FINANCIAL INDUSTRY REGULATORY AUTHORITY
OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT, Complainant, v. ALAN J. DAVIDOFSKY (CRD No. 1389312), Respondent.	Disciplinary Proceeding No. 2008015934801 Hearing Officer—Andrew H. Perkins **HEARING PANEL DECISION** March 30, 2012

Respondent churned a customer's account, made quantitatively unsuitable recommendations, and effected unauthorized transactions. Respondent is barred and ordered to disgorge $11,741.78. In addition, Respondent is ordered to pay costs.

Appearances

For the DEPARTMENT OF ENFORCEMENT, Complainant, Sarah B. Belter, Esq., New Orleans, LA, and David B. Klafter, Esq., Boca Raton, FL.

Alan J. Davidofsky, Respondent, pro se.

DECISION

I. INTRODUCTION

Respondent Alan J. Davidofsky ("Davidofsky") was a registered representative with Oppenheimer & Co., Inc. ("Oppenheimer" or the "Firm") from November 2004 until November 2008. Oppenheimer discharged Davidofsky on November 7, 2008, after the Firm determined that he had engaged in unauthorized trading in customer JL's account. On November 26, 2008, Oppenheimer filed a Uniform Termination Notice for Securities Industry Registration (Form U5) with FINRA, which disclosed that Oppenheimer had discharged Davidofsky for unauthorized trading. FINRA opened an

investigation into the circumstances surrounding his discharge after FINRA received the Form U5, which investigation led to the Complaint in this proceeding.

The Department of Enforcement ("Enforcement") filed the Complaint on February 23, 2011. The Complaint alleges that, over nine months, Davidofsky executed 90 unauthorized and quantitatively unsuitable transactions in Customer JL's IRA securities account at Oppenheimer. There are three separate causes of action. In the first, Enforcement alleges that Davidofsky effected 90 unauthorized transactions in JL's IRA between December 2007 and October 2008, in violation of NASD Rule 2110 and Interpretive Material ("IM") 2310-2 (Fair Dealing with Customers). The second cause of action alleges that the same 90 trades were quantitatively unsuitable, in violation of NASD Rules 2110, 2310, and IM-2310-2. Finally, in the third cause of action, Enforcement alleges that Davidofsky's trading was fraudulently excessive, in violation of Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act"), SEC Rule 10b-5, and NASD Rules 2120 and 2110.

On April 14, 2011, Davidofsky filed an Answer with the Office of Hearing Officers. Davidofsky denied the charges in the Complaint and requested a hearing.

At Davidofsky's request the hearing was held in Boca Raton, Florida, on December 6 and 7, 2011. The Hearing Panel was composed of the Hearing Officer, a current member of FINRA's District 9 Committee, and a former member of FINRA's District 7 Committee. The parties submitted 35 joint exhibits, all of which were admitted into evidence.[1] In addition, Enforcement's exhibits CX-1, CX-3, CX-4, CX-5, and CX-7, and Davidofsky's exhibits RX-1, RX-8, RX-14, and RX-16 were admitted into evidence. Enforcement presented testimony from four witnesses. Davidofsky testified in his defense and presented testimony from two other witnesses.

[1] The joint exhibits are marked "JX," Enforcement's exhibits are marked "CX," and Davidofsky's exhibits are marked "RX." The hearing transcript is cited as "Tr."

For the reasons discussed below, the Hearing Panel found that Davidofsky committed the violations alleged in the Complaint.

II. FINDINGS OF FACT

A. Davidofsky's Background

Respondent began his career in the securities industry in 1985 at which time he registered with FINRA (formerly NASD) as a General Securities Representative. Between 1985 and 2004, Davidofsky was associated with a number of FINRA-registered firms. In 2004, Davidofsky relocated his family from New York to Florida. Shortly after the move, Oppenheimer recruited him to join the firm, which he did in November 2004.[2]

Davidofsky was associated with Oppenheimer from November 19, 2004, until November 7, 2008, at which time Oppenheimer discharged him for effecting unauthorized trades in customer JL's account.[3] After leaving Oppenheimer, Davidofsky was associated with two other FINRA-registered firms. He left the last firm in February 2011, and his last FINRA registration terminated effective March 1, 2011.[4] He is not currently associated with a FINRA-registered firm.

When Davidofsky moved to Oppenheimer in 2004, he brought a book of business with him.[5] In return, Oppenheimer gave Davidofsky an upfront signing bonus structured as a five-year forgivable loan.[6] Under the arrangement, Oppenheimer forgave a portion of the debt each month.[7] If Davidofsky left for any reason before the end of the five-year term, he would be required to repay the balance then due.

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[2] Tr. 351.

[3] CX-1, at 3.

[4] Id. at 2.

[5] Tr. 351.

[6] Tr. 392.

[7] *Id.*

At first, Davidofsky did relatively well. However, by 2006 he had lost two of his largest accounts.[8] Thereafter, Davidofsky struggled personally and financially. In 2008, Davidofsky's personal and business finances worsened, putting him under considerable stress. His commissions were down, and by the spring of 2008 he was working on a plan to file for bankruptcy protection.[9] A critical component of this plan was his continued employment with Oppenheimer. As a result, in April and May 2008, he was in negotiations with Oppenheimer to obtain its approval.[10] In addition, as 2008 progressed, Davidofsky knew that he faced a further reduction in his pay in September 2008 because his production was not hitting the target Oppenheimer had set for him at the beginning of the year.[11] According to Davidofsky, Oppenheimer had warned him that he needed to "get [his] numbers up."[12]

During the same period, Davidofsky was the subject of four customer complaints. Oppenheimer's records indicate that between August 2006 and April 2008, the firm received customer complaints from four different customers; each alleged that Davidofsky had effected unauthorized trades.[13] As a result, in May 2008, Oppenheimer placed Davidofsky on heightened supervision.[14] Under the heightened supervision plan, Davidofsky was required to document every conversation he had with his clients on Insight, the firm's database management system.[15]

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[8] Tr. 352.

[9] Tr. 389-90, 392. Davidofsky filed for bankruptcy in September 2008. The bankruptcy court issued a discharge order in February 2009. (JX-34, at 100-01, 272.)

[10] Tr. 389-90.

[11] Tr. 393.

[12] JX-34, at 204.

[13] JX-2, at 2.

[14] JX-2, at 1; JX-3.

[15] JX-3, at 1.

