FINANCIAL INDUSTRY REGULATORY AUTHORITY
OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT, Complainant, v. RANI T. JARKAS (CRD No. 2642904), and WILLIAM H. CARSON (CRD No. 722967), Respondents.	Disciplinary Proceeding No. 2009017899801 Hearing Officer – SNB **HEARING PANEL DECISION**[1] February 7, 2014

Respondent Carson caused the firm's net capital calculations to be inaccurate, in violation of NASD Rules 3110(a) and 2110 and FINRA Rule 2010; allowed the firm to conduct a securities business with insufficient net capital, in violation of NASD Rule 2110 and FINRA Rule 2010; filed inaccurate FOCUS Reports, in violation of NASD Rule 2110 and FINRA Rule 2010; and caused the firm to fail to notify the regulatory authorities that it had insufficient net capital, in violation of FINRA Rule 2010. Respondent Carson is suspended for two months as a FINOP, fined $5,000, and required to requalify as a FINOP.

Respondent Jarkas allowed the firm to conduct a securities business with insufficient net capital, in violation of NASD Rule 2110 and FINRA Rule 2010; failed to file an application for approval of a material change in business operations, in violation of NASD Rules 1017(a) and 2110; and failed to appear for testimony, in violation of FINRA Rules 8210 and 2010. Respondent Jarkas is barred for the failure to appear for testimony. In light of the bar, no further sanctions are imposed for his other violations.

[1] The Hearing Panel issued its decision on January 31, 2014, which decision was signed by the hearing officer who heard the case and participated in the decision. Following the hearing officer's retirement from FINRA, Jarkas filed an application to redact information about his medical history from the decision, which application was unopposed. The Deputy Chief Hearing Officer was then appointed as a replacement hearing officer pursuant to FINRA Rule 9231(e). Jarkas' application was granted, and the original decision was vacated. This decision incorporates the parties' agreed revisions. No other changes were made to the original decision. The Deputy Chief Hearing Officer did not participate in the decision.

Appearances

David Utevsky, Esq., and John Han, Esq., for the Department of Enforcement.

Robert J. Stumpf, Jr., Esq., for Respondent Rani T. Jarkas.

William H. Carson, pro se.

DECISION

I. Introduction

This case arose from two FINRA examinations of former FINRA member firm Global Crown Capital, LLC ("the Firm"). Tr. 75-76 (Zrull). In the 2008 cycle examination, FINRA Staff ("Staff") investigated trading positions held in a Firm account called the "average price account." Tr. 84 (Zrull). Because, in a number of instances, these positions were held overnight and not allocated to a customer account, the Staff investigated whether they constituted proprietary trades, which would cause the Firm's minimum net capital requirement to increase from $50,000 to $100,000, and which would require the Firm to seek FINRA approval for a material change in the Firm's business operations. CX-81, CX-83; Tr. 78, 80-81 (Zrull). Staff opened a second, special financial and operations examination in 2009, when Staff received a Notice of Levy from the Internal Revenue Service ("IRS") reflecting that in February 2009, the IRS had filed a lien against the Firm for $232,310.04, for failing to pay payroll taxes. CX-48; Tr. 84-88 (Zrull). During the course of this examination, Staff directed Respondent Jarkas to appear for testimony. However, he failed to appear.

Following these investigations, the Department of Enforcement ("Enforcement") filed a complaint against the Firm's Financial and Operations Principal ("FINOP"), William H. Carson ("Carson"), and its Chief Executive Officer and owner, Rani T. Jarkas ("Jarkas").[2]

After careful consideration, the Hearing Panel concluded that Carson, as the Firm's FINOP, violated FINRA's rules by causing the Firm's net capital calculations to be inaccurate; allowing the Firm to conduct a securities business with insufficient net capital; filing inaccurate FOCUS Reports; and, in one instance, failing to ensure proper filing of a required notice that the Firm had insufficient net capital. The Hearing Panel determined that a two month suspension, a $5,000 fine, and a requirement to requalify as a FINOP were appropriately remedial.

With respect to Jarkas, the Hearing Panel concluded that he violated FINRA's rules by allowing the Firm to conduct a securities business with insufficient net capital; failing to file an application for approval of a material change in the Firm's business operations; and failing to appear for testimony. The Hearing Panel determined to impose the standard sanction for his failure to testify – a bar. In light of the bar, the Hearing Panel did not impose further sanctions for the remaining violations.

II. Facts

A. Respondent Jarkas

Jarkas entered the securities industry in 1995. He founded the Firm in March 2002 with co-owners who did not participate in the Firm's business. Jarkas was registered as a General

[2] The Complaint was filed on April 20, 2011. Respondents both filed answers denying the allegations and requesting a hearing. A six-day hearing was held on March 4-6, 2013, March 8, 2013, and resumed on September 12-13, 2013, after an agreed continuance due to Respondent Jarkas' health issues. The hearing was held before a Hearing Panel composed of a former member of the District 7 Committee, a current member of the District 1 Committee, and a Hearing Officer. Enforcement's exhibits CX-1-17, 19-23, 25-48, 50-52, 55, 57-67, 69-85, 87-88, 91-101, 103-109, 119-122, 126, 131-132, 134-138, 140, 143-149, 151-152, 155, 157-166, 168, 172-175, 177-180, 182, 188, 191-192, 194-201, 204-205, 207-256, 258-263, 263A, 264-278, 279-330, 332, 334, 337-343, 345-349, 351-352, 354, 356-361, and 363 were admitted into evidence. Jarkas' exhibits RX 1-4, 35-37, and 46 were admitted into evidence. Carson's exhibits RXX-1 through RXX-5 and RXX-7 through RXX-10 were admitted into evidence. Tr. 1292-1294. Stipulations are cited as "Stip." with the date of the Stipulation.

