BEFORE THE NATIONAL ADJUDICATORY COUNCIL

NASD

In the Matter of Department of Enforcement, Complainant, vs. Ralph Merhi Boca Raton, Florida, Respondent.	DECISION Complaint No. E072004044201 Dated: February 16, 2007

Respondent traded excessively in a customer account and exercised discretion without having prior written authorization. Held, findings and sanctions affirmed.

Appearances

For the Complainant: Leo F. Orenstein, Esq., Dept. of Enforcement, NASD

For the Respondent: Pro Se

Decision

Pursuant to NASD Procedural Rule 9311(a), Ralph Merhi ("Merhi") appeals a March 14, 2006 default decision in which a Hearing Officer found that Merhi made excessive trades and exercised discretion in a customer account without having prior written discretionary authority. The Hearing Officer barred Merhi from associating with any member firm in any capacity and ordered that Merhi pay restitution to a single customer in the amount of $28,454. After a complete review of the record, we find that the Hearing Officer properly found Merhi to be in default, and that Merhi did not establish good cause for his failure to participate in the proceedings before the Hearing Officer. We further find that the record supports the Hearing Officer's findings of violations, and affirm the sanctions imposed upon Merhi.

I. Factual and Procedural History

A. Merhi

Merhi entered the securities industry in July 1998, and first became registered as a registered representative in August 1998. At the time of the events at issue in this case, Merhi was a general securities representative and principal with Newbridge Securities Corporation ("Newbridge"). Merhi remained associated with Newbridge in these capacities until September 2003. Merhi was last registered with an NASD member firm, as a general securities representative and principal, from May 24, 2004, until August 9, 2004. Merhi is not currently registered with an NASD member firm.

B. Procedural History

On October 25, 2005, NASD's Department of Enforcement ("Enforcement") filed a two-cause complaint against Merhi. The complaint alleged that Merhi had: (1) engaged in excessive trading of customer JM's account, in violation of Conduct Rules 2310 and 2110, and IM-2310-2(b)(2); and (2) exercised discretion in JM's account without having prior written discretionary authority, in violation of Conduct Rules 2510(b) and 2110. Pursuant to Procedural Rule 9134, Enforcement sent the complaint and notice thereof by certified and first-class mail to Merhi's address, as listed in NASD's Central Registration Depository ("CRD"®). Although Enforcement staff did not receive a delivery receipt for the certified mailing, neither the certified mailing nor the first-class mailing was returned to Enforcement.

On November 23, 2005, the time for filing an answer having passed, Enforcement sent another copy of the complaint and a second notice of the complaint by certified and first-class mail to Merhi's CRD address pursuant to Procedural Rule 9215(f). The Postal Service returned the certified mailing to Enforcement as "unclaimed," while the first-class mailing was not returned. Merhi did not answer or otherwise respond to the complaint by the December 12, 2005 deadline.

On January 19, 2006, Enforcement filed a Motion for Entry of Default Decision (the "Default Motion"), which was supported by an affidavit and two attached exhibits. Although the Default Motion detailed the violations alleged in the complaint, and the affidavit stated that "legally sufficient evidence" supported the factual and legal allegations in the complaint, the Default Motion was not otherwise accompanied by any independent evidence of misconduct. Enforcement sent the Default Motion by overnight delivery to Merhi's CRD address.

Merhi did not respond to the Default Motion. Thus, on March 14, 2006, the Hearing Officer issued a default decision granting the Default Motion. The Hearing Officer found that Merhi had received constructive notice of the proceeding and that Merhi defaulted by failing to answer. By virtue of Merhi's default and pursuant to Procedural Rule 9269(a)(2), the Hearing Officer accepted the allegations set forth in the complaint as true, and found that Merhi had traded excessively in a customer account and had exercised discretion in a customer account without prior written authority. The Hearing Officer imposed a bar in all capacities upon Merhi and ordered Merhi to make restitution to a single customer in the amount of $28,454.

Merhi timely appealed the default decision pursuant to a letter to NASD staff dated April 8, 2006 (the "Appeal Letter"). After missing the initial briefing deadline established by the Office of General Counsel, and in response to a letter from the Office of General Counsel requesting that Merhi explain why his appeal should not be dismissed as abandoned, Merhi timely submitted a letter dated June 8, 2006 (the "June 8 Letter"), along with a number of attached exhibits.[1] Both the Appeal Letter and the June 8 Letter contested the Hearing Officer's findings of violations and imposition of sanctions.

On July 20, 2006, the National Adjudicatory Council ("NAC") Subcommittee appointed in this case informed the parties that it would treat the June 8 Letter as Merhi's appellate brief, and amended the briefing schedule with respect to Enforcement's brief and Merhi's reply brief. Additionally, pursuant to Procedural Rule 9346(f), the Subcommittee ordered Enforcement to supplement the record with additional evidence referenced in the affidavit submitted with the Default Motion. As directed, Enforcement supplemented the record with eight exhibits not included in the original record.[2]

C. Facts

This case arises out of trading in the account of JM, a 57 year-old sole proprietor. In November 2000, JM opened a securities account with LH, a registered representative at Newbridge. JM's new account form listed "income," "preservation of capital," "capital appreciation," and "speculation" as his investment objectives. The form also stated that JM's annual income was between $100,000 and $250,000, that he had a net worth of more than $500,000, and that he had five years of investing experience. Although Merhi was not the initial representative handling JM's account, Merhi became the broker of record shortly after JM

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[1] Enforcement argues in its appeal brief that such exhibits, consisting of seven letters to and from various parties, should not be admitted into the record because Merhi failed to comply with Procedural Rule 9346(b). To the extent that the letters are not already part of the record, Merhi has failed to demonstrate good cause for his failure to participate in the hearing below, demonstrate the relevance or materiality of the letters, or otherwise comply with the requirements of Procedural Rule 9346. Furthermore, based upon our review of the letters in question, they are not relevant to this appeal, and the information and arguments set forth in such letters are repetitive of other documents already in the record.