B. JL's Oppenheimer IRA Account

1. JL's Financial Background

JL lives in Massachusetts. She is a college graduate with a degree in mass communications. She also did some graduate work at Boston University in broadcasting and film. Throughout most of her work history she was self-employed. She developed and produced multimedia training and marketing materials for corporations.[16] Since 2003, she also worked for her sister's company, which does educational consulting.[17]

JL described her investment experience before 2004 as relatively limited.[18] She testified that she started investing in the 1970s with a small account at DWS Scudder.[19] She described her investment experience since then as generally limited to growth and income funds, which she traded infrequently.[20] Her DWS account records reflect that she had two small retirement accounts with the firm in 2007 and 2008. JL had less than $1,000 in her Roth IRA account and approximately $33,000 in her traditional IRA account.[21] In addition, she had both a Roth IRA and a traditional IRA at Fidelity Investments, worth approximately $13,000,[22] and another traditional IRA at Charles Schwab, worth approximately $6,000.[23]

In about 2000, JL and her sister inherited some money from their father, which they wanted to invest and use the income to benefit their mother.[24] JL's sister suggested

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[16] Tr. 25-26.

[17] Tr. 25.

[18] Tr. 26.

[19] Tr. 26.

[20] *Id.*

[21] JX-25; JX-29.

[22] JX-30.

[23] JX-31.

[24] Tr. 50.

that they contact Charles Shalmi ("Shalmi"), a broker at Advest who had helped JL's sister with some bond trading.[25]

JL opened a joint investment account with Shalmi at Advest (the "Joint Account"), which was owned jointly by JL, her sister, and their mother. Although JL designated her mother as the owner of the account for tax purposes, JL received duplicate copies of the statements and confirmations and made most of the investment decisions in the account based on Shalmi's recommendations.[26] JL also opened two other accounts for her mother,[27] as well as two accounts in her own name—a regular securities account and an IRA account.[28]

In February 2004, Shalmi left Advest and joined Oppenheimer, at which time he brought all of JL's and her mother's accounts with him.[29] It was at this time that Shalmi opened JL's Oppenheimer IRA account that is the subject of this proceeding.[30]

JL's account opening document and other evidence established JL's financial situation at the time she opened the accounts at Oppenheimer with Shalmi. The account documentation identified JL as a single 57-year old with no dependents and ten years investment experience with equities, mutual funds, and municipals. The account document reflected that JL had been self-employed for ten years and earned an annual income of $50,000.[31] At the hearing, she testified that her annual income was closer to $63,000 at the time in question.

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[25] Tr. 27.

[26] JX-17

[27] Tr. 28.

[28] *Id.*

[29] Tr. 27, 401.

[30] JX-11 (new account form dated February 26, 2004).

[31] *Id.*

With respect to her assets and net worth, the new account form indicated that her total net worth was approximately $300,000 and that her liquid net worth ("Exclusive of Home, Auto, Etc.") was $10,000.[32] Her account records reflect that most of her investment assets consisted of the securities in her IRA account. The asset value of her IRA account at the end of December 2007 was approximately $126,000.[33]

2. Davidofsky is Assigned JL's Account

In March 2007, Shalmi had to discontinue handling JL's IRA account because he was no longer able to keep his Massachusetts securities license.[34] Shalmi recommended that Davidofsky take over JL's accounts because Davidofsky and he were friends, and Shalmi considered Davidofsky to be a fine broker.[35] Shalmi continued to service JL's mother's accounts, including the Joint Account.

When Davidofsky took over JL's IRA account, he promptly conducted a review of the account and spoke to Shalmi about JL. During his on-the-record interview, Davidofsky explained that he wanted to get some background information and learn what type of person JL was.[36] Davidofsky further stated that JL asked him to review her portfolio.[37] Davidofsky saw that JL's objectives did not match the holdings in her account. Based on the nature of the holdings in the IRA, Davidofsky concluded that JL "was completely wrong [about] her stated objectives."[38] Davidofsky told JL this during their first conversation.[39] He went over the various holdings, pointing out that he did not

[32] JX-11.

[33] JX-14, at 1.

[34] Tr. 407.

[35] Tr. 408.

[36] JX-34, at 15.

[37] *Id.*

[38] JX-34, at 104.

[39] Tr. 354-55.

believe that she had a conservative portfolio. For example, he highlighted that she owned two junk bonds and some closed-end funds.[40]

JL generally confirmed Davidofsky's account of their initial conversation. JL testified that Davidofsky called her on her cell phone while she was at a convention. JL recalled that Davidofsky told her that he had gone over her IRA account and that he questioned some of the investments Shalmi had recommended.[41] She further recalled that Davidofsky recommended that she purchase BlackRock Global Equity Income Fund, which she approved.[42] She was not able to recall if Davidofsky had suggested any other changes to her IRA.

3. JL's Investment Objectives

There is conflicting evidence concerning JL's investment objectives. The new account form originally reflected that JL's investment objectives were "current income (conservative)" and "capital appreciation (conservative)."[43] At the hearing, JL testified that those were her investment objectives throughout the time she had the Oppenheimer IRA account.[44] However, the securities in the account did not match those conservative objectives. Shalmi testified that from the time he opened the account he recommended and purchased aggressive funds for the account.[45] Shalmi could not remember why his recommendations did not more closely match her stated investment objectives.[46]

In June 2008, after Davidofsky had taken over the account, JL's IRA account documents were amended to change her investment objectives to "current income

[40] Tr. 355.

[41] Tr. 101-02.

[42] Tr. 102.

[43] JX-11, at 3.

[44] Tr. 34-35.

[45] Tr. 403-04.

[46] Tr. 404.

(aggressive)"; "capital appreciation (aggressive)"; and "short term trading."[47] Oppenheimer sent JL notice of the changes to her IRA account in her June 2008 account statement.[48] The notice was included among some boilerplate disclosures at the end of the statement. However, JL claimed that she neither initiated nor approved any changes to her investment objectives.[49] JL testified that she did not open her statements for the period at issue and thus claimed that she would not have seen the verification notice of the changes.

