 2d 1275 (S.D. Fla. 2007), a case similar to this matter in which the Commission imposed sanctions for fraudulent cherry picking. Given the voluminous amount of trading data to digest, the nature of the fraudulent scheme alleged, and Collier's specialized knowledge, skill and prior experience analyzing an SEC enforcement action involving a fraudulent cherry-picking scheme, we affirm the Extended Hearing Panel's reliance on Collier's report and testimony in this case.

Furthermore, we independently assessed Collier's methodology and find it and the results of his computations to be reliable. Collier identified all the documents upon which he relied, explained his basis for counting trades, and provided details regarding the calculations upon which he based his analysis. Additionally, Enforcement produced to respondents Collier's reports from prior cherry-picking cases in which Collier provided an opinion.

We affirm the Hearing Officer's July 28, 2011 pre-hearing rulings.

2. *The Hearing Officer's February 16, 2012 Post-Hearing Ruling Was Fair*

Respondents argued on appeal that the Hearing Officer's February 16, 2012 post-hearing order was prejudicial because the Hearing Officer unfairly denied respondents the opportunity to respond to Enforcement's post-hearing arguments. We find that respondents had fair and adequate opportunity to address Enforcement's arguments and reject this argument.

Enforcement filed a post-hearing motion on February 6, 2012, seeking to exceed the post-hearing brief page limit by attaching Appendix A to its brief. Appendix A included a list of all 2004 and 2005 cross trades between Dratel and DGI customers. Enforcement also requested that the Hearing Panel take official notice of historical price reports regarding the securities included in Appendix A and add the price reports to the record.[62] The Hearing Officer allowed Enforcement to exceed the page limit by attaching Appendix A and denied Enforcement's motion for the Hearing Panel to take official notice of historical price reports and add price reports to the record. Respondents thereafter filed a post-hearing reply brief.

At the outset, we note that evidence of the cross trades identified in Appendix A were already included elsewhere in the record. Furthermore, Dratel himself offered evidence of his cross trades with customers at above-market prices, and he testified that he did so to account for investment "mistakes" that he made in his customers' accounts. *See supra* Section III.A.4.c. Additionally, Dratel introduced into evidence documentation to demonstrate that, in 2004 and 2005, he sustained losses while his customers' accounts profited. The losses resulted, in part, from voluntary cross trades between Dratel's personal account and customer accounts at above-market prices. Enforcement identified approximately 70 trades during the hearing that were among Dratel's cross trades with customers away from the market. Subsequent to the hearing, Enforcement identified 18 additional trades and listed all of the cross trades on Appendix A. Evidence of the additional trades was already in the record, but Enforcement had not compiled a complete list wherein the trades were identified in one location. Respondents have not

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[62] Enforcement offered historical price reports to show that the prices that Dratel paid in customer cross trades were above the market.

demonstrated that they were denied an opportunity to respond to Enforcement's arguments and, in fact, admitted to the existence of and submitted evidence regarding these cross trades during the hearing. Respondents also had a chance to respond in their reply briefs. We find that respondents had adequate opportunity to address the issue of Dratel's cross trades.

We affirm the Hearing Officer's February 16, 2012, post-hearing ruling. *Cf. Kevin Lee Otto*, 54 S.E.C. 847, 852-53 (2000) (rejecting procedural arguments where respondent provided no substantive basis for his objections), *aff'd*, 253 F.3d 960 (7th Cir. 2001).

3. Unreasonable Delay

Respondents argued that they were unfairly and materially prejudiced by Enforcement's "unnecessarily protracted investigation and its unreasonably delayed initiation of these proceedings." We find no evidence to support respondents' contention.