Securities Principal and served as the Chief Executive Officer. Stip.1, May 29, 2012. He managed the Firm and was also the responsible broker for certain institutional accounts and a small number of retail accounts. Tr. 1095 (Jarkas). Jarkas oversaw the Firm's finances and its outside accountant. Jarkas was registered with FINRA until September 2009, when the Firm ceased operations. CX-10, at 6. Jarkas has not been registered since that time.

B. Respondent Carson

Carson entered the securities industry in 1980. He has been registered with FINRA since 1988, and is currently registered. CX-14. He has served as a FINOP for a number of firms. CX-14. He joined the Firm as a part-time FINOP in October 2006, working remotely from his office in Colorado. Carson served as the Firm's FINOP until he resigned on May 1, 2009, immediately after learning of the IRS lien. CX-14.

C. The Firm Engaged in Proprietary Trading in the Average Price Account

The Firm maintained a retail average price account, the stated purpose of which was to allow it to open securities positions at various times during a trading day, and then to allocate those securities to one or more retail customers after the close of trading for that day. Tr. 254 (Flotow OTR). The average price account was generally used for large orders in thinly traded stock, where the order might not be completed within a day. Tr. 258 (Flotow OTR).

Philip Flotow ("Flotow") was the Firm's Director of Operations and was responsible for entering trades in the Firm's average price account. Tr. 248 (Flotow OTR).[3] Jarkas and Flotow were the only people who could enter trades in the average price account. Tr. 254 (Flotow OTR). It was Flotow's responsibility to allocate the trades at the end of the day. Tr. 257 (Flotow

[3] Flotow was no longer subject to FINRA's jurisdiction and unavailable to testify at the time of the hearing, but had previously testified at an on-the-record interview. Tr. 247. The portions of his on-the-record testimony read into the record at the hearing are cited as Tr. __ (Flotow OTR).

OTR). Flotow received allocation instructions in advance from other brokers with the Firm. Tr. 264-265 (Flotow OTR). However, Jarkas sometimes did not provide allocation instructions in advance, so Flotow was required to contact him at the end of each trading day to receive instructions. Tr. 252, 259, 261 (Flotow OTR). Sometimes Flotow was not able to reach Jarkas. In other instances, Jarkas instructed Flotow to wait until the next day. Tr. 257, 1021, 1027, 1040 (Flotow OTR).

During the period of August through September 2008, 49 securities positions placed by Jarkas in the average price account were held overnight, sometimes much longer, before they were eventually allocated to a customer account or closed, resulting in a profit or loss to the Firm.[4] CX-241, CX-356, CX-357. For example, trades placed on September 10 and 12, 2008, were not allocated until September 24, 2008. CX-252; Tr. 269 (Flotow OTR). In some instances, the trades were not allocated before they were sold, and resulted in a profit or loss to the Firm. CX-257. As discussed below, the trades that were held overnight should have been classified as proprietary trades, and caused the Firm's minimum required net capital to increase from $50,000 to $100,000.

D. The Firm Did Not Include Federal Taxes Payable to the IRS in the Firm's Books

On or about April 27, 2009, FINRA Staff received an IRS Notice of Levy for $244,246[5] against the Firm for failure to pay payroll taxes for the quarters ended June and September 2008.[6] CX-48. Upon learning of the tax lien, which was issued on February 18, 2009, Staff checked the Firm's FOCUS Report for March 2009 and found that the Firm's payroll taxes were not recorded as a liability. CX-47; Tr. 88-90 (Zrull). Moreover, the FOCUS Report reflected

[4] Another 24 trades were opened and closed within a single day.

[5] The Notice of Lien to the Firm was for $232,310. With the additional statutory interest, the Notice of Levy reflected an unpaid balance of $244,246.

[6] The Notice required FINRA to turn over any Firm assets to the IRS to help satisfy the IRS lien against the Firm.

only approximately $50,000 in excess net capital. CX-78; Tr. 89-92 (Zrull). Accordingly, the Staff sent the Firm a notice that it appeared to be operating with insufficient net capital. CX-95; Tr. 91-93 (Zrull). The notice indicated that the Firm had an obligation to provide notice to the SEC and FINRA, pursuant to SEC Rules 17a-11(b) and (g), that FINRA notified it of an apparent violation of SEC Rule 15c3-1. CX-95; Tr. 91-93 (Zrull).

On April 28, 2009, Staff examiners Zrull and Chong telephoned the Firm and spoke with Jarkas. Tr. 93-94 (Zrull), 204-206 (Chong). Jarkas told the Staff that he was unaware of the tax lien, and that he would promptly make a capital contribution to address the deficiency. Tr. 94-95 (Zrull), 206 (Chong). Staff asked for documentation supporting the capital contribution. Tr. 94-95 (Zrull), 206 (Chong).

On the same day, the Firm provided Staff with a Board Resolution reflecting a $250,000 capital contribution from Firm co-owner AB, along with a copy of a check from a Kuwaiti bank, and a net capital computation prepared by Carson.[7] CX-46; Tr. 123 (Zrull). The net capital computation reflected that the IRS liability was $198,621, rather than the $244,246 shown in the Notice of Levy. CX-46, CX-48. The Firm claimed that the reduction was a result of a partial payment to the IRS in the amount of $45,624. Tr. 207 (Chong). There was also a withdrawal from the Firm's checking account of that same amount. CX-135, at 25. The Firm's general ledger showed a Firm payment in that amount on April 20, 2009, but the payee's name is blank. CX-135, at 25.

The Firm did not provide any supporting documentation to indicate that it actually paid the IRS, such as a bank statement, wire, or cancelled check. CX-135, at 25; Tr. 207, 221

[7] Carson prepared the April 28, 2009, reconciliation with the adjustment for a $45,624 payment to "IRS liability" without obtaining any supporting documentation from the Firm. However, when Carter sent him a copy of the IRS lien on May 1, 2009, Carson became uncomfortable with the situation and resigned on May 1, 2009.