Davidofsky did not claim to have a clear recollection of how the change came about. Nonetheless, he explained during his on-the-record interview that when he spoke to JL initially, he told her what *his* goals were for her.[50] As Davidofsky put it, he would have changed her objectives because of the current ratings of the bonds she held in the account.[51]

> And as far as short-term trading, I said to her, as I do with most people, … short-term trading [is not] day trading. If there is an opportunity … within your risk parameters, … you shouldn't be afraid to take a profit, especially on a retirement account where it is tax deferred. So although it is checked off … I never really maintained it for her to be the top priority. I felt her most important priority would be the capital appreciation.[52]

Davidofsky testified during his on-the-record interview that he thought he had updated JL's investment objectives before June 2008 because her conservative designation made "absolutely no sense."[53] Katie Saia, Oppenheimer's Branch Administrative Manager at the Boca Raton office, had a different recollection. She

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[47] JX-11, at 1.

[48] JX-14, at 39.

[49] Tr. 35.

[50] JX-34, at 106.

[51] JX-34, at 106-07.

[52] JX-34, at 107.

[53] JX-34, at 111.

testified that JL's IRA appeared on an account activity report in June 2008.[54] When Saia saw the report, she attempted to contact JL by telephone. Saia reached JL, but JL said that she did not have time to speak and that she would call Saia back. JL however never returned Saia's call.[55] Although Saia was not able to confirm that JL approved of the change, Saia nonetheless processed the change to the account on June 16, 2008. When JL did not call back, Saia tried again to reach JL in August 2008. This time, Saia left a voicemail message for JL. JL did not return that call either. Accordingly, Saia was not able to confirm that JL approved the change in her IRA account profile. In addition, although Saia testified that she would not have made the change unless Davidofsky told her that JL had approved it, Saia did not have a specific recollection of such a conversation.

Regardless of which version is the more accurate, the Hearing Panel concluded that JL did not change her investment objectives to aggressive, short-term trading. While Davidofsky correctly observed that JL's IRA holdings did not fit a very conservative profile, that fact did not support his conclusion that JL was wrong in describing her investment objectives as "current income (conservative)" and "capital appreciation (conservative)." Indeed, Davidofsky conceded that he knew that JL's primary priority was capital appreciation. In addition, JL's limited activity in her other accounts support her contention that she did not change her objectives or wish to engage in short-term trading. JL testified that she followed Shalmi's recommendations 90 percent of the time.[56] Shalmi generally confirmed her testimony. He stated that she usually accepted his recommendations although there were "a couple of times" that she did not because she considered them too aggressive.[57] She also did not understand that the funds Shalmi had

[54] Tr. 307-08.

[55] Tr. 308.

[56] Tr. 58.

[57] Tr. 410.

recommended could be considered risky. When she was asked about the securities in her accounts, she testified that she considered them conservative because they earned less than ten percent per year.[58] JL did not appear to have a greater understanding of the nature of her investments. Nevertheless, near the end of 2007, Davidofsky decided to initiate a new short-term trading strategy in JL's account.

C. Davidofsky Devises a New Trading Strategy

Davidofsky sought to "reinvent" himself in late 2007.[59] At his on-the-record interview Davidofsky explained that what he meant by "reinvent" was that he was trying to "brand" himself at Oppenheimer because he was thinking of spending the rest of his career there.[60] Along with an effort to step up better communications with his customers, Davidofsky settled on a new trading strategy for his clients. Under this strategy, Davidofsky tried to "take advantage of the turns in the market."[61] He looked for brand name companies—particularly financial companies—that were trading 25 to 40 percent off their highs.[62] Davidofsky reasoned that "if they're all being recommended [by all Wall Street analysts] at, say, $50.00 a share … and at $30.00 a share the analysts are still recommending them, that's a bargain."[63]

Davidofsky also turned to preferred stocks to increase short-term returns. He had noted that many preferred stocks from "financial companies, mortgage companies, etcetera, … were trading [at] $22.00, $20.00 and below, and [their] stories [hadn't] changed."[64] Davidofsky saw this as an opportunity because "many of these preferred

[58] Tr. 91.

[59] Tr. 276.

[60] JX-34, at 164.

[61] Tr. 362.

[62] Tr. 360-61.

[63] Tr. 361.

[64] Tr. 364.

stocks were trading at extraordinary yields and discounts to their coupon."[65] He reasoned that if he could "could buy a preferred stock at $20.00, on or around the time they are going to declare a dividend, which is every three months, [he had] the chance[] of collecting a dividend and holding onto the stock and selling it for capital appreciation."[66] Davidofsky testified that he represented to JL that this was a "win-win scenario."[67] Davidofsky further testified that he told JL about his new strategy, and she said that "it was a little bit riskier than what she was used to, but she was not against the idea."[68] Importantly, Davidofsky did not testify that JL specifically authorized him to employ the new riskier strategy in her IRA account. Nonetheless, Davidofsky did go ahead and use the strategy for her account starting in December 2007.

At the hearing, Davidofsky conceded that it was this "poorly executed trading strategy" that caused the losses in JL's account.[69] Nonetheless, he believed that "the recommended selling had to occur,"[70] because timed selling was the critical tool he employed to limit losses in customers' accounts under his new trading strategy.[71] He testified that if he did not continue selling, JL "would have been even worse off sooner rather than later."[72]

D. Davidofsky's Activity in JL's Oppenheimer IRA Account

The frequency and style of trading did not change immediately after Davidofsky was assigned to JL's IRA account. In the second half of 2007, Davidofsky effected six

[65] Tr. 365.

[66] Tr. 365.

[67] Tr. 365.

[68] Tr. 363.

[69] Tr. 397.

[70] Tr. 389.

[71] JX-34, at 170.

[72] Tr. 389.

trades in the account,[73] which activity level was generally consistent with past activity in her accounts. Beginning in December 2007, Davidofsky's trading and commissions increased dramatically. From December 1, 2007, through September 30, 2008, Davidofsky effected 104 transactions in 38 securities.[74] Davidofsky effected trades on a substantial number of days—61 days during the review period, and he often made multiple trades a day. The transactions totaled more than $1.4 million; the purchases totaled $759,915.59.[75] Ninety of the transactions generated $31,311.42 in commissions, of which $11,741.78 went to Davidofsky.[76] In 2008, approximately 18% of Davidofsky's total commissions came from the trading in JL's IRA.[77]

Davidofsky's trading in a number of securities evidenced a strategy of "in-and-out trading."[78] For example, Davidofsky bought and sold 4350 shares of Evergreen Solar, Inc. in eight transactions between January 2 and July 28, 2008. Davidofsky bought and sold 3050 shares of Agfeed Industries, Inc. in ten transactions between April 18 and September 4, 2008. In some instances, Davidofsky resold securities in as few as two days, and often held securities for less than a few weeks. On December 5, 2007, Davidofsky bought 1100 shares of Canadian Solar, Inc., which he sold two days later. And on August 13, 2008, he bought 750 shares of Lehman Brothers Holdings, Inc., which he sold two days later. Likewise, on January 28, 2008, Davidofsky bought 3500 shares of Pacific Ethanol Inc., which he sold two days later. Furthermore, a clear pattern

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[73] Tr. 175.