"[T]he disciplinary authority of private self-regulatory organizations ('SROs') such as [FINRA] is not subject to any statute of limitations." *Stephen J. Gluckman*, 54 S.E.C. 175, 185-86 (1999); *see also William D. Hirsh*, 54 S.E.C. 1068, 1077 (2000) (holding that no statute of limitations applies to the disciplinary actions of SROs). Furthermore, we find no evidence of an inordinate time delay that would render this proceeding inherently unfair. Section 15A(b)(8) of the Exchange Act requires that FINRA disciplinary proceedings be conducted in accordance with fair procedures. *See Mark H. Love*, 57 S.E.C. 315, 323 (2004). There are "no bright-line rules or mechanical tests concerning the impact of a delay on a disciplinary proceeding's fairness." *Dep't of Enforcement v. Kaweske*, Complaint No. C07040042, 2007 NASD Discip. LEXIS 5, at *39 (NASD NAC Feb. 12, 2007). Fairness depends on a review of the entirety of the record. *Id.* The proponent of the defense must demonstrate that the alleged undue delay caused prejudice. *Feeley & Willcox Asset Mgmt. Corp.*, 56 S.E.C. 1264, 1268 (2003).

Although a mechanical analysis of time periods identified as fair or unfair in earlier cases does not, in and of itself, establish whether a proceeding is fair, the relevant time periods in this case are generally shorter in duration than in cases in which the adjudicator found unfair delay. For instance, the time elapsed between the first date of misconduct alleged (for the majority of violations alleged) and the filing of the complaint is approximately five years or less, the time elapsed between the last date of misconduct alleged (for the majority of violations alleged) and the filing of the complaint is approximately three years or less, the time elapsed between FINRA's discovery of the alleged misconduct and the filing of the complaint is approximately four years, and the time elapsed between the commencement of FINRA's investigation and the filing of the complaint is approximately four years. *Cf. Kaweske*, 2007 NASD Discip. LEXIS 5, at *40 (finding no unfair delay where time elapsed between first date of misconduct and the filing of a complaint is six years and two months, last date of misconduct and the filing of a complaint is five years and 10 months, SRO discovery and the filing of a complaint is four years and one month, and the commencement of the SRO investigation and the filing of the complaint is four years and one month); *Dep't of Enforcement v. Morgan Stanley D.W., Inc.*, Complaint No. CAF000045, 2002 NASD Discip. LEXIS 11, at *33-37 (NASD NAC July 29, 2002) (finding unfair delay where time elapsed between first date of misconduct and the filing of a complaint is eight years, last date of misconduct and the filing of a complaint is seven years, SRO discovery and the filing of a complaint is five years and 10 months, and the commencement of the SRO investigation and the filing of the complaint is four years and 10 months); *Jeffrey*

Ainley Hayden, 54 S.E.C. 651, 653-54 (2000) (finding unfair delay where time elapsed between first date of misconduct and the filing of a complaint is 13 years and nine months, last date of misconduct and the filing of a complaint is six years and seven months, SRO discovery and the filing of a complaint is five years, and the commencement of the SRO investigation and the filing of a complaint is three years and six months).

Furthermore, respondents have not "made the required showing of prejudice resulting from a delay." *James Gerard O'Callaghan*, Exchange Act Release No. 57840, 2008 SEC LEXIS 1154, at *32 (May 20, 2008). There is no indication in the record that witnesses or documents became unavailable or that the witnesses who testified were unable to recall the specifics of DGI's operations and procedures. Additionally, DGI and Dratel share some responsibility for the time required for Enforcement to conduct its investigation. *See Kaweske*, 2007 NASD Discip. LEXIS 5, at *42 (noting, in rejecting unfair delay argument, that respondent shared the blame for the delay). PH testified that many of DGI's responses to FINRA requests for information were incomplete and required follow-up requests. Furthermore, PH testified that she had to visit DGI's offices to further the investigation and facilitate DGI's record production.[63]

Respondents' ability to mount a defense has not been compromised, and there is no evidence of unfairness. We reject this argument.

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FINRA provided respondents with a fair procedure.