(Chong). The Firm also did not provide Staff with the bank statements it requested from the Firm's co-owner, AB, to allow Staff to trace the alleged capital contribution.[8] CX-135; Tr. 172, 186 (Zrull).

Staff reviewed the Firm's general ledger and found a series of payments from the Firm's checking account that were reflected as withdrawals rather than checks during the month of August 2008, after Jarkas terminated the payroll service company. Tr. 1245 (Jarkas). Most of these payroll liability "payments" – six of them – were rounded to the nearest thousand dollars and ranged from $5,000 to $40,000 during a three-week period in August 2008. The recipient of these payments was never determined. However, Staff wanted to investigate whether they were IRS tax liability payments, because the payments were in round numbers, and also because they were withdrawals and not checks.

The Hearing Panel found that the Firm omitted its $244,246 payroll tax liability from the Firm's net capital computation for March 31, 2009. The Firm's March 2009 FOCUS Report also omitted the payroll tax liability and was therefore inaccurate.[9] In addition, the Hearing Panel found that the Firm's net capital computation for April 28, 2009, was incorrect. In that case, the Firm omitted two additional IRS tax liens: a December 31, 2008, lien in the amount of $137,746.94, and a March 31, 2009, lien in the amount of $89,074.43. CX-51-52, CX-75, CX-78.

[8] The Firm claimed that AB was a silent partner, and that he was unwilling to provide his bank statements.

[9] Enforcement offered evidence of other errors in the Firm's books and reports. *See, e.g.,* Tr. 291-292 (Simmer). The Hearing Panel determined it was not necessary to consider these adjustments for liability or sanctions purposes because they were generally immaterial. Tr. 302 (Simmer).

E. Carson Failed to Prepare Accurate Net Capital Computations, Allowed the Firm to Operate with Inadequate Net Capital and Failed to Prepare Accurate FOCUS Reports

As the FINOP, Carson was responsible for preparing the Firm's net capital computations and its net capital compliance, and preparing FOCUS Reports. However, Carson relied upon outside accountant Chad Masri ("Masri") to compile the Firm's financial information. Tr. 1099 (Jarkas). Working from his office in Georgia, Masri provided accounting services to the Firm, including preparation of Firm Financial Statements based upon information provided by Jarkas. Carson also relied on the information provided by Masri to prepare the Firm's FOCUS Report. Tr. 487, 733 (Flotow OTR). However, he never verified the numbers that Masri gave him or otherwise reviewed important underlying documentation. For example, Carson admitted that he did not review the Firm's general ledger, because Masri summarized that information in the financial statements that he prepared and provided to Carson. Carson did not detect the proprietary trading in the Firm's average price account despite several red flags. For example, the settlement summary he received from the clearing firm reflected "inventory transactions" as well as profits and losses to the Firm. Tr. 280-282 (Flotow OTR), 696, 699, 714-715 (Carson); see, e.g., CX-71, at 4, CX-72, at 1. Carson did not notice or inquire about the inventory profits and losses, testifying that Masri took care of it. Tr. 717 (Carson).

Because the Firm's books incorrectly reflected a $50,000 minimum net capital requirement, rather than the $100,000 minimum net capital requirement for 2008, Carson's computation of its net capital position and its FOCUS reports were inaccurate. Specifically, the net capital computations for August 29, 2008, September 30, 2008, and December 31, 2008, and its FOCUS reports for September 30, 2008, and December 31, 2008, were materially inaccurate.

In addition, in 2009, because the Firm's books failed to include the Federal tax liability to the IRS, Carson's computation of the Firm's net capital position and its FOCUS Reports were

again inaccurate. Specifically, the net capital computations for March 31, 2009, and April 28, 2009, and the FOCUS report for March 31, 2009, were materially inaccurate.

Moreover, because Carson failed to accurately calculate the Firm's net capital, he allowed the Firm to operate with insufficient net capital.

F. Carson Failed to Ensure Proper Filing of an SEC Rule 17a-11 Notification of Net Capital Deficiencies

The Complaint asserts two instances where Carson failed to comply with his obligation to provide notice of capital deficiencies. In the first, Carson failed to file a notice after the Staff informed him, during an exit meeting on January 14, 2009, that the Firm had deficient net capital on September 30, 2008, largely attributable to the fact that it failed to reflect the $100,000 minimum net capital requirement resulting from the Firm's proprietary trading. CX-79, at 7, 9, CX-81, at 3-4; Tr. 155-159 (Zrull). Carson did not dispute these facts, but argued that Staff made no mention of the Firm's obligation to report the deficiency under SEC Rule 17a-11. Carson did not understand that he would be required to file a notice with the SEC for a deficiency occurring months earlier.

In the second instance, the Complaint asserts that Carson failed to ensure proper and complete filing of the Rule 17a-11 Notice that he prepared on April 28, 2009, after the IRS lien came to light, because he allegedly failed to file with the SEC.[10] Tr. 144-145 (Zrull). On April 28, 2009, Carson drafted a 17a-11 notice reporting the Firm's net capital deficiency, which Henry Carter ("Carter"), the CCO, sent to FINRA. CX-107; Tr. 141-142, 144 (Zrull). Staff acknowledges that it received the Rule 17a-11 notice by facsimile rather than the required electronic format. CX-107. Enforcement offered no evidence that the Firm failed to notify the

[10] See Enforcement's Pre-Hearing Brief at 21.

SEC as required. Accordingly, Enforcement failed to prove that Carson failed to make the required filing with the SEC.