[74] CX-4. One trade is not counted because it was canceled immediately. Thirteen other trades are not included in Enforcement's analysis because no commission was charged on the transactions.

[75] JX-32.

[76] Tr. 196-97. Enforcement excluded 14 trades from its analysis for which no commissions were charged.

[77] Tr. 197-98.

[78] "In-and-out trading" is the sale of all or part of the securities in an account, reinvestment of the sale proceeds in other securities, followed by the sale of the newly acquired securities. *Richard G. Cody*, Exchange Act Rel. No. 64565, 2011 SEC LEXIS 1862, at *47 n.39 (May 27, 2011).

of short-term trading was evident in trades Davidofsky executed for several other issues, including: KB Home; Lord Abbett Affiliated Fund; Wachovia Corp New; Washington Mutual Inc.; and Ambac Financial Group, Inc.[79]

Davidofsky considered this rapid trading—even day trading—to be consistent with JL's financial needs and objectives. However, his explanation did not take those factors into account. Instead, Davidofsky focused on the volatile market conditions at the time.[80] He conceded that in a less volatile market his strategy would not have been appropriate for JL.[81] In effect, his position was that the difficult market conditions forced him to employ a riskier strategy than what was otherwise warranted in her account.

David N. Morantez ("Morantez"), a Principal Examiner in FINRA's New Orleans office, testified that he performed an analysis of the activity in JL's Oppenheimer IRA account between December 1, 2007 and September 30, 2008.[82] The results of his analysis are set out in Exhibit JX-32. Morantez determined that the average month-end equity in the IRA was $83,760.64, the annualized turnover ratio was 10.89, and the annualized commission-to-equity ratio was 44.86 percent. Morantez's analysis further showed that JL's IRA balance declined by approximately $108,000 over the review period. Marantez attributed most of the losses in the IRA to the commissions and the rapid trading.[83] Enforcement did not allocate any of the declines to market conditions.

Davidofsky and JL gave strikingly differing testimony regarding Davidofsky's authority to effect the trades he made. Davidofsky claimed that he spoke to JL before each and every transaction.[84] He further maintained that he made each call on his office

[79] CX-4.

[80] JX-34, at 178.

[81] JX-34, at 178-79.

[82] Tr. 176.

[83] Tr. 231-32.

[84] Tr. 272-73.

telephone. Davidofsky flatly denied exercising any discretion in the account.[85] JL, on the other hand, claimed that she spoke to Davidofsky no more than six times between March 2007 and October 2008.[86] JL further testified that in only three or four of these conversations did Davidofsky make any recommendations regarding her IRA.[87] A few other calls took place in April 2008 when JL sought to correct an overfunding in her IRA.[88] JL admitted that she approved a few purchases, such as Blackrock Global Equity Income Trust, Evergreen, and Lord Abbett Affiliated Fund, but she claimed that she never approved any sales.[89] Finally, JL testified that she never gave Davidofsky discretionary authority to execute trades in her account.[90]

JL testified that she discovered the unauthorized activity in her account in October 2008, when she first reviewed her statements.[91] JL explained that she did not open her account statements and confirmations notices as they arrived because she did not feel a need to do so.[92] First, she believed the Oppenheimer mailings related to the activity in the Joint Account because she was making trades in that account based upon Shalmi's recommendations.[93] Second, she thought review was unnecessary because she had intended to employ a buy-and-hold strategy with mutual funds.[94] JL testified that for the most part she had rejected purchasing individual stocks because she thought that they had

[85] Tr. 273.

[86] Tr. 30, 60-61.

[87] Tr. 60.

[88] Tr. 60; JX-4, at 10.

[89] Tr. 107, 113.

[90] Tr. 32.

[91] Tr. 35-36.

[92] Tr. 39-40.

[93] Tr. 69. JL also testified that she could not recall opening the account statements for the Joint Account. Tr. 48.

[94] Tr. 42, 126.

gone as high as they were going to go.[95] Accordingly, she did not believe there was any activity that needed her attention. She also testified that she had the least interest in reviewing the Oppenheimer statements because they contained so many pages, whereas her other statements were just a page or so.[96]

JL was finally prompted to review her account statements after the steep market decline in September 2008 and some friends had told her of the losses they had sustained due to the September market crash.[97] When she opened the statements in October 2008, she found that she had lost approximately 90 percent of the value of her IRA. She also claimed that she did not recognize many of the securities in her account.[98] She immediately emailed Davidofsky and told him that she would call him later that day to discuss her findings.[99] JL also complained to Oppenheimer, which investigated her complaint. Following the investigation, Oppenheimer entered into a settlement agreement and paid her $100,000 "as a refund for account losses."[100]

E. Oppenheimer's Telephone Records Do Not Support Davidofsky's Claim That He Spoke to JL Before Each Trade.

In November 2008, Saia asked Oppenheimer's telecommunications department to search for records of all telephone calls between the two general branch office telephone numbers[101] and JL's telephone numbers for the period of November 2007 through November 2008.[102] Kevin Blunnie ("Blunnie"), Oppenheimer's Senior Director of

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[95] Tr. 125.

[96] Tr. 72.

[97] Tr. 127.

[98] Tr. 35.

[99] JX-4, at 23.

[100] JX-35, at 1.

[101] All outgoing calls from the Boca Raton branch office were routed through the branch's two general numbers: 561-416-4958 and 561-416-8600. CX-1, at 2 (Blunnie Aff. ¶ 10).

[102] CX-1, at 1.

Communications, completed the search, the results of which Oppenheimer provided to Enforcement in June 2011. The relevant call detail reports are contained in exhibit CX-1.