IV. Sanctions

The Extended Hearing Panel fined DGI $185,000 and barred the firm from engaging in day trading. The Extended Hearing Panel calculated the fine as follows: $100,000 for violations under causes one, two, and three (fraudulent cherry picking, falsifying and maintaining inaccurate trade tickets, time stamping blank order tickets, and failing to identify customer names on trade tickets prior to execution); $50,000 for cause five (failing to establish and maintain a reasonable supervisory system); $10,000 for cause six (failing timely to update

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[63] Respondents claimed during the hearing that PH may have compromised the integrity of some of DGI's records when she photocopied them. Specifically, Dratel questioned why the facsimile dates and times (that the facsimile machine generated automatically) were positioned as they were on some of the FiNet tickets. Enforcement denied tampering with the documents or changing the locations of the facsimile dates and times, and Enforcement indicated that it would produce the original documents from its files during a break in the proceeding. This occurred on the sixth day of hearing. On appeal, respondents criticize Enforcement for failing to follow through by producing the FiNet tickets from Enforcement's files. The record demonstrates, however, that neither Dratel nor respondents' counsel ever raised the issue later on day six or on days seven or eight of the hearing. Respondents also offered no evidence to support Dratel's theory that PH moved facsimile dates and times when she photocopied FiNet tickets. He simply claimed that he suspected it. We reject this claim as unsubstantiated.

customer account information); and $25,000 for cause seven (failing to obtain photographic identification of new customers and to independently test DGI's AML system). The Extended Hearing Panel barred Dratel from associating with any member firm in any capacity and ordered him to disgorge $489,000 (his 2006 profits from day and overnight trading in his account) for violations under causes one, two, and three (fraudulent cherry picking, falsifying and maintaining inaccurate trade tickets, time stamping blank order tickets, and failing to identify customer names on trade tickets prior to execution). In light of the bar of Dratel, the Extended Hearing Panel did not impose additional sanctions for violations under causes five (failing to establish and maintain a reasonable supervisory system) and six (failing timely to update customer account information).[64]

Our review of the sanctions imposed by the Extended Hearing Panel is de novo, and we must assign our own weight to the relevant, and often countervailing, factors in each case. *Dep't of Enforcement v. Leopold*, Complaint No. 2007011489301, 2012 FINRA Discip. LEXIS 2, at *17 (FINRA NAC Feb. 24, 2012). "The relevancy and characterization of [an aggravating or mitigating] factor depends on the facts and circumstances of a case and the type of violation."[65] Balancing the factors present in this case, we modify these sanctions.

A. Sanctions for Violations Under Causes One, Two, and Three

Respondents violated the antifraud and books and records provisions of the federal securities laws and FINRA's rules, and they enriched Dratel at the expense of the Discretionary Customers. *See, e.g., Springer*, 55 S.E.C. at 648-49 ("Springer's failure to allocate securities transactions fairly to his customers goes to the heart of the duties owed by a securities professional to his investor clients."). As explained in more detail below, we find their misconduct to be "highly egregious, pervasive, premeditated," and the potential cause of significant customer loss. *K.W. Brown*, 555 F. Supp. 2d at 1311. We therefore affirm a bar in all capacities of Dratel. In lieu of a bar from day trading and $100,000 fine, for violations under causes one, two, and three, we expel DGI from membership. We also order Dratel to disgorge $489,000, and we order that he pay prejudgment interest on this amount. In light of our imposition of a bar and expulsion, we have not imposed additional sanctions for the respondents' other violations.

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[64] The dissenting member of the Extended Hearing Panel recommended dismissing the allegations under cause one, and therefore imposing no sanction. For violations under causes two and three, the dissenting member recommended that Dratel be fined $20,000 and suspended in all capacities for 60 days and that DGI be fined $20,000. For violations under cause five, the dissenting member recommended that Dratel be fined $10,000 and suspended in all capacities for 21 days and that DGI be fined $10,000. For violations under cause seven, the dissenting member recommended that DGI be fined $5,000. The dissenting member did not recommend sanctions for violations under cause six.