[2] Enforcement argues that this appeal should be dismissed as abandoned pursuant to Procedural Rule 9344(b). Despite several deficiencies with respect to Merhi's compliance with NASD's Procedural Rules, the arguments set forth in the June 8 Letter demonstrate that Merhi has neither abandoned his appeal nor his contention that the Hearing Officer erroneously determined that he traded excessively in JM's account and exercised discretion without prior written authority. *See Dep't of Enforcement v. Brinton*, Complaint No. C04990005, 1999 NASD Discip. LEXIS 36 (NAC Dec. 14, 1999) (rejecting Enforcement's motion to dismiss pro se respondent's appeal as abandoned, NAC decides appeal of a default decision on the written record and accepts a late-filed letter from respondent as respondent's brief).

opened the account at Newbridge. At that time, JM informed Merhi that his annual income was approximately $200,000, and that his investment objective was "to earn a profit with a moderate amount of risk." JM's only prior investment experience was with a mutual fund in his 401(k) account and with limited partnerships. JM had never engaged in short-term trading of securities, and never discussed such trading with Merhi.

In April 2002, Merhi purchased shares of Nextel Corporation stock on behalf of JM and pursuant to JM's request. In July 2002, Merhi convinced JM to sell his Nextel shares and take a profit because Merhi had "some great investment opportunities coming up with great profit potential." In late July or early August 2002, Merhi asked JM over the telephone if it was necessary to continue to contact JM prior to each transaction in his account. JM told Merhi that if a proposed investment "was a no-brainer and the trade was going to make money to go ahead and do the trade without calling me."

Subsequent to JM's conversation with Merhi in late July or early August 2002, the size and frequency of transactions in JM's account increased significantly. From late July 2002 through March 2003, Merhi made over 70 trades in JM's account.[3] Although Merhi does not dispute that in late July or early August 2002 JM granted him oral discretionary authority to trade in JM's account, Merhi alleges that despite JM's grant of discretion, Merhi never effectuated a transaction in JM's account without first contacting JM. JM, however, asserts that he and Merhi did not have a single conversation after JM granted Merhi oral discretionary authority. The record indicates that after JM granted Merhi oral discretionary authority, only six calls totaling five minutes were made from Newbridge to JM's various telephone numbers during the nine-month period in question.

During this time period: (a) Merhi effected 32 purchases totaling $471,458 and 42 sales totaling $468,642; (b) JM's average account equity was $31,058;[4] (c) JM was charged commissions totaling approximately $20,750 and margin interest of approximately $1,344; (d) JM suffered losses totaling $28,454 (comprised of realized losses on the trades in question and the commissions paid by JM in connection with such trades), for which he has received no

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[3] Although the Hearing Officer found that a number of Merhi's trades involved low-priced, speculative securities, Enforcement did not allege that Merhi violated IM-2310-2(b)(1), which provides that the recommendation of "speculative low-priced securities to customers without knowledge of or attempt to obtain information concerning the customers' other securities holdings, their financial situation, and other necessary data" is a practice that clearly violates a member's responsibility for fair dealing with customers. The record does not contain sufficient evidence to decide this issue.

[4] Enforcement alleges that the average equity in JM's account was $31,280. In calculating average equity, Enforcement erroneously utilized an equity balance of $44,322 for the month of August 2002 instead of $42,322 (as set forth in JM's August 2002 statement). Thus, Enforcement overestimated the average account equity in JM's account. In addition, the equity in JM's account totaled $49,841 as of July 31, 2002.

reimbursement; (e) the annual turnover rate in JM's account was 20.24;[5] (f) the annualized cost-to-equity ratio was 94.85%;[6] and (g) the majority of securities purchased were held for 30 days or less.

In January 2003, and in connection with Newbridge's change of clearing agents, Merhi completed a new client worksheet for JM's account, which listed speculation as JM's primary objective and short term gain as JM's secondary objective.[7] An account detail for JM's account created by Newbridge in February 2003 also lists speculation as JM's primary investment objective, although it lists JM's risk tolerance as conservative. In February 2003, Newbridge sent JM a letter regarding the active trading in his account. JM subsequently complained to Newbridge regarding the level of activity in his account and ultimately closed his account in September 2003. NASD investigated the trading in JM's account, and Enforcement's allegations against Merhi are the result of this investigation.