G. Respondent Jarkas Fails to Appear for Testimony

After discovering the IRS lien and speaking with Jarkas, Staff opened a special financial and operations examination. Tr. 205 (Chong). As part of this investigation, Staff made a Rule 8210 request for the Firm to provide information to verify the capital contribution, and determine why the IRS liability was less than the Notice of Lien that Staff recently received, among other things. CX-134; Tr. 172 (Zrull). Staff wanted to validate the capital contribution, confirm that the $45,624 payment reflected in the Firm's reconciliation was actually paid to the IRS, and determine whether additional payroll tax liabilities had accrued after the date of the Notice of Lien, which had been issued more than two quarters earlier. Tr. 135-138, 172 (Zrull).

After requesting further information from the Firm without success, on October 21, 2009, Staff requested that Jarkas appear for testimony on November 11, 2009.[11] CX-165; Tr. 552, 555 (Lee). The request was sent via regular and certified mail to Jarkas' business address and his CRD residential address. CX-165; Tr. 552, 555 (Lee). The Firm's outside lawyer, Melvin K. Patterson ("Patterson"), testified that he received the request and discussed it with Jarkas. Tr. 823-829 (Patterson). Jarkas did not appear. CX-353.

Accordingly, Staff sent a second request, pursuant to Rule 8210, directing Jarkas to appear on November 30, 2009. CX-166, at 8; Tr. 556 (Lee). Again, the request was sent via

[11] The Staff requested documentation to resolve the discrepancy. The Firm provided a reconciliation asserting that the IRS lien had been reduced by a payment made from the Firm's bank account. However, the Firm did not provide documentation showing the withdrawal; nor did it document the payment to the IRS. The Staff also requested the current status of the payroll taxes, because two additional quarters had passed since the time period referenced in the Notice of Lien. The Firm did not produce the requested information and documentation, and, shortly thereafter, it ceased operations.

regular and certified mail to Jarkas' business address and his CRD residential address. CX-166, at 8; Tr. 556 (Lee). However, Jarkas did not appear.

Jarkas offered a number of reasons for his failure to appear. First, around the time of the November 11, 2009, request, Patterson advised Jarkas that because he was no longer registered with FINRA at the time of the request, he did not have to appear. Tr. 825-827 (Patterson). Patterson further advised, however, that FINRA may take a different view. Tr. 825-827 (Patterson).

Second, in his Wells submission, Jarkas claimed that because he had already provided on-the-record testimony once, he could not be required to testify again. CX-213, at 2. However, that testimony was in connection with the 2008 examination concerning proprietary trading. He had never provided testimony regarding the 2009 special examination concerning a new issue - the Firm's IRS tax liability.

Third, Jarkas testified that he was not able to testify due to a medical condition. Jarkas was treated for a serious medical condition in 2008. Tr. 1051-53 (Jarkas' doctor); RX-35, at 8, 12. In March 2009, his doctor indicated that this condition was in remission, but he was concerned about other medical issues. Tr. 1114 (Jarkas). Jarkas did not seek treatment at that time. Tr. 1115-1116 (Jarkas). In the fall of 2009, when Staff issued its Rule 8210 request for testimony, Jarkas was not receiving medical treatment. Tr. 1051-1052 (Jarkas' doctor), 1109-12 (Jarkas). It was not until February 2010, when Jarkas' doctor found that his condition was more serious and required immediate surgery, that Jarkas was medically incapacitated. Tr. 1119-1120 (Jarkas). Thus, while Jarkas has faced serious health issues, he did not establish that those health issues interfered with his ability to appear for testimony in the fall of 2009.

Finally, Jarkas claimed that he asked Patterson to obtain a postponement and believed that FINRA had agreed. Patterson testified that he called FINRA and spoke with FINRA examiner David Lee ("Lee") to inform him that Jarkas was not available, and he did not know when he would be. Patterson claimed that Lee's response was, "okay." Tr. 828-892 (Patterson). Lee, however, testified that the conversation with Patterson never took place. Tr. 557-558 (Lee). The Hearing Panel credits Lee's testimony over Patterson's, finding it unlikely that Lee would simply say "okay" to an open-ended postponement, without documentation of the medical condition.

Moreover, to the extent that Jarkas mistakenly believed that, for whatever reason, FINRA was no longer interested in his testimony, this confusion was resolved on January 27, 2011, when Staff sent Jarkas a Wells Notice indicating it intended to recommend a disciplinary action for his failure to testify. CX-212, at 2. However, even then, Jarkas did not offer to provide testimony. Tr. 1275-1276 (Jarkas).

III. Violations

A. Carson Failed to Maintain Accurate Books and Records by Failing to Make Accurate Net Capital Calculations, in Violation of NASD Rules 3110(a) and 2110 and FINRA Rule 2010

The First Cause of the Complaint charges Carson with causing the Firm's books and records to be inaccurate based upon inaccurate net capital computations on five dates from August 30, 2008, through April 29, 2009.

NASD Rule 3110(a) requires member firms to make and preserve books and records in conformity with SEC Rule 17a-3. SEC Rule 17a-3 requires that member firms maintain accurate books and records, including net capital computations.

A FINOP's role is to "[ensure] investor protection by being responsible for the Firm's compliance with applicable net capital, recordkeeping and other financial and operational rules."[12] In addition, "the review and understanding of the computations and the ability to explain the mechanics and rationale of the computations to FINRA staff … [resides] with the Firm's properly registered associated person vested with authority and responsibility for this function."[13] A part-time or off-site FINOP has the same responsibilities as a full-time FINOP who is employed by a member firm.[14]

On August 29, 2008, September 30, 2008, December 31, 2008, March 31, 2009, and April 28, 2009, Carson prepared incorrect calculations of net capital, resulting in inaccurate firm books and records. There were two major reasons for the inaccurate net capital computations. In 2008, Carson failed to take into account that proprietary trading caused the Firm's net capital requirement to increase. In 2009, Carson failed to take into account the Firm's unpaid payroll taxes.