[65] *FINRA Sanction Guidelines*, at 6 (2013), http://www/finra.org/web/groups/industry /@ip/@enf/@sg/documents/industry/p011038.pdf (hereafter "*Guidelines*").

1. Bar and Expulsion

We turn first to the FINRA Sanction Guidelines ("Guidelines"). The Guidelines for misrepresentations or omissions of fact recommend, for intentional or reckless misconduct, a fine of $10,000 to $100,000 and a suspension of an individual and a firm for 10 business days to two years.[66] For egregious cases, the Guidelines recommend consideration of a bar of an individual and expulsion of a firm.[67] The Guidelines for recordkeeping violations recommend, in egregious cases, a fine of $10,000 to $100,000, a suspension of up to two years for an individual and a firm or a bar of an individual respondent and expulsion of a firm.[68]

There are no specific considerations in the Guidelines for material omissions. The recordkeeping Guidelines recommend that we consider the nature and materiality of the inaccurate or missing information.[69] "Order tickets play an important role in the recording and settlement of a brokerage firm's transactions." *Richard G. Strauss*, 50 S.E.C. 1316, 1317 n.5 (1992). Here, respondents falsified order tickets, time stamped blank tickets, back-dated tickets, and failed to identify customers before execution to further a fraudulent scheme. The falsifications and inaccuracies in DGI's order tickets were a material aspect of the overall cherry-picking scheme and enabled Dratel to allocate trades only after he assessed profitability.

We also consult the Guidelines' Principal Considerations in Determining Sanctions.[70] At the outset, we note that Dratel and DGI have disciplinary histories.[71] In July 2006, DGI and Dratel settled a matter with FINRA. FINRA censured Dratel and fined Dratel and DGI $15,000, jointly and severally. FINRA found that DGI and Dratel failed to timely report two customer complaints that they subsequently settled, failed to amend and update Dratel's Form U4, and failed to timely obtain an opinion of counsel concerning a lawsuit for $1,250,000 that could have had a material impact on DGI's net capital computation. FINRA also found that DGI failed to notify FINRA of net capital deficiencies. In November 2003, DGI settled a matter in which FINRA found that DGI failed timely to report equity transactions to ACT, failed accurately to disclose required information, including if the firm acted on an agency or principal basis, on confirmations, failed to report time on order tickets in seconds, and failed to prepare order tickets for riskless principal trades in government securities. FINRA censured DGI and fined it $9,000.

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[66] *See Guidelines*, at 88.

[67] *Id.*

[68] *Id.* at 29.

[69] *Id.*

[70] *See Guidelines*, at 6.

[71] *Id.* at 6 (Principal Consideration No. 1 (relevant disciplinary history)).

Dratel's and DGI's disciplinary histories demonstrate their past disregard for regulatory requirements. We consider this aggravating.[72]

We also find aggravating that respondents' scheme evinces a high degree of scienter.[73] Respondents' cherry-picking scheme "required specific preparation and the deliberate allocation of a disproportionate number of profitable trades to [Dratel's] own account." *Dawson*, 2010 SEC LEXIS 2561, at *17. The Discretionary Customers granted Dratel and DGI control and authority over their accounts. Rather than acting in good faith, respondents exploited their positions of trust and engaged in an allocation scheme that benefitted Dratel over the Discretionary Customers.[74] In furtherance of the scheme, Dratel intentionally falsified and maintained inaccurate order tickets. This level of scienter, in our view, exacerbates the egregiousness of respondents' misconduct. *See Dawson*, 2010 SEC LEXIS 2561, at *17.

Also aggravating is the fact that respondents' misconduct was not one isolated incident.[75] Rather, respondents engaged in this fraudulent scheme over the course of one full year, and their misconduct, which involved 25 customers, deprived the customers of fair treatment and exposed them to the potential for significant customer loss and extensive personal gain for Dratel.[76] As we discuss in more detail with respect to our order of disgorgement, Section IV.A.2 *infra*, as a result of respondents' cherry-picking scheme, Dratel earned approximately $489,000 of profits in day and overnight trading in his personal account. Conversely, the Discretionary Customers potentially lost profits in that Dratel allocated to them only losing or less profitable day and overnight trades during the course of 2006. We find these factors to be aggravating.