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[5] Generally, the turnover rate is calculated "by dividing the aggregate amount of the purchases by the average cumulative monthly investment, the latter representing the cumulative total of the net investment in the account at the end of each month, exclusive of loans, divided by the number of months under consideration." *Frederick C. Heller*, 51 S.E.C. 275, 279 n.10 (1993). In accounts that primarily hold securities rather than cash, a modified formula is used, which divides the total cost of purchases by the average monthly equity. *See Dep't of Enforcement v. Stein*, Complaint No. C07000003, 2001 NASD Discip. LEXIS 38, at *16 n.15 (NAC Dec. 3, 2001), *aff'd*, 2003 SEC LEXIS 338 (Feb. 10, 2003). In this case, Enforcement utilized the modified formula to calculate a turnover rate of 19.36. Enforcement's calculation, however, underestimates the actual turnover rate, as in addition to Enforcement's overestimate of the average equity in JM's account, Enforcement's calculation of the total purchases in the account appears to have inadvertently excluded a purchase of $17,149 in November 2002. We find that the difference between Enforcement's alleged turnover rate and the actual turnover rate is immaterial to our finding that Merhi traded excessively.

[6] We have previously described the cost-to-equity ratio as the measure of the amount of income that an account would need to generate in order to merely break even. *Dep't of Enforcement v. O'Hare*, Complaint No. C9B030045, 2005 NASD Discip. LEXIS 39, at *13 (NAC Apr. 21, 2005). In this case, and in connection with Enforcement's overestimate of the average equity in JM's account, Enforcement's calculation of a 94.17% cost-to-equity ratio was slightly less than the actual rate of 94.85%. This difference is immaterial to our finding that Merhi traded excessively.

[7] Newbridge changed clearing agents in mid 2002. JM did not sign the new client worksheet created by Merhi in January 2003, and there is no evidence in the record that JM reviewed or approved the worksheet.

II. Discussion

We first address whether the Hearing Officer properly determined that Merhi was in default. We find that the determination was correct. Second, we consider whether Merhi has demonstrated good cause for his failure to participate in the proceedings before the Hearing Officer. We find that he has not. Finally, we consider the merits of this appeal and conclude that Merhi traded excessively in JM's account and exercised discretion in JM's account without having prior written discretionary authority.

A. The Hearing Officer Properly Entered the Default Decision

After reviewing the record, we find that the Hearing Officer properly entered the default decision against Merhi after he failed to respond to the complaint and the Default Motion. Procedural Rule 9269 allows a Hearing Officer to enter a default after Enforcement serves first and second notices of the complaint and the respondent fails to file an answer or otherwise respond after a specified time. We find that Enforcement properly served Merhi with the first and second notices of the complaint to his address listed in CRD. *See* Procedural Rule 9134(b)(1) (allowing for service at CRD address). Indeed, Merhi has never alleged that he did not have notice of the complaint, the Default Motion, or any other communication in this case. We therefore find that Merhi had notice of the complaint. *See Dep't of Enforcement v. Verdiner*, Complaint No. CAF020004, 2003 NASD Discip. LEXIS 42, at *5 n.1, *6 (NAC Dec. 9, 2003) (finding that respondent received constructive notice when complaint was mailed to respondent's CRD address). Further, it is undisputed that Merhi failed to file an answer to the complaint. Thus, the Hearing Officer properly entered the default decision against Merhi.

B. Merhi Has Failed to Demonstrate Good Cause

Pursuant to Procedural Rule 9344(a), the NAC will consider an appeal of a default decision on the basis of the written record without the opportunity for oral argument, unless the respondent demonstrates good cause for his failure to participate in the proceedings below. Merhi has not provided any reason whatsoever for his failure to participate in the proceedings below, nor has he requested oral argument in connection with this appeal. Consequently, we find that Merhi has not established good cause, and we consider this matter solely on the basis of the written record. *See Dep't of Enforcement v. Salaverria*, Complaint No. C07040077, 2005 NASD Discip. LEXIS 10, at *11 (NAC Dec. 12, 2005) (holding that respondent who failed to answer complaint and motion for default despite having notice of proceedings did not show good cause).

C. Evidentiary Basis Supporting Findings of Violations

The Hearing Officer made findings of violations based on the allegations deemed admitted as a result of Merhi's default and the evidence that Enforcement presented in support of its Default Motion (i.e., the affidavit and the two exhibits attached thereto). The SEC has indicated that when a default decision is appealed, the record should contain sufficient independent evidence to support the findings of violation to enable the SEC to discharge its

review function under Section 19 of the Securities Exchange Act of 1934.[8] Thus, although we can deem the allegations of the complaint admitted, we have not done so and have conducted an independent review of the evidence (including a review of the supplemental evidence submitted by Enforcement at the direction of the Subcommittee). Based upon such review, we find that the record, as supplemented, supports the Hearing Officer's findings that Merhi traded excessively in JM's account and exercised discretion in JM's account without written authority.

1. Merhi Traded Excessively in JM's Account.

Conduct Rule 2310 requires that a registered representative have reasonable grounds, based upon a customer's investment objectives, financial situation, and needs, for believing that a recommended transaction is suitable for a customer. *See Rafael Pinchas*, 54 S.E.C. 331, 341 (1999). A violation of this suitability rule may be established if a representative's recommendations are quantitatively unsuitable, "i.e., the representative excessively traded the account." *O'Hare*, 2005 NASD Discip. LEXIS 39, at *11-12. "[E]xcessive trading represents an unsuitable frequency of trading and violates NASD suitability standards." *Paul C. Kettler*, 51 S.E.C. 30, 32 (1992).[9] The suitability rule applies only to securities that a registered representative recommends to his or her customer. *Dep't of Enforcement v. Chase*, Complaint No. C8A99081, 2001 NASD Discip. LEXIS 30, at *15 (NAC Aug. 15, 2001), *aff'd*, Exchange Act Rel. No. 47476, 2003 SEC LEXIS 566 (Mar. 10, 2003).