In December 2011, shortly before the scheduled hearing, Blunnie produced a corrected list of telephone calls, which was marked as exhibit CX-3. Blunnie testified that he conducted the second search in December 2011 because Oppenheimer's telephone carrier sometimes incorrectly attributes branch office telephone calls to the wrong branch office. Thus, Blunnie had his assistant perform a nationwide search of all traffic between the same telephone numbers, as well as the toll free number for the Boca Raton branch office.[103] The second search uncovered an additional six calls.[104]

Enforcement then compared the phone calls between the Boca Raton office and JL with the trade dates for the trades Davidofsky effected in JL's IRA. Enforcement was able to match only ten calls with corresponding trades.[105] There are no telephone records that correspond to the remaining trades at issue.

III. CONCLUSIONS OF LAW

A. Davidofsky Effected Unauthorized Transactions in JL's Account

Unauthorized trading in a customer's account is a "fundamental betrayal of the duty owed by a salesman to his customers"[106] and a serious violation of Rule 2110, which

[103] Tr. 145.

[104] Tr. 146. The additional calls were on December 11, 2007, April 14 and 18, 2008, and August 14, 15, and 18, 2008.

[105] CX-4. No commission was charged on the Federal National Mortgage Association trade dated September 15, 2008. CX-4, at 11.

[106] *Keith L. DeSanto*, 52 S.E.C. 316, 323 (1995), *aff'd*, 101 F.3d 108 (2d Cir. 1996) (unpublished table decision) quoted in *Dep't of Enforcement v. Haq*, No. ELI2004026701, 2009 FINRA Discip. LEXIS 3, at *15-16 (Apr. 6, 2009).

requires that a member "shall observe high standards of commercial honor and just and equitable principles of trade."[107]

Here, the record established that Davidofsky effected 104 transactions in JL's IRA between December 1, 2007, and October 1, 2008, one of which appears to have been an error and was cancelled. Enforcement alleged that 90 of the transactions were unauthorized. Enforcement excluded transactions for which no commission is shown in the account records.[108]

The Hearing Panel excluded eight additional transactions because the updated telephone records Oppenheimer provided Enforcement shortly before the hearing reflected calls between JL and Davidofsky at about the same time as those eight transactions. Although there is no evidence of the substance of Davidofsky and JL's discussions on those eight telephone calls, the Hearing Panel nonetheless considered the possibility that JL could have approved the transactions that appear close in time to the calls.

The Hearing Panel concluded that JL did not authorize the remaining 82 transactions. The Hearing Panel found that JL's testimony that she spoke to Davidofsky a limited number of times between December 2007 and October 2008 to be credible and supported by the documentary evidence. Foremost, the Hearing Panel found the Oppenheimer telephone records to be reliable evidence that Davidofsky did not get JL's approval for the 82 transactions.[109] Davidofsky claimed that with one exception he always

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[107] *Haq*, 2009 FINRA Discip. LEXIS 3, at *15 (citations omitted). NASD Rule 0115 makes all FINRA rules, including Rule 2110, applicable to both FINRA members and all persons associated with FINRA members.

[108] Tr. 186. Morantez testified that he excluded 12 trades from the 102 listed on exhibit CX-4. The Hearing Panel found that there were 104 transactions listed on exhibit CX-4, 14 of which showed no commission. The Hearing Panel considered the discrepancy to be immaterial for the purposes of the analysis of the activity in the account because the Complaint focused on the same remaining 90 trades.

[109] *See Haq*, 2009 FINRA Discip. LEXIS 3, at *18-19 (finding that the firm's telephone records supported the hearing panel's findings that the respondent had engaged in unauthorized trading).

called JL from his office telephone. In addition, he verified the accuracy of the telephone numbers Oppenheimer included in the telephone records searches. Although Davidofsky questioned the accuracy of Oppenheimer's telephone records, he offered no explanation for the fact that there were no telephone records for the 82 transactions. The Hearing Panel further found it significant that Oppenheimer's records showed no calls between Davidofsky and JL for the entire months of January, March, and July 2008.

The Hearing Panel also noted that the telephone records did correlate accurately to the records of transactions Shalmi made in JL's accounts during the same period. A comparison of Oppenheimer's telephone records (CX-3) to Shalmi's Insight notes (JX-19) shows eight out of nine transactions can be matched to a telephone call. The Hearing Panel considered this a strong indication of the reliability and accuracy of the telephone records Oppenheimer produced.

Finally, JL's testimony that she had not approved Davidofsky's trading in her IRA is supported by her trading history. Although her investments in her other accounts were not as conservative as she thought, the records show that she was not an active trader. Indeed, there is nothing in the pattern of her investing that would give credibility to Davidofsky's claim that she would have approved more than 100 transactions in ten months.

Accordingly, the Hearing Panel finds that Davidofsky violated NASD Rule 2110 and IM-2310-2 by effecting unauthorized transactions in JL's IRA between December 1, 2007, and October 1, 2008.

B. Davidofsky Engaged in Quantitatively Unsuitable (Excessive) Trading

NASD Rule 2310(a) provides that "[i]n recommending to a customer the purchase, sale or exchange of any security, a member shall have reasonable grounds for believing that the recommendation is suitable for such customer upon the basis of the facts, if any, disclosed by such customer as to his other security holdings and as to his

financial situation and needs."[110] Among the obligations under the suitability rule is "quantitative suitability," which focuses on "whether the number of transactions within a given timeframe is suitable in light of the customer's financial circumstances and investment objectives."[111] "A finding of quantitative unsuitability requires a showing of: (1) 'broker control over the account in question'; and (2) 'excessive trading activity inconsistent with the customer's financial circumstances and investment objectives.'"[112] In addition, a violation of the suitability rule requires proof that the respondent "recommended" the trades at issue. This requirement is satisfied "[w]hen a broker exercises discretion to make trades or engages in unauthorized trading … [because] such trades are considered to be implicitly recommended for purposes of the suitability rule."[113]

The Hearing Panel finds that Davidofsky controlled JL's IRA account and that he made an excessive number of trades in JL's IRA, which trading activity was inconsistent with JL's financial circumstances and investment objectives.

1. Davidofsky Controlled the Trading in JL's Account

The record demonstrates that Davidofsky controlled JL's IRA account between December 2007 and October 2008. As the Securities and Exchange Commission and FINRA's National Adjudicatory Council have said, "Unauthorized trading constitutes 'clear evidence of control' for the purposes of an excessive trading claim."[114] FINRA also

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[110] NASD Rules that apply to members, such as NASD Rule 2310, apply with equal force to FINRA members and their associated persons. NASD Rule 0115(a).