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[72] *Id.* at 2 (General Principles Applicable to All Sanction Determinations No. 2) ("An important objective of the disciplinary process is to deter and prevent future misconduct by imposing progressively escalating sanctions on recidivists . . . including barring registered persons and expelling firms."); *Edward C. Farni*, 51 S.E.C. 1118, 1121 (1994) (upholding propriety of FINRA's consideration of prior misconduct in fashioning sanctions).

[73] *Id.* at 7 (Principal Consideration No. 13 (whether respondents' misconduct was intentional, reckless, or negligent)).

[74] Furthermore, as Dratel acknowledged, his exercise of discretion in customer accounts created a fiduciary duty between himself and his discretionary customers. We find it further aggravating that Dratel disregarded his fiduciary obligations. *See Dawson*, 2009 SEC LEXIS 4143, at *17 ("There could not be a more blatant breach of a fiduciary duty or the exercise of a higher degree of scienter than deliberately establishing a separate account and deliberately allocating to that account trades Dawson knew were more profitable than the trades he allocated to the accounts of his clients, all of whom were family or friends.").

[75] *See Guidelines*, at 6 (Principal Consideration Nos. 8, 9 (whether respondents engaged in numerous acts or a pattern of misconduct and whether the misconduct occurred over an extended period of time)).

[76] *Id.* at 6-7 (Principal Consideration Nos. 11, 17 (whether respondents' misconduct resulted in customer harm and the potential for gain for the respondents)).

We also consider Dratel's efforts to conceal his actions.[77] Dratel failed to disclose his fraudulent allocation scheme to the Discretionary Customers, letting them instead believe that he and DGI complied with their obligations to abide by high standards of commercial honor. Furthermore, Dratel failed even to advise the Discretionary Customers that he was day and overnight trading for his own account alongside their accounts and through the Firm Account. He also did not reveal to the Discretionary Customers that he sometimes traded in the same stock on the same day in his own account and their accounts, including that he often gave himself the more advantageous trades. In sum, we find that respondents expended significant effort on concealing their misconduct, and we find this aggravating.

We also note that, according to Dratel, many of the Discretionary Customers were close friends, family, and long-term clients of DGI. As friends, family, and long-term clients, these individuals had every reason to trust Dratel. But his relationships with them did not deter him from cherry picking advantageous trades for himself to their detriment. We find his willingness to victimize friends and family aggravating.[78] *See Dawson*, 2009 SEC LEXIS 4143, at *17 (finding aggravating that respondent intentionally allocated unprofitable or less profitable trades to the accounts of family or friends).

Dratel argued that the Extended Hearing Panel failed to give him credit for the number of tickets that DGI completed correctly. He opined that DGI completed more than 20,000 tickets in 2005 and more than 15,000 tickets in 2006 and that Enforcement only identified a small portion of those tickets as having been completed inaccurately or incompletely. We do not agree that this is mitigating. Respondents were "required to comply with [FINRA's] high standards of conduct at all times," not just when completing some of their trade tickets. *Rooms v. SEC*, 444 F.3d 1208, 1214 (10th Cir. 2006); *accord Scott Epstein,* Exchange Act Release No. 59328, 2009 SEC LEXIS 217, at *74 (Jan. 30, 2009) (rejecting prior exemplary conduct as mitigating and holding that respondent should not be rewarded for acting in accordance with his duties as a securities professional).