Two elements are necessary to demonstrate excessive trading. First, the registered representative must have control over the customer's account. *See Harry Gliksman*, 54 S.E.C. 471, 475 (1999), *aff'd*, 24 F. App'x 704 (9th Cir. 2001). Control over a customer's account is established if the account is discretionary. *See Peter C. Bucchieri*, 52 S.E.C. 800, 805 n.11 (1996). In the absence of formal discretionary authority over an account, de facto control over a customer's account may satisfy this requirement if "a customer . . . so relies upon the broker that the latter is in a position to control the volume and frequency of transactions in the account." *John M. Reynolds*, 50 S.E.C. 805, 807 (1991); *Donald A. Roche*, 53 S.E.C. 16, 23 n.14 (1997) (holding that de facto control is established if the customer habitually follows the broker's advice). In addition, other factors considered in determining whether a broker exercises control

[8] *See James M. Russen, Jr.*, 51 S.E.C. 675, 678 & n.12 (1993) (noting approvingly in default case that NASD, rather than simply basing its conclusions on the allegations in the complaint, had reviewed the record evidence and determined that it supported a finding of violation); *Troy A. Wetter*, 51 S.E.C. 763, 767-68 (1993) (ruling in default case that the SEC could "conclude, on this record, that [the firm] effected only 5, rather than 30, securities transactions" and reducing sanctions).

[9] Indeed, IM-2310-2(b)(2) provides that "[s]ome practices that have resulted in disciplinary action and that clearly violate this responsibility for fair dealing [include] . . . Excessive activity in a customer's account, often referred to as 'churning' or 'overtrading.' There are no specific standards to measure excessiveness of activity in customer accounts because this must be related to the objectives and financial situation of the customer involved."

over a customer's account include: (1) the actual discretion given to the broker by the customer; (2) the age, education, intelligence, and investment experience of the customer; (3) the relationship between the customer and the broker; and (4) the reliance placed by the customer on the broker. *See Zaretsky v. E. F. Hutton & Co.*, 509 F. Supp. 68, 74 (S.D.N.Y. 1981).

Second, the level of activity in the account must be inconsistent with the customer's objectives and financial situation. "The starting point for such an inquiry is, of course, delineation of the customer's investment goals, for those objectives significantly illuminate the context in which the trading took place, and, indeed, form standards against which the allegations of excessiveness may be measured." *Costello v. Oppenheimer & Co.*, 711 F.2d 1361, 1368 (7th Cir. 1983). While there is no single test to determine whether trading is excessive, the turnover rate in the customer's account, the cost-to-equity ratio, the number and frequency of trades in the account, and "in-and-out"[10] trading in the account may all provide a basis for a finding of excessive trading. *See Gliksman*, 54 S.E.C. at 477. Where a broker has de facto control over a customer's account, a high turnover rate by itself may be sufficient to establish excessive trading. *See Pinchas*, 54 S.E.C. at 340 n.17 (*citing David A. Gingras*, 50 S.E.C. 1286, 1289 (1992)).

As set forth below, we find that the record supports the Hearing Officer's findings that Merhi's recommendations to JM[11] were unsuitable because Merhi controlled JM's account and because Merhi traded excessively in JM's account.

a. Merhi Exercised Control over JM's Account.

Although JM did not give Merhi formal written authority to exercise discretion in his account, the record demonstrates that JM granted Merhi oral authority to exercise discretion and, in fact, Merhi subsequently traded in JM's account without obtaining JM's authorization prior to executing each transaction. From late July 2002 through March 2003, Merhi made more than 70 trades in JM's account. This trading occurred after JM, in response to Merhi's inquiry as to whether it was necessary to contact JM prior to trading in JM's account, informed Merhi that if the trade "was a no-brainer and the trade was going to make money" Merhi could execute a trade without first contacting JM. In essence, JM turned over decision-making in his account to Merhi and relied upon Merhi to control the volume and frequency of transactions in the account. *See Gliksman*, 54 S.E.C. at 475 (finding that broker exercised control such that customer was unable to evaluate broker's recommendations and exercise independent judgment); *Reynolds*, 50 S.E.C. at 807 (finding that broker exercised control where customer relied on broker to manage account

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[10] "The term 'in and out' trading denotes the sale of all or part of a customer's portfolio, with the money reinvested in other securities, followed by the sale of the newly acquired securities. In and out trading is a practice extremely difficult for a broker to justify." *Gliksman*, 54 S.E.C. at 478 n.13 (citations omitted).

[11] There is no dispute that Merhi recommended the sales and purchases of the securities at issue in this case.

and let broker "run with" trades). During the relevant time period, the record indicates that only six calls totaling five minutes were made to JM from Newbridge's office. Merhi could not explain the small number of phone calls compared to the more than 70 trades executed in JM's account during the relevant time period to support his assertion that he contacted JM prior to each trade. We find that the record generally supports JM's assertion that Merhi did not discuss trades with him prior to effectuating such transactions, which further evidences Merhi's control over the account. *See Gliksman*, 54 S.E.C. at 475 (finding that respondent, who had "virtually no contact" with customer, controlled customer account).