1. The 2008 Net Capital Computations Were Inaccurate

The 2008 net capital computations were inaccurate because they failed to take into account that the Firm engaged in proprietary trading, which caused the Firm's net capital requirement to increase from $50,000 to $100,000.

During the period at issue, the Firm claimed that its minimum net capital requirement was $50,000. However, under Exchange Act Rule 15c3-1, firms that act as dealers, that is, firms that effect more than ten transactions per year in their own investment account are required to

[12] NTM 06-23; see also NTM 01-52.

[13] FINRA Reg. Notice 11-14, at 5, discussing clearing or carrying firms' restrictions and obligations regarding outsourced activities. http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p123398.pdf

[14] *Dep't of Enforcement v. Respondent 1*, No. C8A980059, 2000 NASD Discip. LEXIS 21, at *31 (NAC Nov. 6, 2000).

maintain net capital of not less than $100,000.[15] A firm classified as a dealer under this rule continues to be a dealer for the remainder of that calendar year.[16] The SEC imposes this higher net capital requirement on dealers, in part, in recognition of the risks of a dealer's business, including the potential for severe market volatility.[17] Even if the firm does not intend to engage in proprietary trading, trades are considered proprietary if the positions are held overnight. The SEC has held that holding securities in a firm's error account overnight before re-selling them constitutes proprietary trading, which causes the firm to be a dealer subject to the $100,000 net capital requirement.[18]

Here, the Firm effected 49 transactions in the Firm's average price account during August and September 2008. It held the positions overnight or longer, incurring the market risk against which the higher net capital requirement for proprietary traders is designed to protect. Accordingly, the trades were proprietary and the Firm's net capital requirement was $100,000, not $50,000. The Firm's books failed to reflect its $100,000 minimum net capital requirement, and therefore were materially inaccurate.

2. The 2009 Net Capital Computations were Inaccurate

The 2009 net capital computations in the Firm's books were inaccurate because they did not reflect that the Firm failed to pay and record payroll taxes, resulting in a large debt to the Internal Revenue Service, which ultimately resulted in an IRS tax lien and judgment.

[15] Exchange Act Rule 15c3-1(a)(2)(iii).

[16] *Id.*

[17] *William K. Cantrell*, Exchange Act Rel. No. 38570, 1997 SEC LEXIS 990, at *3 (May 5, 1997).

[18] *Cantrell*, 1997 SEC LEXIS 990, at *4-12 (May 5, 1997).

3. Carson Prepared Inaccurate Net Capital Computations

Carson failed to fulfill his responsibilities as a FINOP. Instead, he accepted the financial summaries he received at face value, despite red flags that should have prompted further inquiry.

Accordingly, the Hearing Panel concluded that by preparing inaccurate net capital computations, Carson caused the Firm to have inaccurate books and records, in violation of NASD Rules 3110(a) and 2110 and FINRA Rule 2010.

B. Carson and Jarkas Allowed the Firm to conduct a Securities Business without Maintaining Sufficient Net Capital, in violation of NASD Rule 2110 and FINRA Rule 2010

The Second Cause of the Complaint charges that Carson and Jarkas allowed the Firm to conduct a securities business while the Firm did not meet the minimum net capital requirement.

"The principal purposes of the net capital rule are to protect customers and other market participants from broker-dealer failures and to enable those firms that fall below the minimum net capital requirements to liquidate in an orderly fashion without the need for a formal proceeding or financial assistance from the Securities Investor Protection Corporation."[19] Engaging in securities transactions while a firm is in violation of the net capital rule constitutes a violation of FINRA Rule 2010.[20] As the Firm's FINOP, Carson was responsible for ensuring compliance with the net capital rule.[21]

When a FINRA member firm effects securities transactions while the firm has a net capital deficiency, the firm operates a securities business, in violation of Exchange Act Rule 15c3-1, and therefore violates FINRA Rule 2010.[22]

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[19] *Fox & Company Investments, Inc.*, Exchange Act Rel. No. 52697, 2005 SEC LEXIS 2822, at *18 (Oct. 28, 2005) (citations omitted).

[20] *Id.* at *27, n.29; *Paul Joseph Benz*, Exchange Act Rel. No. 51046, 2005 SEC LEXIS 116, at *10 (Jan. 14, 2005).

[21] *James S. Pritula*, Exchange Act Rel. No. 40607, 1998 SEC LEXIS 2425, at *10, n.13 (Nov. 9, 1998).

[22] *Paul Joseph Benz*, Exchange Act Rel. No. 51046, 2005 SEC LEXIS 116, at *10 (Jan. 14, 2005).

Here, the Firm's FOCUS reports for September 30, 2008, and December 31, 2008, failed to take into account that, because it engaged in proprietary trading, the Firm was required to maintain a minimum net capital of $100,000, rather than $50,000. Further, the Firm's FOCUS report for March 31, 2009, failed to include large payroll tax liabilities that were memorialized in a February 20, 2009 IRS tax lien. Had the net capital requirement been properly included, it would have shown the Firm was operating with insufficient net capital.

Carson does not dispute that his net capital computations were wrong. Tr. 53 (Carson). His defense is that he was unaware of the proprietary trading and the payroll tax liabilities. He claims that the financial statements he received from the Firm's outside CPA showed that the payroll taxes were paid. Tr. 56 (Carson). However, there were red flags to prompt further inquiry, and Carson should not have simply taken the information provided at face value.