Dratel also argued that the Extended Hearing Panel erred in failing to credit him with the positive testimony offered by two of the Discretionary Customers. He noted that neither had negative comments or complaints about Dratel's handling of his account. We do not find the customers' testimony mitigating. Some of Dratel's Discretionary Customers may have earned profits overall in their accounts in 2006. Certainly they earned profits when Dratel executed above-market cross trades with them, and in subsequent years, when Dratel paid certain customers to cover their losses. As such, these customers had no way of discerning Dratel's fraudulent allocation scheme, particularly given that Dratel had not even advised them that he day and overnight traded his own account alongside theirs. *See Dawson*, 2010 SEC LEXIS 2561, at *14 (rejecting argument that customers' failure to complain demonstrates that cherry picking was not egregious).

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[77] *Id.* at 6 (Principal Consideration No. 10 (whether respondents attempted to conceal their misconduct)).

[78] *Id.* at 7 (Principal Consideration No. 18 (consider character of transactions at issue)).

"Conduct that violate[s] the antifraud provisions of the federal securities laws is especially serious and subject to the severest of sanctions . . . ." *Alvin W. Gebhart, Jr.*, 53 S.E.C. 1133, 1177 (2006) (*citing Marshall E. Melton*, 56 S.E.C. 695, 713 (2003)). Respondents' misconduct was egregious. Dratel engaged in an ongoing pattern of placing his own interests before those of his customers with respect to day and overnight trading. He also withheld material information from his customers, notwithstanding his heightened duties as a fiduciary because of the discretionary control that he exercised. His failure to allocate securities transactions fairly to his customers "goes to the heart of the duties owed by a securities professional to his investor clients." *Springer*, 55 S.E.C. at 649. Given the many aggravating factors present in this case, respondents' disciplinary history, the lack of care that respondents have demonstrated towards the Discretionary Customers, and respondents' lack of appreciation for the wrongful nature of their misconduct, we conclude that respondents cannot continue in this industry in a compliant manner. We therefore bar Dratel in all capacities and expel DGI. *See Mission Sec. Corp.*, Exchange Act Release No. 63453, 2010 SEC LEXIS 4053, at *53-54 (Dec. 7, 2010) (holding that respondents' demonstrated lack of fitness to be in the securities industry supports the remedial purposes of a bar and expulsion); *Dawson*, 2010 SEC LEXIS 2561, at *19 (finding respondent's lack of appreciation for the wrongful nature of his misconduct indicative of a potential for recurrence).

2. Disgorgement

We affirm the Extended Hearing Panel's disgorgement order. "[D]isgorgement is intended to force [the] wrongdoers to give up the amount by which they were unjustly enriched." *Michael David Sweeney*, 50 S.E.C. 761, 768 (1991). Adjudicators generally should order disgorgement in sales practice cases, even if an individual is barred, where, as here, the respondent has retained substantial ill-gotten gains. *See Guidelines*, at 10 (Technical Matters). "The law does not require precision in determining the proper amount of disgorgement." *K.W. Brown*, 555 F. Supp. 2d at 1312. "Rules for calculating disgorgement must recognize that separating legal from illegal profits exactly may at times be a near-impossible task." *SEC v. First City Fin. Corp., Ltd.*, 890 F.2d 1215, 1231 (D.C. Cir. 1989). As such, the disgorgement amount need only be a reasonable approximation of the ill-gotten gains causally connected to the violation. *Id.*

Dratel testified before the Extended Hearing Panel that the day and overnight trading that he conducted in his personal account in 2006 generated profits of approximately $489,000. Record evidence based upon the profit and loss blotters provided by Oppenheimer corroborated this figure. The Extended Hearing Panel based its disgorgement order on this figure, and we affirm the disgorgement order.