Further, of all the trading in JM's account, JM personally requested that Merhi execute a trade on only one occasion, and this occurred prior to the conversation with Merhi in which JM granted Merhi oral discretion. *See Michael David Sweeney*, 50 S.E.C. 761, 765 (1991) (finding control where "[w]ith few exceptions, the customers did not initiate the transactions in their accounts").

As further support that Merhi exercised control over JM's account, the record establishes that JM was not sophisticated.[12] JM's account detail listed his educational experience as "some college," and JM did not have an investment background. JM had only limited investing experience with a mutual fund in his 401(k) account and some experience with limited partnerships. Further, JM had no experience with short-term trading. In light of the foregoing facts, and considering that Merhi generally made trades in JM's account without communicating with JM prior to each trade at issue, the record unequivocally demonstrates that Merhi had control over JM's account.[13]

b. Merhi Traded Excessively in JM's Account.

In light of JM's investment objective, and as reflected by the high turnover rate, the cost-to-equity ratio, and the in-and-out trading in JM's account, we affirm the Hearing Officer's determination that Merhi traded excessively in JM's account. First, the record generally indicates that JM's investment objective was to earn profits while taking a moderate amount of risk and not, as Merhi asserts, speculation. While JM's account summary—a document that JM did not prepare, sign, or review—lists speculation as his primary objective, this same document lists JM's risk tolerance as conservative. The only document that lists JM's primary investment objective as purely speculative is the new account worksheet created and signed by Merhi in

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[12] However, "even a sophisticated investor who blindly relinquishes all decisions to a broker may not be in control of his account." *Tiernan v. Blyth, Eastman, Dillon & Co.*, 719 F.2d 1, 3 (1st Cir. 1983).

[13] Merhi asserts that the only discretion he exercised in connection with JM's account was with respect to pricing and timing. As set forth herein, we reject this contention. However, even assuming that Merhi had discretion only with respect to pricing and timing, such limited discretion is another indication that Merhi had control over JM's account. *See O'Hare*, 2005 NASD Discip. LEXIS 39, at *16 n.14 (citing *Gliksman*, 54 S.E.C. at 476).

January 2003—five months *after* Merhi began trading excessively in JM's account. The preponderance of the evidence in the record leads us to conclude that JM's investment objective was to earn profit while taking a moderate amount of risk.[14]

Second, in light of JM's investment objectives, Merhi's trading in JM's account was clearly excessive. Although there is no fixed turnover rate that establishes excessive trading, generally a turnover rate of six or more indicates that excessive trading has occurred. *See Bucchieri*, 52 S.E.C. at 805.[15] In this case, the annual turnover rate in JM's account was 20.24—more than triple the turnover rate that is generally considered indicative of excessive trading. On this basis alone, the record supports the Hearing Officer's determination that Merhi traded excessively in JM's account. *See Pinchas*, 54 S.E.C. at 340 n.17.

Furthermore, the cost-to-equity ratio provides additional evidence that Merhi traded excessively in JM's account. We have previously held that "it is axiomatic that a cost-to-equity ratio of 20 percent or more generally indicates that excessive trading has occurred." *O'Hare*, 2005 NASD Discip. LEXIS 39, at *13. The cost-to-equity ratio of JM's account was 94.85% (meaning that JM's account would need to nearly double for JM to have earned a profit on the account). This cost-to-equity ratio is substantially more than the 20% ratio that is generally considered indicative of excessive trading, and "where a trading strategy results in costs so high as to make the generation of any profit unlikely, the trading is excessive." *See Clyde J. Bruff*, 53 S.E.C. 880, 885 (1998), *aff'd*, 198 F.3d 253 (9th Cir. 1999) (table format).

Finally, during the nine months at issue, Merhi engaged in more than 70 trades, and the majority of securities purchased were held for 30 days or less. Merhi's purchases and sales of securities, followed rapidly by further trading of those securities, reflect the in-and-out nature of Merhi's trading in JM's account. *See J.W. Barclay & Co.*, 2003 SEC LEXIS 2529, at *75 (Oct. 23, 2003) ("A pattern of in-and-out trading, showing that positions have been held only for a short period of time, is also an indicator of churning."); *Gliksman*, 54 S.E.C. at 478 (finding aggressive in-and-out trading where a majority of the trades during the relevant period were held open between zero and 30 days). Thus, the record overwhelmingly supports the Hearing Officer's finding that Merhi traded excessively in JM's account.

Although Merhi states that he has "never denied that [JM] traded often," nor "that there was a high turnover in [JM's] account," Merhi attempts to justify the trading in JM's account by

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[14] JM's sworn declaration states that his investment objective was to earn profits while taking a moderate amount of risk. However, and as set forth below, even if JM's primary investment objective was speculation, the egregious nature of the excessive trading in JM's account supports our findings.