[111] *Dep't of Enforcement v. Medeck*, No. E9B2003033701, 2009 FINRA Discip. LEXIS 7, at *32 (NAC July 30, 2009).

[112] *Dep't of Enforcement v. Cody*, No. 2005003188901, 2010 FINRA Discip. LEXIS 8, at *33 (NAC May 10, 2010) (quoting *Medeck*, 2009 FINRA Discip. LEXIS 7, at *34).

[113] *Dep't of Enforcement v. Murphy*, No. 2005003610701, 2011 FINRA Discip. LEXIS 42, at *43 n.33 (NAC Oct. 20, 2011) (citations omitted).

[114] *Haq*, 2009 FINRA Discip. LEXIS 3, at *22-23 (quoting *Olde Disc. Corp.*, 53 S.E.C. 803, 832 (1998)).

has pointed out that courts often interpret unauthorized trading as a usurpation of control by a broker.[115] As discussed above, the evidence shows that at least 82 of the 90 trades listed in the Complaint were unauthorized.[116]

2. Davidofsky's Level of Trading in JL's Account was Excessive

The Hearing Panel next addressed the issue of whether there was excessive trading activity inconsistent with JL's financial circumstances and investment objectives. "Although there is no single test for what constitutes excessive activity, factors such as turnover rate, cost-to-equity ratio, and use of 'in and out' trading in an account may provide a basis for a finding of excessive trading."[117]

The Hearing Panel finds that the level that Davidofsky traded JL's IRA account was wholly inconsistent with her financial circumstances and objectives. The annualized turnover rate—the rate at which the securities in the account are sold and replaced on an annual basis—was 10.89, which is far higher than generally accepted rates. An annualized turnover rate greater than six is generally considered to evidence excessive trading.[118]

Another objective measure of the activity in JL's account is the annualized commission-to-equity ratio, which was 44.86 percent. The Hearing Panel finds that the commission-to-equity ratio is completely excessive. This ratio demonstrates that the account would have had to appreciate by almost 45 percent to break even. Significantly lower commission-to-equity ratios have supported excessive trading findings in other

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[115] *Haq*, 2009 FINRA Discip. LEXIS 3, at *23 (citing *Leib v. Merrill, Lynch, Pierce, Fenner & Smith, Inc*., 461 F. Supp. 951, 954 (E.D. Mich. 1978).

[116] *Cf. Gerald E. Donnelly*, 52 S.E.C. 600, 603-04 (1996) (finding that broker controlled account where he "exercised discretionary authority in 20 percent of the transactions" and where customers approved other transactions "simply on the basis of [the broker's] recommendations").

[117] *Medeck*, 2009 FINRA Discip. LEXIS 7, at *34-35.

[118] *Jack H. Stein*, Exchange Act Rel. No. 47335, 2003 SEC LEXIS 328, at *118 (Feb. 10, 2003).

cases.[119] Indeed, the SEC has ruled that a commission-to-equity ratio above 20 percent evidences excessive trading.[120]

The Hearing Panel also considered that Davidofsky did a substantial amount of in-and-out trading in the account, including some day trading. The high frequency of trading reinforces the Hearing Panel's conclusion that the trading was excessive.[121] In addition, the record reflects that Davidofsky implemented this high level of trading to benefit himself, not his customers. As discussed above, Davidofsky sought to reinvent himself in late 2007 because he had lost valued accounts and was under ever increasing financial pressure. Davidofsky needed to get his numbers up in order to meet Oppenheimer's expectations. Faced with falling revenue and personal bankruptcy, Davidofsky elected to trade JL's account to improve his numbers.

C. Davidofsky Churned JL's IRA Account

In the third cause of action, Enforcement alleged that Davidofsky's excessive trading was fraudulent. To prove fraudulent excessive trading (commonly referred to as "churning"), scienter must be shown.[122] "Scienter requires proof that a respondent intended to deceive, manipulate, or defraud, or 'acted with severe recklessness involving an extreme departure from the standards of ordinary care.'"[123] With regard to churning, scienter may be established by showing that "the activity and commissions were so

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[119] *Murphy*, 2011 FINRA Discip. LEXIS 42, at *47.

[120] *See, e.g.*, *Rafael Pinchas*, Exchange Act Rel. No. 41816, 1999 SEC LEXIS 1754, at *18 (Sept. 1, 1999) (explaining that "[w]e have previously found that a cost-to-equity ratio in excess of 20% indicates excessive trading").

[121] *See Stein*, 2003 SEC LEXIS 328, at *16 (stating that trading frequency is indicative of excessive trading).

[122] *Medeck*, 2009 FINRA Discip. LEXIS 7, at *34. Churning also violates a registered representative's responsibility of fair dealing. See IM-2310-2(b)(2).

[123] *Medeck*, 2009 FINRA Discip. LEXIS 7, at *34-35 (citing *Aaron v. SEC*, 446 U.S. 680, 686-87 n.5 (1980); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 (1976) and quoting *Dep't of Enforcement v. Reynolds*, No. CAF990018, 2001 NASD Discip. LEXIS 17, at *44 & n.27 (NAC June 25, 2001)).

unreasonable in light of the customer's investment objectives and financial situation that they evidence intentional misconduct or recklessness."[124]

The record demonstrates that Davidofsky effected the trading in JL's account with a reckless disregard of her interests. The trading costs were so high that JL had to earn more than 44 percent on an annualized basis just to break even. Davidofsky's trading generated more than $31,000 in commissions in ten months, which equaled approximately 25 percent of the original value of the account and approximately 37 percent of the average account equity. Equally reckless was the dollar amount of the trading in comparison to her income. JL was 57 years old, single, and self-employed, with an annual income of approximately $63,000 per year. Nonetheless, Davidofsky effected trades totaling more than $1.4 million in her IRA over the ten-month period. These facts led the Hearing Panel to conclude that Davidofsky effected the trades primarily for his benefit, without regard for JL's interest.