We also order Dratel to pay pre-judgment interest on the disgorgement amount. "By failing to order prejudgment interest on a disgorgement amount, an adjudicator falls short of achieving the proper deterrence for the misconduct because disgorgement alone does not reflect the time value of ill-gotten gains, and in effect, provides the respondent with an interest free loan until the disgorgement order is final." *Dep't of Enforcement v. Davidofsky*, Complaint No. 2008015934B01, 2013 FINRA Discip. LEXIS 7, at *42 (FINRA NAC Apr. 26, 2013). The rate of prejudgment interest is the rate established for the underpayment of income taxes in the Internal Revenue Code. *Id.* Dratel earned his ill-gotten gains in a fraudulent cherry-picking

scheme that occurred throughout 2006. Thus, we order that Dratel disgorge to FINRA $489,000, plus interest at the rate established for the underpayment of income taxes in Section 6621(a) of the Internal Revenue Code, 26 U.S.C. § 6621(a), from January 1, 2007, until paid.

B. Sanctions for Violations Under Causes Five, Six, and Seven

In light of our imposition of a bar of Dratel and expulsion of DGI, we do not impose additional sanctions for the respondents' violations under causes five, six, and seven. We, however, briefly discuss the sanctions that we find appropriate and would have imposed had we not barred Dratel and expelled DGI.

Under cause five, we find that respondents failed to establish, maintain, and implement supervisory procedures sufficient to prevent post-execution allocation of trades and ensure timely and accurate completion of order tickets. The Guidelines for deficient written supervisory procedures recommend a fine of $1,000 to $25,000 and the Guidelines for the failure to supervise recommend a fine of $5,000 to $50,000.[79] The Guidelines also recommend consideration of various suspensions, bars, and expulsions for more egregious cases.[80]

The Extended Hearing Panel fined DGI $50,000 for violations under cause five and, in light of the bar, imposed no additional sanctions as to Dratel.[81] Although we impose no additional sanctions in light of the bar and expulsion, we agree that a $50,000 fine would be appropriately remedial in light of the seriousness of this misconduct. There is no evidence in the record to suggest that DGI had written procedures in place that adequately addressed the completion of order tickets and prohibited the post-execution allocation of trades. The record also demonstrates that there were no supervisory controls in place. The lack of supervisory procedures and controls enabled Dratel to engage in a fraudulent cherry-picking scheme unfettered.[82]

Under cause six, we find that respondents willfully failed to update customer account information for 42 customers. The Guidelines for recordkeeping violations recommend a fine of $1,000 to $10,000 and, for egregious violations, a fine of $10,000 to $100,000.[83] The Guidelines

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[79] *See Guidelines*, at 103-04.

[80] *Id.*

[81] The Extended Hearing Panel would have also fined Dratel $50,000 and suspended him as a principal for 30 days if it had not barred Dratel. For the reasons discussed in the body of this decision, we agree that, had we not barred Dratel, this would have been an appropriately remedial sanction.

[82] *See Guidelines*, at 103 (for a failure to supervise, consider the nature, extent, size, and character of the underlying misconduct); *id.* at 104 (for deficient supervisory procedures, consider whether deficiencies allowed violative conduct to occur or to escape detection).

[83] *Id.* at 29.

also recommend consideration of various suspensions and bars and expulsions for more egregious cases.[84]

The Extended Hearing Panel fined DGI $10,000 for violations under cause six and, in light of the bar, imposed no additional sanctions as to Dratel.[85] Although we impose no additional sanctions in light of the bar and expulsion, we agree that a $10,000 fine would be appropriately remedial. Maintaining accurate and up-to-date customer account information is integral to ensuring that registered representatives know their customers enough to recommend only suitable investments.[86] *See Books and Records Requirements for Brokers and Dealers under the Securities Exchange Act of 1934*, Exchange Act Release No. 44992, 2001 SEC LEXIS 2278, at *18 (Oct. 26, 2001) (stating that one purpose of Rule 17a-3 is to ensure that regulators have access to sufficient customer information to oversee compliance with suitability requirements). DGI's customer information for 42 customers was not updated, leaving a potential for reliance on inaccurate information.