[15] Turnover rates less than six, however, have triggered liability for excessive trading. *See, e.g.*, *Stephen Stout*, 54 S.E.C. 888, 912 (2000) (finding annualized turnover rates of 3.44 to 11.84 excessive, especially considering high cost-to-equity ratios); *Roche*, 53 S.E.C. at 21-22 (holding that turnover rates of 3.3, 4.6 and 7.2 provided strong support for excessive trading).

arguing that such trading was consistent with the trading in JM's account when the account was profitable, and that JM only complained when his account started losing money. Excessive trading, however, cannot be justified based upon a customer's prior transactions. *See Dist. Bus. Conduct Comm. v. Vaughan*, Complaint No. C07960105, 1998 NASD Discip. LEXIS 47, at *13 (NAC Oct. 22, 1998) (finding that customer's history of risky trading does not mitigate broker's conduct, as customer's prior transactions are irrelevant). Indeed, "even where a customer affirmatively seeks to engage in highly speculative or otherwise aggressive trading, a broker has a duty to refrain from making recommendations that are incompatible with the customer's financial situation and needs." *Chase*, 2001 NASD Discip. LEXIS 30, at *18; *see also Shearson Lehman Hutton Inc.*, 49 S.E.C. 1119, 1121 (1989) (affirming excessive trading with turnover rate of 7.4 where customer had asked that his account be handled aggressively and had objectives of capital gains and speculation, stating that "[t]here is a difference between aggressive investing and excessive trading"); *Eugene J. Erdos*, 47 S.E.C. 985, 989 (1983), *aff'd*, 742 F.2d 507 (9th Cir. 1984) (affirming excessive trading violation and stating that "the fact that [the customer] may have authorized the transactions in her account does not alter that conclusion").

Merhi further argues that Newbridge's internal review of the matter and alleged finding of no wrongdoing exonerates Merhi. Merhi's argument is without merit. Newbridge's alleged determination that Merhi committed no wrongdoing with respect to JM's account is irrelevant to NASD's independent determination that a violation has or has not occurred. Indeed, even had Newbridge and Merhi's direct supervisors approved each trade prior to Merhi's execution of such trade, this would not justify Merhi's excessive trading in JM's account. *See Pinchas*, 54 S.E.C. at 338 (rejecting a registered representative's argument that his supervisor's approval of trading ticket orders in account absolved representative of blame; "A registered representative is responsible for his actions and cannot shift that responsibility to the firm or his supervisors."). Further, the active account letter[16] sent by Newbridge to JM does not, as Merhi suggests, exonerate Merhi. Rather, the active account letter provides additional evidence that Merhi made excessive trades in JM's account. *See Sweeney*, 50 S.E.C. at 765 n.14 ("Further evidence that these accounts were excessively traded is found in DWR's own activity runs, which flagged these accounts numerous times due to the volume of trading, resulting in numerous activity letters from the branch manager to the customers."). Moreover, the account detail prepared by Newbridge in February 2003 provides additional evidence of the excessive trading in JM's account.

Finally, Merhi implies that because JM "was aware of each and every trade conducted in his account," Merhi's trading in JM's account did not violate NASD rules. Although JM received and reviewed monthly statements and trade confirmations in connection with his account, this fact alone does not preclude a finding of excessive trading, particularly where the customer is not sophisticated. *See, e.g.*, *Costello*, 711 F.2d at 1370 (declining to hold that customer, a college graduate and vice-president of a company with some trading experience, was

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[16] In addition to the active account letter sent to JM in February 2003, Newbridge sent a similar letter to JM in August 2002 in connection with his account held at Newbridge's prior clearing agent. *See supra*, note 7.

barred from asserting churning claim despite customer's receipt and examination of monthly statements and trading confirmations); *Hecht v. Harris, Upham & Co.*, 430 F.2d 1202, 1209 (9th Cir. 1970) (holding that customer who received trade confirmations, monthly statements, and who met regularly with broker and had other parties review her statements was not estopped from asserting an excessive trading claim); *George Inserra*, SEC Admin. Proceeding No. 3-6691, 1988 SEC LEXIS 1965, at *87 n.55 (Sept. 30, 1988) (citing *Hecht*, SEC rejects argument that customer's receipt of confirmation slips and monthly statements precludes finding of excessive trading). Accordingly, we reject Merhi's alleged defenses and find that the record demonstrates that Merhi traded excessively in JM's account, in violation of Conduct Rules 2310 and 2110,[17] and IM-2310-2(b)(2).

2. Merhi Exercised Discretion in JM's Account Without Prior Written Discretionary Authority.

The Hearing Officer determined that Merhi exercised discretion in JM's account without JM's prior written authority, in violation of Conduct Rules 2510(b) and 2110. After a thorough review of the record, we find that the evidence supports the Hearing Officer's findings.

Conduct Rule 2510(b) requires that a registered representative obtain written authorization from his or her customer, and written acceptance by such representative's member, prior to the representative's exercise of any discretionary power in a customer's account. As set forth above, we find that Merhi exercised discretion in JM's account after Merhi's conversation with JM in July or August 2002. Further, Merhi conceded at his on-the-record interview in December 2004 that he did not obtain JM's written authority. Thus, the record contains sufficient evidence to support the Hearing Officer's finding that Merhi violated Conduct Rule 2510(b).[18]

In the Appeal Letter and again in the June 8 Letter, Merhi states that he "never exercised discretion except for pricing and timing which was openly discussed with [JM.]" Conduct Rule 2510(d)(1) provides that a registered representative need not obtain prior written authorization

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[17] Conduct Rule 2110 requires observation of "high standards of commercial honor and just and equitable principles of trade." A violation of Conduct Rule 2310 is also a violation of Conduct Rule 2110. *See Dep't of Enforcement v. Belden*, Complaint No. C05010012, 2002 NASD Discip. LEXIS 12, at *13 (NAC Aug. 13, 2002), *aff'd*, Exchange Act Rel. No. 47859, 2003 SEC LEXIS 1154 (May 14, 2003). In addition, NASD Rule 115(a) imposes upon associated persons all duties and obligations of members.