Jarkas claims that because he is not a FINOP, he was not responsible for making net capital computations. However, the errors were not technical in nature; he knew or should have known that there were errors in the Firm's net capital computations.[23] The 2008 error was in large part due to the fact that he was personally engaging in proprietary trading, resulting in an increase of the required net capital minimum from $50,000 to $100,000. The Hearing Panel finds that Jarkas knew, or should have known, that his proprietary trading would cause the Firm to have a higher net capital requirement. The 2009 error was attributable to the Firm's failure to pay payroll taxes. Jarkas, who terminated the Firm's outside payroll company, had responsibility to ensure that the Firm's taxes were paid. Tr. 1245 (Jarkas).

By allowing the Firm to effect securities transactions when it had a net capital deficiency, Carson and Jarkas violated NASD Rule 2110 and FINRA Rule 2010.

[23] *Kirk A. Knapp*, Exchange Act Rel. No. 31556, 1992 SEC LEXIS 2971, at *26 (Dec. 3, 1992)(rejecting firm president's claim that he was not responsible for incorrect net capital calculations because he was not the firm's FINOP).

C. Carson Filed Inaccurate FOCUS Reports on behalf of the Firm, in Violation of NASD Rule 2110 and FINRA Rule 2010

The Third Cause of the Complaint alleges that Carson filed inaccurate FOCUS reports on September 30, 2008, December 31, 2008, and March 31, 2009.

Exchange Act Rule 17a-5 requires firms to file FOCUS Reports with FINRA. Inherent in that requirement is that the FOCUS Reports must be materially accurate. The filing of an inaccurate FOCUS Report is a violation of NASD Conduct Rule 2110.[24] Here, the Firm, acting through Carson, filed materially inaccurate FOCUS Reports for the periods ending September 30, 2008; December 31, 2008; and March 31, 2009. Each of these FOCUS Reports materially misstated the Firm's net capital position. Accordingly, Carson violated NASD Rule 2110 and FINRA Rule 2010 by filing inaccurate FOCUS Reports.

D. Carson Failed to File Notice of Net Capital Deficiencies

The Fourth Cause of the Complaint charges Carson with twice causing the Firm to fail to file the required SEC notice when the Firm's net capital was less than the required amount, in violation of FINRA Rule 2010.

Exchange Act Rule 17a-11 provides:

> Every broker or dealer whose net capital declines below the minimum amount required pursuant to § 240.15c3-1 shall give notice of such deficiency that same day in accordance with paragraph (g) of this section. The notice shall specify the broker or dealer's net capital requirement and its current amount of net capital. If a broker or dealer is informed by its designated examining authority or the Commission that it is, or has been, in violation of Rule 15c3-1 and the broker or dealer has not given notice of the capital deficiency under this Rule 17a-11, the broker or dealer, even if it does not agree that it is, or has been, in violation of Rule 15c3-1, shall give notice of the claimed deficiency, which notice may specify the broker's or dealer's reasons for its disagreement.[25]

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[24] *See, e.g., Dist. Bus. Conduct Comm. No. 1 v. L.H. Alton & Company*, Complaint Nos. C01960003 and C01960024, 1997 NASD Discip. LEXIS 60 (NAC Dec. 17, 1997); *aff'd*, Exchange Act Rel. No. 40886, 1999 SEC LEXIS 17, at *9 (Jan. 6, 1999).

[25] 17 C.F.R. § 240.17a-11(b)(1).

A notice is required to be delivered to the SEC's Washington, D.C. headquarters, its closest regional office, and its designated examining authority; in this case, FINRA.[26] Failure to file the required notice with the SEC and FINRA constitutes a violation of FINRA Rule 2010.[27]

Here, Carson failed to file the required notice following the Staff's notification to Carson and the Firm during the January 14, 2009, exit interview for the 2008 Examination that the Firm had a net capital deficiency on September 30, 2008.[28] Accordingly, the Hearing Panel finds that Carson violated FINRA Rule 2010 by failing to file the required notice for the September 30, 2008, deficiency.

However, as noted above, the Hearing Panel finds that there is insufficient evidence that Carson failed to file the required April 28, 2009, notice.

E. Jarkas Failed to File an Application for Approval of a Material Change in Business Operations, in violation of NASD Rules 1017(a) and 2110

The Fifth Cause of the Complaint alleges that Jarkas failed to file a Rule 1017(a) application to seek FINRA's approval of a material change in the Firm's business operations.

The Firm's Membership Agreement is dated June 9, 2003, and was signed by Jarkas. CX-26. It stated that the Firm would maintain a minimum net capital requirement of $50,000 pursuant to SEC Rule 15c3-1(a)(2)(iv). It stated that the Firm would engage in specified types of business which did not include proprietary trading. It also provided that

[26] Exchange Act Rule 17a-11(g).

[27] *Dist. Bus. Conduct Comm. v. First Heritage Investments*, No. C02910081, 1992 NASD Discip. LEXIS 47, at *9-10 (NBCC Dec. 9, 1992); *Fundclear, Inc.*, Exchange Act Rel. No. 34735, 1994 SEC LEXIS 2956, at *2 n.2, and *11 (Sept. 28, 1994).

[28] Carson argued that, during the exit interview, Staff never mentioned that he should file a Rule 17a-11 notice with the SEC. However, this is not a defense to his failure to comply with the requirement. *Richard F. Kresge,* Exchange Act Rel. No. 55988, 2007 SEC LEXIS 1407, at *29 (June 29, 2007).

the Firm undertook to file a written notice and application with FINRA pursuant to NASD Membership and Registration Rule 1017 at least 30 days before effecting a material change in its business operations. CX-26.