Davidofsky's disregard for JL's interests is further demonstrated by the benefit Davidofsky derived from his high volume of trading. The trading in JL's account generated a substantial portion of Davidofsky's income in 2008. As stated above, during a period when he was under significant pressure from Oppenheimer to increase his production, commissions from JL's account amounted to approximately 18 percent of his total income. Under Davidofsky's management, JL's account value dropped more than 80 percent in ten months, or by more than 50 percent before the market crash in September 2008.[125] Moreover, Davidofsky devised his new trading strategy for his

[124] *Medeck*, 2009 FINRA Discip. LEXIS 7, at *53. *See also Dep't of Enforcement v. Kelly*, No. E9A20004048801, 2008 FINRA Discip. LEXIS 48, at *18 (NAC Dec. 16, 2008) (holding that scienter "may be established by showing a broker's 'reckless disregard for the customers' interests'").

[125] Murphy, 2011 FINRA Discip. LEXIS 42, at *58 (finding that commissions equaling 42 percent of the average account equity and nearly 17 percent of respondent's salary supported the finding that respondent acted recklessly).

benefit. It was a central component of his plan to reinvent himself in the eyes of his Oppenheimer supervisors and secure his future with the firm. Davidofsky did not come up with the trading strategy to meet JL's financial needs and objectives. Such circumstances justify an inference that Murphy was acting merely to increase his own commissions.

Furthermore, as an experienced securities professional, Davidofsky knew that the level of trading was reckless in light of what he knew about JL. There was nothing in the account records that would support the level of trading he recommended. In addition, Davidofsky spoke to Shalmi, who had been JL's financial advisor for more than ten years, to learn more about JL. There is nothing in the record to support the conclusion that Shalmi would have indicated that day trading or in-an-out trading was a suitable strategy for JL's IRA.

Taken as a whole, the foregoing circumstances justify an inference that Davidofsky was acting merely to increase his own commissions. Accordingly, the Hearing Panel finds that Davidofsky excessively traded JL's IRA with scienter and thereby churned her account, in violation of Section 10(b) of the Exchange Act, SEC Rule 10b-5, and NASD Rules 2120 and 2110.

D. Davidofsky's Defense

Davidofsky's primary argument to excuse his unauthorized trading, excessive trading, and churning violations was to blame JL for ignoring her confirmations and monthly statements. This defense however lacks merit. Davidofsky's attempt to shift the blame to JL is "completely irrelevant to [Davidofsky's] responsibility for his own misconduct" and must be considered an "indicia of his failure to take responsibility for his actions."[126]

[126] *Clyde J. Bruff*, 53 S.E.C. 880, 887 (1998), aff'd, 1999 U.S. App. LEXIS 27405 (9th Cir. Oct. 18, 1999).

IV. SANCTIONS

A. Unauthorized Trading

The FINRA Sanction Guidelines ("Guidelines") for unauthorized transactions recommend a fine of $ 5,000 to $ 75,000 and a suspension from 10 business days to one year.[127] In egregious cases, the Guidelines suggest a longer suspension (of up to two years) or a bar. In addition to the "Principal Considerations in Determining Sanctions"[128] applicable to all sanctions determinations, the Guidelines for unauthorized transactions specifically direct Hearing Panels to consider: (1) whether the respondent misunderstood his or her authority or the terms of the customer's order; and (2) whether the unauthorized trading was egregious. To determine whether a respondent's unauthorized trading was egregious, the Guidelines note that the NAC has identified the following three categories of egregious unauthorized trading: (1) quantitatively egregious unauthorized trading, *i.e.*, unauthorized trading that is egregious because of the sheer number of unauthorized trades executed; (2) unauthorized trading accompanied by aggravating factors, such as, efforts to conceal the unauthorized trading, attempts to evade regulatory investigative efforts, customer loss, or a history of similar misconduct; and (3) qualitatively egregious unauthorized trading. Two factors are relevant to a determination as to whether unauthorized trading is qualitatively egregious: (1) the strength of the evidence, and (2) the respondent's motives; *i.e.*, whether the respondent acted in bad faith or as a result of a reasonable misunderstanding.[129]

First, the Hearing Panel determined that the level of trading in JL's IRA was not the result of any misunderstanding. Both Davidofsky and JL testified that they never discussed granting Davidofsky discretionary authority, and the telephone records

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[127] FINRA Sanction Guidelines 98 (2011), http://www.finra.org/web/groups/industry/@ip/@enf/@sg/documents/industry/p011038.pdf.

[128] Guidelines 6-7.

[129] Guidelines 98 n.2. *See, e.g., Daniel S. Hellen*, No. C3A970031, 1999 NASD Discip. LEXIS 22, at *15-24 (NAC June 15, 1999).

establish that Davidofsky did not speak to JL before he made no fewer than 82 trades between December 2007 and October 2008. Accordingly, Davidofsky could not have believed that he had authority to make the trades in question.

Second, the Hearing Panel found that the unauthorized trading was quantitatively egregious because of the sheer number of unauthorized trades Davidofsky executed. Davidofsky executed 82 unauthorized trades over a ten-month period. The Hearing Panel's finding is consistent with the NAC's prior findings of quantitatively egregious unauthorized trading in other cases.[130]

The Hearing Panel also found that Davidofsky's unauthorized trading was qualitatively egregious because he acted in bad faith. Specifically, the evidence in the record showed that he was motivated by self-interests. As discussed above, Oppenheimer had warned him that he needed to get his numbers up, and he was otherwise having what he called a very bad year. In addition, Davidofsky came up with the new trading strategy primarily to solidify his position at Oppenheimer, not to benefit his customers.[131] By so doing, Davidofsky "intentionally abrogated the duty he owed to his customer."[132] Furthermore, the evidence in the record shows that Davidofsky recorded notes in the firm's Insight database management system to conceal the fact that he was making the trades without obtaining JL's authorization.[133] At the time, Davidofsky was under

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[130] *Dep't of Mkt. Regulation vs. Field*, No. CMS040202, 2008 FINRA Discip. LEXIS 63, at *42-43 (NAC Sept. 23, 2008) (finding quantitatively egregious conduct for 15 trades); *Dep't of Enforcement v. Bond*, No. C10000210, 2002 NASD Discip. LEXIS 6, at *12 (NAC Apr. 4, 2002) (finding quantitatively egregious conduct for 12 unauthorized trades); *Dist. Bus. Conduct Comm. v. Levy*, No. C07960085, 1998 NASD Discip. LEXIS 22, at *11 (NAC Mar. 6, 1998) (finding quantitatively egregious conduct for 16 unauthorized trades). *Cf. Dep't of Enforcement v. Griffith*, No. C01040025, 2006 NASD Discip. LEXIS 30, at *25-26 (NAC Dec. 29, 2006) (finding that two unauthorized trades are not quantitatively egregious).