Finally, under cause seven, we find that DGI opened 11 new customer accounts without requiring photo identification and failed to independently test its AML system in 2006 and 2007. There are no guidelines specific to these violations, but we find that the Guidelines for supervisory violations are applicable. The Guidelines for deficient written supervisory procedures recommend a fine of $1,000 to $25,000 and the Guidelines for the failure to supervise recommend a fine of $5,000 to $50,000.[87] The Guidelines also recommend consideration of various suspensions, bars, and expulsions for more egregious cases.[88]

The Extended Hearing Panel fined DGI $25,000 for violations under cause seven.[89] Although we impose no additional sanctions in light of the expulsion, we agree that a $25,000 fine would be appropriately remedial. DGI's misconduct in this regard was serious. Federal law requires that every broker-dealer implement an effective AML program to prevent money laundering and independent testing is critical to ensuring that a satisfactory program is in place. Additionally, it is imperative that firms not only have effective programs in place, but that they fully implement those programs. Here, DGI's procedures required new customers to produce photographic identification to open new accounts, and Dratel ignored those procedures.

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[84] *Id.*

[85] The Extended Hearing Panel would have also fined Dratel $10,000 and suspended him in all capacities for one week if it had not barred Dratel. For the reasons discussed in the body of this decision, we agree that, had we not barred Dratel, this would have been an appropriately remedial sanction.

[86] *See Guidelines*, at 29 (consider the nature and materiality of inaccurate information).

[87] *Id.* at 103-04.

[88] *Id.*

[89] Dratel was not named in cause seven of the complaint.

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Thus, we bar Dratel from associating with any member firm in any capacity and expel DGI from membership. In light of the bar and expulsion, we impose no fines. We also order Dratel to disgorge $489,000 to FINRA plus interest at the rate established for the underpayment of income taxes, from January 1, 2007, until paid.[90]

V. Conclusion

We affirm the Extended Hearing Panel's findings under causes one, two, three, five, and six of the complaint that respondents engaged in a willful and fraudulent trade allocation or cherry picking scheme, in violation of Section 10(b) of the Exchange Act, Exchange Act Rule 10b-5 and NASD Rules 2110 and 2120, willfully falsified and backdated order tickets, time stamped blank order tickets, and failed to identify customer names on order tickets until after execution, in violation of NASD Rules 2110 and 3110, failed to establish, maintain and enforce supervisory procedures adequate to prevent post-execution allocation of trades and ensure timely and accurate completion of customer order tickets, in violation of NASD Rules 2110 and 3010(a) and (b), and willfully failed periodically to update customer account information, in violation of NASD Rules 2110 and 3110. We also affirm the Extended Hearing Panel's findings under cause two that DGI willfully violated Section 17(a) of the Exchange Act and Exchange Act Rules 17a-3(a)(6) and (7) and under cause six that DGI willfully violated Section 17(a) of the Exchange Act and Exchange Act Rules 17a-3(a)(6) and (7). We further affirm the Extended Hearing Panel's findings under cause seven of the complaint that DGI opened 11 new customer accounts without requiring the customers to show photographic identification and failed independently to test DGI's AML program in 2006 and 2007, in violation of NASD Rules 2110 and 3011(b) and (c).

Accordingly, we bar Dratel from associating with any member firm in any capacity and expel DGI from FINRA membership. The bar and expulsion are effective immediately upon issuance of this decision. We also order that Dratel disgorge to FINRA $489,000, plus interest at the rate established for the underpayment of income taxes in Section 6621(a) of the Internal Revenue Code, 26 U.S.C. § 6621(a), from January 1, 2007, until paid. Additionally, we affirm the Extended Hearing Panel's assessment of hearing costs of $16,077.60 and assess appeal costs of $2,534.[91]

On Behalf of the National Adjudicatory Council,

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Marcia E. Asquith
Senior Vice President and Corporate Secretary

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[90] Because we find that Dratel's and DGI's violations of the Exchange Act were willful, this decision also subjects Dratel and DGI to statutory disqualification from the securities industry.

[91] We have considered and reject without discussion all other arguments advanced by the parties.