The Firm held numerous overnight positions in its retail average price account in August and September 2008, putting the Firm at risk and increasing the Firm's net capital requirement. Under FINRA Rule 1011(k)(3), activity that results in an increase in the net capital requirement, such as proprietary trading, is presumptively a material change that requires the filing of a Rule 1017 continuing membership application. Nonetheless, Jarkas failed to file this required application for approval to engage in such proprietary trading. The Hearing Panel finds that Jarkas violated NASD Rules 1017(a) and 2110 by failing to file a Rule 1017(a) application seeking FINRA's approval of a material change in business operations.

F. Jarkas Failed to Appear for Testimony, in violation of FINRA Rules 8210 and 2010

The Sixth Cause of the Complaint alleges that Jarkas failed to appear for testimony, in violation of FINRA Rules 8210 and 2010.

FINRA Rule 8210 requires that associated persons provide information orally or in writing with respect to any matter related to a FINRA investigation, complaint, examination, or proceeding. "FINRA Rule 8210 is unequivocal and grants FINRA broad authority to obtain information concerning an associated person's securities-related business ventures."[29] "Associated persons therefore must cooperate fully in providing FINRA with information and may not take it upon themselves to determine whether the information FINRA has requested is

[29] *Dep't of Enforcement v. Gallagher*, No. 2008011701203, 2012 FINRA Discip. LEXIS 61, at *12, 21 (NAC Dec. 12, 2012).

material."[30] Delay or neglect on the part of members and their associated persons in responding to Rule 8210 requests for information and documents undermines FINRA's ability to conduct investigations and thereby protect the public interest.[31]

Here, Jarkas failed to appear for testimony. In his Wells submission, Jarkas claimed that he was not required to testify because he had already testified. However, respondents may not second guess FINRA's requests, or substitute their judgment as to the appropriateness of the request.[32]

FINRA had jurisdiction to require Jarkas' testimony in the fall of 2009 because he had been registered with a member firm within the previous two years.[33] FINRA's requests were properly served on Jarkas, and he therefore had constructive notice of them. Moreover, he confirmed that he had actual notice of FINRA's request for testimony when he testified that he spoke with Patterson about it. Jarkas also claimed that he relied on Patterson's advice that he was not required to testify. However, reasonable reliance on counsel, while it may bear on the appropriate sanction, is immaterial to the obligation of an associated person to supply information upon FINRA's request.[34]

Jarkas also claimed that his health issues prevented him from appearing for testimony. However, as discussed above, he failed to establish that he was medically unable to appear for testimony in the fall of 2009 when he received the request. However, even if Jarkas was unable

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[30] *Id.* at *13 (citing *CMG Inst. Trading, LLC*, Exchange Act Rel. No. 59325, 2009 SEC LEXIS 215, at *21 (Jan. 30, 2009)).

[31] *See, e.g., Paz Sec., Inc.*, Exchange Act Rel. No. 57656, 2008 SEC LEXIS 820, at *12-13 (Apr. 11, 2008), *petition denied*, 566 F.3d 1172 (D.C. Cir. 2009).

[32] *Morton Bruce Erenstein*, Exchange Act Rel. No. 56768, 2007 SEC LEXIS 2596 (Nov. 8, 2007) (citations omitted)*; Joseph Patrick Hannan*, Exchange Act Rel. No. 40438, 1998 SEC LEXIS 1955 at *11 (Sept. 14, 1998).

[33] FINRA By-Laws, Article V, Sec. 4(a); Rule 8210(a)(1); *Market Regulation Comm. V. Zubkis*, Complaint No. CMS950129, 1997 NASD Discip. LEXIS 47, at *12 (NBCC August 12, 1997); *aff'd*, 53 SEC 794, 1998 SEC LEXIS 1904 (1998).

[34] *Michael Markowski*, 51 S.E.C. 553, 557 (1993), *aff'd*, 34 F.3d 99 (2d Cir. 1994).

to testify for medical reasons, he "was obligated to contact the staff, explain and document the circumstances, and propose alternative places and dates for his testimony."[35] "[R]ecipients of requests under Rule 8210 must promptly respond to the request or explain why they cannot."[36]

IV. Sanctions

A. Carson

FINRA's Sanction Guidelines ("Guidelines") for net capital violations recommend a fine of $1,000 to $50,000, and a suspension for up to 30 business days, or, in egregious cases, a longer suspension or bar.[37] For recordkeeping violations, the Guidelines recommend a fine of $1,000 to $10,000, and a suspension in any or all capacities of up to 30 business days.[38] For filing false or misleading FOCUS reports, the Guidelines recommend a fine of $10,000 to $50,000, and a suspension for up to two years.[39] There is no guideline for failure to file a required notice under SEC Rule 17a-11. An analogous guideline, for failing to file reportable events under NASD Rule 3070, recommends a fine of $5,000 to $100,000 and a suspension of 10 to 30 business days.[40]

In determining the appropriate sanction for Carson's violations, the Hearing Panel considered that Carson's violations were not intentional, but resulted from a failure to identify and check red flags. The Hearing Panel also considered that Carson resigned after learning of the unpaid tax liability, demonstrating that he was not willing to knowingly violate the rules.

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[35] *Dep't of Enforcement v. Walblay*, No. 2011025643201, 2012 FINRA Discip. LEXIS 68, at *10-11, *22, *29 (OHO Nov. 1, 2012).

[36] *Dep't of Enforcement v. Hodge*, No. 2006003995001, 2008 FINRA Discip. LEXIS 52, at *9 (OHO Oct. 1, 2008)(quoting *Charles C. Fawcett*, Exchange Act Rel. No. 56770, 2007 SEC LEXIS 2598, at *18 (Nov. 8, 2007).

[37] *Guidelines* at 28.

[38] *Id.* at 29.

[39] *Id.* at 68.

[40] *Id*. at 74.

On the other hand, the Hearing Panel considered that he had a disciplinary history with FINRA for net capital violations. In 2004, he submitted an Offer of Settlement incorporating findings that he caused a firm to conduct a securities business with insufficient net capital. CX-16. In April 2008, a Hearing Panel found him liable for net capital violations at another firm. CX-17.