[18] *Cf. Dep't of Enforcement v. Kapara*, Complaint No. C10030110, 2005 NASD Discip. LEXIS 41, at *21-22 (NAC May 25, 2005) (dismissing finding of Conduct Rule 2510(b) violation where "[t]he only independent evidence within the record in support of this cause of the complaint is the declaration of customer RV. . . . The record does not contain any circumstantial or direct evidence that Kapara failed to obtain written authorization to exercise discretionary control over RV's account.").

from either the customer or his or her member firm with respect to discretion granted as to the price at which, or the time when, a customer order shall be effectuated.[19] This exception to Conduct Rule 2510(b), however, does not apply to this case. First, as stated above, because Merhi made decisions concerning which securities to purchase and sell and not merely at what price or time to purchase or sell such securities, the exception does not apply. *See Scott E. Wiard*, Exchange Act Rel. No. 50393, 2004 SEC LEXIS 2112, at *12-13 (Sept. 16, 2004). Second, even assuming that Merhi exercised discretion only with respect to pricing and timing, the record is devoid of evidence indicating that Merhi had JM's authorization to exercise pricing and timing discretion. JM's general statement to Merhi that Merhi could invest in a particular stock if such investment "was a no-brainer" does not satisfy the requirements of Conduct Rule 2510(d)(1). *See Raghavan Sathianathan*, Exchange Act Rel. No. 54722, 2006 SEC LEXIS 2572, at *35 (Nov. 8, 2006) (holding that general strategy discussions are insufficient to establish pricing and timing discretion), *appeal docketed*, No. 07-1002 (D.C. Cir. Jan. 3, 2007). Consequently, we find that the pricing and timing exception does not apply to this case and that Merhi exercised discretion in JM's account without prior written authority, in violation of Conduct Rules 2510(b) and 2110.[20]

III. Procedural Issues

In the June 8 Letter, Merhi requested an explanation of why NASD was not pursuing Newbridge and individuals associated with Newbridge in connection with the alleged violations and other perceived wrongdoings. NASD has wide discretion in deciding against whom to proceed. *See Nicholas T. Avello*, 55 S.E.C. 1197, 1209 (2002), *aff'd*, 454 F.3d 619 (7th Cir. 2006). Indeed, NASD's failure to prosecute or investigate others does not absolve a respondent from complying with NASD rules. *See Dist. Bus. Conduct Comm. v. Van Clemens & Co.*, Complaint No. C04920012, 1993 NASD Discip. LEXIS 258, at *12 (NBCC Apr. 22, 1993). To the extent that Merhi argues that NASD has engaged in selective prosecution, he must demonstrate that: (1) he was singled out for enforcement while others similarly situated were not; and (2) such prosecution was motivated by arbitrary or unjust considerations (e.g., race, religion, or the desire to prevent the exercise of a constitutionally protected right). *See Terrance Yoshikawa*, Exchange Act Rel. No. 53731, 2006 SEC LEXIS 948, at *28-29 (Apr. 26, 2006). The record is devoid of evidence to support such a contention.

Finally, in the June 8 Letter, Merhi requests that NASD produce evidence in its possession related to the violations. We interpret Merhi's request as a request for the inspection and copying of documents pursuant to Procedural Rule 9251. The production of documents at

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[19] Conduct Rule 2510(d)(1) was amended effective January 31, 2005, to limit discretionary authority with respect to pricing and timing to the end of the business day it was granted, absent a specific, written indication signed by the customer. *See NASD Notice to Members 04-71* (Oct. 2004). We review Merhi's alleged defense under the rule in effect in 2002.

[20] A violation of Conduct Rule 2510 is also a violation of Conduct Rule 2110. *See Michael F. Flannigan*, Exchange Act Rel. No. 47142, 2003 SEC LEXIS 40, at *20 (Jan. 8, 2003).

this late stage, however, is inappropriate. Until Merhi noticed his appeal of the default decision, he ignored the proceedings against him. We will not, in contravention of Procedural Rule 9251, require Enforcement to now produce documents to Merhi in response to a request made more than nine months after Enforcement filed the complaint and after the Hearing Officer entered the default decision. Accordingly, we deny Merhi's request.

IV. Sanctions

In connection with Merhi's excessive trading violations, the Hearing Officer found that Merhi's conduct was egregious and that there were no mitigating circumstances that would justify a lesser sanction. The Hearing Officer thus imposed a bar upon Merhi in all capacities, and ordered Merhi to pay JM $28,454 in restitution. In light of the bar imposed upon Merhi for his excessive trading, the Hearing Officer did not impose any additional sanction for Merhi's exercise of discretion in JM's account without JM's prior written authority. After careful consideration, we affirm the Hearing Officer's sanctions.