[131] *See, e.g., Dep't of Enforcement v. Wells*, No. C07970045, 1998 NASD Discip. LEXIS 32, at *6-7 (NAC July 24, 1998) (finding egregious unauthorized trading where the respondent effected the trades to "make some money" for himself).

[132] *Id.* at *7.

[133] Guidelines 7 (Principal Considerations in Determining Sanctions No. 10).

heightened supervision, and he knew that if he had another problem his position at Oppenheimer would be at jeopardy. Finally, the Hearing Panel found that JL's resulting loss was an aggravating factor.

In summary, the Hearing Panel found that Davidofsky's unauthorized trading, when viewed in its entirety, was egregious, and that the Guidelines' recommendation of a bar for egregious trading should apply.

B. Churning and Unsuitable Excessive Trading

The Guidelines for churning or excessive transactions recommend suspending a respondent in any or all capacities for ten business days to one year, and, in egregious cases, imposing a longer suspension up to two years or a bar. The Guidelines also recommend a fine of up to $75,000.[134] The Guidelines for unsuitable recommendations are identical except that the recommended minimum fine for a suitability violation is $2,500 as opposed to $5,000 for churning.[135]

The Hearing Panel concluded that Davidofsky's churning and unsuitable excessive trading violations were egregious for the same reasons the Hearing Panel set forth above in finding that Davidofsky's unauthorized transactions violation was egregious. In addition, the Hearing Panel found that Davidofsky recklessly churned JL's account for an extended period lasting approximately ten months.[136] Davidofsky gave no consideration to the excessive commission expenses that were depleting the account. Also, Davidofsky benefitted from his misconduct. As discussed above, the commissions he earned on JL's IRA equaled approximately 18 percent of his total commissions during the relevant period and were important to Davidofsky's scheme to improve his image

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[134] Guidelines 79.

[135] *Id.* 96.

[136] *Id.* 6, 7 (Principal Considerations in Determining Sanctions Nos. 9 and 13). *Cf. Dep't of Enforcement v. Kelly*, No. E9A2004048801, 2008 FINRA Discip. LEXIS 48, at *30-31 (Dec. 16, 2008) (churning over approximately one year considered to be egregious).

with his firm.[137] On the other hand, JL lost approximately $100,000 during the same period, or about 90 percent of the value of her account.[138] The Hearing Panel also took into consideration the fact that JL was a relatively unsophisticated investor.[139] Her account history reflects that she had not engaged previously in such rapid trading and did not desire to assume such a high degree of risk with her retirement account. Finally, Davidofsky did not accept responsibility for his violations; he instead blamed JL for failing to review her statements and confirmations.[140]

The Hearing Panel found no mitigating factors. Specifically, the Hearing Panel considered and rejected as mitigating the fact that his misconduct involved a single customer. Davidofsky's gross indifference to JL's overall interests overrides any arguable mitigation that could be found in the fact that he did not engage in the same misconduct in other customer accounts.[141]

The Hearing Panel concluded that to remedy Davidofsky's violations and protect the investing public, serious sanctions were needed. Accordingly, the Hearing Panel will bar Davidofsky for unsuitable excessive trading and churning.[142] In addition, the Hearing Panel will order Davidofsky to pay disgorgement in the amount of $11,741.78, which

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[137] Guidelines 7 (Principal Considerations in Determining Sanctions No. 17).

[138] *Id.* 6 (Principal Considerations in Determining Sanctions No. 11). Davidofsky argued that the losses in the account were largely attributable to the unusual market conditions in September 2008. While the Hearing Panel agrees that some of the loss JL suffered in September 2008 resulted from the market crash at the time, her loss would not have been nearly as large but for Davidofsky's misconduct. The adverse impact of the high commission expenses and undue concentration in financial stocks were attributable or worsened by Davidofsky's ill-conceived and inappropriate trading strategy. The commissions alone amounted to approximately 26 percent of the initial value of the account.

[139] Guidelines 7 (Principal Considerations in Determining Sanctions No. 19).

[140] *Id.* 6 (Principal Considerations in Determining Sanctions No. 2).

[141] *Cf. Kelly*, 2008 FINRA Discip. LEXIS 48, at *32 (misconduct was mitigated by the fact that it involved a single customer account and respondent was remorseful for his actions).

[142] The Hearing Panel aggregated the two violations for the purpose of determining sanctions because the violations resulted from a single, underlying problem. *See* Guidelines 4 (General Principles Applicable To All Sanction Determinations, No. 4).

equals the amount he received in commissions. "[D]isgorgement is intended to force wrongdoers to give up the amount by which they were unjustly enriched."[143] "Disgorgement is appropriate in all sales practice cases, even where an individual is barred, if, among other things, 'the respondent has retained substantial ill-gotten gains.'"[144]

V. ORDER

Alan J. Davidofsky is barred from associating in any capacity with any FINRA-registered firm for effecting unauthorized trades in JL's account, in violation of NASD Conduct Rule 2110 and IM-2310-2. Alan J. Davidofsky also is barred for unsuitable excessive trading, in violation of NASD Rules 2110, 2310, and IM-2310-2, and churning in violation of Section 10(b) of the Exchange Act, SEC Rule 10b-5, and NASD Rules 2120 and 2110. The bars shall become effective immediately if this decision becomes FINRA's final action.

In addition, Alan J. Davidofsky is fined $11,741.78, an amount that represents disgorgement. Finally, Alan J. Davidofsky is ordered to pay costs in the amount of $4,125.35, which includes an administrative fee of $750 and hearing transcript costs of

[143] *Murphy*, 2011 FINRA Discip. LEXIS 42, at *116 (quoting *Michael David Sweeney*, 50 S.E.C. 761, 768 (1991)).

[144] *Id.* (quoting Guidelines 10). Restitution also would be appropriate. However, the Hearing Panel has not ordered restitution because Oppenheimer paid JL for the losses she suffered in the account.

$3,375.35. The fine and costs shall be due on a date set by FINRA, but not sooner than 30 days after this decision becomes FINRA's final disciplinary action in this proceeding.[145]

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Andrew H. Perkins
Hearing Officer
For the Hearing Panel

Copies to:

Alan J. Davidofsky (*via electronic and first-class mail*)
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[145] The Hearing Panel has considered and rejects without discussion all other arguments of the parties.