In addition, the Hearing Panel considered that Carson still did not seem to appreciate his responsibilities as a FINOP, which include exercising a level of scrutiny over the financial information he is provided. For example, Carson did not inquire about why a firm with supposedly no proprietary trading would have inventory positions in securities and gains and losses, or why there were a large number of "payroll liability" payments, all in round numbers, occurring over a one month period, and why they were withdrawals, and not checks. Moreover, Carson testified that he did not know he was required to file a net capital deficiency report if the deficiency occurred in the past. However, Exchange Act Rule 17a-11 makes clear that a firm must file a notice when it is so informed by its examining authority. For this reason, and based upon his prior disciplinary history, the Panel determined to require Carson to requalify as a FINOP.

In summary, the Hearing Panel concluded that a two-month suspension as FINOP, requalification as FINOP, and a $5,000 fine, were appropriately remedial.

B. Jarkas

The Sanction Guidelines with respect to FINRA Rule 8210 provide that, absent mitigating circumstances, a bar should be the standard sanction when an individual fails to respond in any manner.[41] The imposition of a bar for a complete failure to respond to FINRA

[41] FINRA Sanction Guidelines 33 (2011), *available at* http://www.finra.org/sanctionguidelines.

information requests "reflects the judgment that, in the absence of mitigating factors, a complete failure to cooperate with [FINRA] requests for information or testimony is so fundamentally incompatible with [FINRA's] self-regulatory function that the risk to the markets and investors posed by such misconduct is properly remedied by a bar."[42]

By refusing to testify, Jarkas completely failed to respond. He asserts several factors as mitigating. First, he claimed that he relied upon advice of counsel in electing not to appear. However, for this to be mitigating, Jarkas' reliance must be reasonable.[43] Here, it was not. Jarkas could not have reasonably believed that because he appeared for an on-the-record interview in connection with the 2008 examination involving proprietary trading, he could not be required to testify again, particularly when the request involved the 2009 examination and the Firm's IRS tax liabilities, which were not known by FINRA at the time of the previous on-the-record interview. He also could not reasonably rely on counsel's advice that he could avoid testifying by terminating his registration, as FINRA's continuing jurisdiction was clear under the By-Laws.

Shifting gears, Jarkas argued that his failure to testify resulted from a misunderstanding; he claimed that he did not realize that Staff continued to want his testimony, a position the Hearing Panel did not find credible. However, any misunderstanding was cleared up when Jarkas received the Wells Notice indicating that Staff was contemplating a disciplinary action. Even then, Jarkas did not offer to testify.

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[42] *Paz Sec.*, 2008 SEC LEXIS 820, at *9 (citing *Charles C. Fawcett, IV*, Exchange Act Rel. No. 56770, 2007 SEC LEXIS 2598, at *21-22 (Nov. 8, 2007)).

[43] *Howard Brett Berger*, Exchange Act Rel. No. 58950, 2008 SEC LEXIS 3141, at *40 (Nov. 14, 2008), *pet. denied*, 347 F. *App'x* 692 (2d Cir. 2009); *Accord Dep't of Enforcement v. Padilla*, No. 2006005786501, 2012 FINRA Discip. LEXIS 46, at *27 (NAC Aug. 1, 2012).

Jarkas also pointed to his medical condition. However, as noted above, while Jarkas established that he has faced serious health issues, he did not establish that those health issues interfered with his ability to appear for testimony in the fall of 2009.

The Hearing Panel also considered the importance of the information being sought. Staff had serious concerns after it learned of the IRS tax lien indicating that there were substantial unpaid payroll taxes indicating a possible net capital deficiency.

The Hearing Panel concluded that there were no mitigating factors that would justify a sanction below the standard for a failure to testify. Accordingly, it concludes that the appropriate sanction is a bar. In light of the bar, no further sanctions are imposed for Jarkas' other violations.

V. CONCLUSION

Respondent Carson caused the firm's net capital calculations to be inaccurate, in violation of NASD Rules 3110(a) and 2110 and FINRA Rule 2010; allowed the firm to conduct a securities business with insufficient net capital, in violation of NASD Rule 2110 and FINRA Rule 2010; filed inaccurate FOCUS Reports, in violation of NASD Rule 2110 and FINRA Rule 2010; and caused the firm to fail to notify the regulatory authorities that it had insufficient net capital, in violation of FINRA Rule 2010. Respondent Carson is suspended for two months as a FINOP, fined $5,000, and required to requalify as a FINOP. In addition, Carson is responsible for one half of the cost of the hearing, in the amount of $5,436.13, which includes the cost of the transcript and a $750 administrative fee. If this Hearing Panel Decision becomes FINRA's final disciplinary action, Carson's suspension shall become effective with the start of business on Monday, April 7, 2014, and terminate at the close of business on Friday, June 6, 2014.

Respondent Jarkas allowed the firm to conduct a securities business with insufficient net capital, in violation of NASD Rule 2110 and FINRA Rule 2010; failed to file an application for approval of a material change in business operations, in violation of NASD Rules 1017(a) and 2110; and failed to appear for testimony, in violation of FINRA Rules 8210 and 2010. Respondent Jarkas is barred for the failure to appear for testimony. Jarkas also is responsible for one half of the cost of the hearing in the amount of $5,436.14, which includes a $750 administrative fee and the cost of the hearing transcript. In light of the bar, no further sanctions are imposed for his other violations. The bar shall become effective immediately if this Decision becomes the final disciplinary action of FINRA.[44]

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Andrew H. Perkins
Deputy Chief Hearing Officer
For the Hearing Panel

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[44] The Hearing Panel considered and rejected without discussion all other arguments of the parties.