A. Excessive Trading

For excessive trading violations, NASD's Sanction Guidelines ("Guidelines") suggest that the adjudicator should "[s]uspend respondent in any or all capacities for a period of 10 business days to one year. In egregious cases, consider a longer suspension (of up to two years) or a bar."[21] In addition, the Guidelines recommend that we consider ordering restitution where appropriate to remediate misconduct, and that we "may order restitution when an identifiable person, member firm or other party has suffered a quantifiable loss as a result of a respondent's misconduct, particularly where a respondent has benefited from the misconduct."[22] Restitution, an equitable remedy, seeks either to prevent a respondent from being unjustly enriched, or requires that the respondent return his victim to the position he or she occupied prior to the misconduct. *Charles E. French*, 52 S.E.C. 858, 864 (1996).

Upon consideration of the record in this case, the relevant Guidelines, the Principal Considerations in Determining Sanctions, and the General Principles applicable to all sanction determinations,[23] we affirm the sanctions imposed by the Hearing Officer. First, Merhi's conduct was egregious. Merhi executed more than 70 trades in JM's account during the nine-month period in question and thereby generated commissions for himself. Merhi's trading occurred after he sought and obtained oral discretion to trade in JM's account, although he later testified that he never executed any of the more than 70 trades in JM's account without first speaking with JM, contrary to the evidence in the record. The turnover rate in JM's account was

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21 *NASD Sanction Guidelines* 82 (2006), http://www.nasd.com/web/groups/enforcement/documents/enforcement/nasdw_011038.pdf [hereinafter *Guidelines*].

22 *Id.* at 4 (General Principles Applicable to All Sanction Determinations, No. 5).

23 *Guidelines*, at 2-7.

20.24—more than triple the turnover rate that generally indicates that excessive trading has occurred. Further, the cost-to-equity ratio of 94.85% is well above the 20% cost-to-equity ratio that is generally considered indicative of excessive trading. Clearly, Merhi's pattern of trading in JM's account was egregious.

Second, additional aggravating factors support the imposition of a bar for Merhi's egregious conduct. In connection with the trades executed by Merhi in JM's account, and in stark contrast to the losses suffered by JM, Merhi's misconduct resulted in substantial financial gains for Merhi—more than $20,000 in commissions. Merhi has not accepted any responsibility for his actions; in fact, Merhi asserts that he "regrets nothing he has done" and places the blame for the active trading and high turnover in the account on JM, Newbridge, and his supervisors. In light of the foregoing, and because the record does not support any mitigating factors, we find that a bar is necessary to protect the investing public. Thus, we affirm the Hearing Officer's bar of Merhi in all capacities.

In addition to the bar, we find that restitution to JM is appropriate and affirm the Hearing Officer's order that Merhi make restitution to JM in the amount of $28,454, which represents JM's quantifiable losses (comprised of realized losses on the trades in question and commissions paid by JM in connection with such trades). We further order that Merhi pay 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 July 16, 2002 until paid. *See O'Hare*, 2005 NASD Discip. LEXIS 39, at *23 (awarding restitution to customer in an amount approximately equal to customer's losses).

B. Exercising Discretion Without Written Authority

For exercising discretion without prior written authorization in violation of Conduct Rule 2510(b), the Guidelines suggest a suspension for 10 to 30 business days in egregious cases, and a fine of $2,500 to $10,000.[24] In light of the bar, the Hearing Officer did not impose any additional sanctions for this violation, although she indicated that Merhi's "conduct would merit a fine and suspension in the upper end of the recommended range[.]"

We agree with the Hearing Officer, as Merhi completely disregarded his obligations under Conduct Rule 2510(b) by failing to obtain written authority from JM to exercise discretion in his account. Indeed, Merhi's erroneous and factually baseless assertion that he properly exercised discretion with respect to pricing and timing demonstrates that Merhi has no understanding of Conduct Rule 2510 and his obligations thereunder. Moreover, Merhi abused JM's oral discretionary authority (granted by JM only after Merhi requested such authority over the telephone) by trading excessively in JM's account. As set forth above, Merhi's trading in JM's account resulted in losses of $28,454 to JM and commissions to Merhi of more than $20,000. Under the facts and circumstances of this case, and because the record does not support any mitigating factors, we agree that Merhi's exercise of discretion without prior written authority merits a fine and suspension in the upper end of the recommended ranges.

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[24] *Guidelines*, at 90.

Specifically, we find that it would be appropriate to impose a 30-business-day suspension, $10,000 fine, and an order that Merhi pay restitution to JM totaling $28,454 in connection with Merhi's exercise of discretion without prior written authority. In light of the bar imposed upon Merhi and the order that Merhi pay restitution in connection with his excessive trading, however, we consider the suspension and order to pay restitution redundant and do not impose them. In addition, in light of our policy determination that, in certain cases involving the imposition of a bar, no further remedial purpose is served by the additional imposition of a monetary sanction, we also do not impose a fine for Merhi's exercise of discretion without prior written authority.

V. Conclusion

We affirm the Hearing Officer's findings that Merhi traded excessively in JM's account, in violation of Conduct Rule 2310(b), Conduct Rule 2110, and IM-2310-2(b)(2), and exercised discretion in JM's account without written authority, in violation of Conduct Rules 2510(b) and 2110. Accordingly, we bar Merhi in all capacities and order Merhi to make restitution in the amount of $28,454, plus interest as set forth herein.[25]

On Behalf of the National Adjudicatory Council,

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Barbara Z. Sweeney, Senior Vice President and Corporate Secretary

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[25] The bar is effective as of the date of this decision. We have also considered and reject without discussion all other arguments advanced by the parties.