

**FINANCIAL INDUSTRY REGULATORY AUTHORITY  
OFFICE OF HEARING OFFICERS**

DEPARTMENT OF ENFORCEMENT,

Complainant,

v.

J. W. KORTH & COMPANY  
(CRD No. 26455),

Respondent.

Disciplinary Proceeding  
No. 2012030738501

Hearing Officer–CC

**HEARING PANEL DECISION**

January 26, 2017

**Respondent, a fixed income dealer, charged excessive markups on 38 sales of municipal bonds and nine sales of corporate bonds, and excessive markdowns on four purchases of corporate bonds. For these violations, Respondent is ordered to pay restitution and, in lieu of a fine, to retain an independent consultant to review and monitor for fairness the firm’s pricing practices. Allegations dismissed as to three sales of collateralized mortgage obligations, six sales of municipal bonds, and two sales of corporate bonds.**

**Appearances**

For Complainant: Christopher Burky, Esq., and Mark J. Fernandez, Esq., Department of Enforcement, Financial Industry Regulatory Authority.

For Respondent: James W. Korth.

**I. Introduction**

This case involves allegations that member firm J. W. Korth & Company (“J. W. Korth”) charged customers unfair prices in sales of municipal and corporate bonds and collateralized mortgage obligations (“CMOs”) and excessive markdowns in purchases of corporate bonds. At issue are markups and markdowns of 3.10 percent to 8.33 percent in 62 transactions. J. W. Korth admits the prices at which the firm bought and sold bonds and CMOs, but denies that its markups and markdowns were unfair. J. W. Korth contends that its purchase and sale prices were fair, given the specialized services that the firm offers its customers, the firm’s business model, and its unique expertise and position in the fixed income market. J. W. Korth also argues that FINRA improperly relies on an unpublished three percent threshold for pricing debt securities, and criticizes FINRA for offering the fixed income community inadequate guidance on pricing.

## II. Procedural History

FINRA's Department of Enforcement ("Enforcement") filed the Complaint on December 10, 2014. Cause one alleges that J. W. Korth charged unfair prices on sales of municipal securities in 44 transactions, in violation of Municipal Securities Rulemaking Board ("MSRB") Rules G-30 and G-17.<sup>1</sup> Cause two alleges that J. W. Korth charged unfair prices on sales or paid unfair prices in purchases of corporate bonds and CMOs in 18 transactions, in violation of NASD Rule 2440, IM-2440-1, and FINRA Rule 2010.<sup>2</sup>

J. W. Korth filed an Answer on January 7, 2015, and an Amended Answer on March 5, 2015. J. W. Korth denied allegations of wrongdoing and requested a hearing. In an order dated February 11, 2015, the Office of Hearing Officers ("OHO") scheduled a multi-day hearing to commence on October 19, 2015, in Chicago, Illinois.

On August 7, 2015, Enforcement filed a motion stating that James Korth ("Korth"), the Respondent's representative, had indicated in an email dated August 4, 2015, that he intended to withdraw the Firm's request for a hearing. Korth sent the email to Enforcement's attorney after he received the Hearing Officer's July 30, 2015 order denying Respondent's Motion to Compel the Testimony of Richard Ketchum, then Chief Executive Officer of FINRA. Enforcement sought clarification as to whether Korth intended to participate in the hearing scheduled to begin on October 19, 2015. On August 10, 2015, OHO received a document filed on behalf of J. W. Korth in which Korth stated that he withdrew J. W. Korth's request for a hearing and reserved the right to file a brief for the Hearing Panel's consideration.

On August 10, 2015, OHO issued an order adjourning the hearing, vacating the remaining pre-hearing deadlines, and setting the case for a scheduling and status conference, in which the parties participated on August 26, 2015. Both parties represented that they could present their cases on the papers and without a hearing. On August 28, 2015, the Hearing Officer issued an order granting the parties' request to present this matter on the papers.

---

<sup>1</sup> Cause one of the Complaint initially alleged that J. W. Korth charged unfair prices in 51 sales, as indicated on Schedule A to the Complaint. Enforcement later withdrew its allegations as to seven of the 51 transactions and introduced into the record as Complainant's Exhibit 3 ("CX-3") Amended Schedule A that excluded the seven withdrawn trades.

<sup>2</sup> The purchases and sales at issue in cause two of the Complaint are identified on Schedule B to the Complaint. Enforcement amended Schedule B (but did not withdraw allegations as to any of the 18 alleged transactions) and introduced Amended Schedule B into the record as CX-4.

### III. Factual Background

Korth founded member firm J. W. Korth in 1982.<sup>3</sup> J. W. Korth was approved for FINRA membership in April 1983.<sup>4</sup> J. W. Korth is also a member of the MSRB.<sup>5</sup> J. W. Korth is headquartered in Lansing, Michigan.<sup>6</sup> During 2009, 2010, and 2011, the period relevant to the allegations of the Complaint, the firm generated total revenues of approximately \$3.2 million, \$3.7 million, and \$2.8 million, respectively.<sup>7</sup>

J. W. Korth focuses its business on fixed income products and has developed an expertise in this area.<sup>8</sup> The firm generates the majority of its revenue from servicing financial advisors, institutions, and wealthy individuals with diversified fixed income accounts.<sup>9</sup> During the relevant period, April 2009 through December 2011, J. W. Korth provided all of its clients with a proprietary web-based system—Shop4Bonds—that enabled its customers to see the inter-dealer prices of bonds, without markups, for approximately 90 percent of U.S. bond offerings.<sup>10</sup> J. W. Korth states that it researches and recommends to its clients smaller, more obscure bond issues with ratings that are below investment grade or bonds with complicated structures that a general, less-specialized firm may not recommend.<sup>11</sup>

J. W. Korth states that before the start of the relevant period, it set its internal markup limit at 3.5 percent, and subsequently raised it to 3.9 percent in February 2009.<sup>12</sup> The firm asserts that it set this policy after careful consideration of the factors identified in FINRA's and MSRB's rules.<sup>13</sup> The firm represents that the prices it charged on each transaction were subject to four levels of review. First, the representative who recommended the bond sent the trade to the trading desk. Second, the trader executed the trade with firm inventory or a trading partner. Third, the Chief Compliance Officer reviewed the trade and approved it. Fourth, the Chief Executive Officer approved the trade.<sup>14</sup>

---

<sup>3</sup> J. W. Korth's Amended Response to the Complaint ("Ans.") at 2. During the relevant period and currently, Korth is managing partner, general principal, and municipal principal of J. W. Korth. Ans. at 18. Korth reviewed all trading at the firm and holds an ownership interest in excess of 75 percent. Answer ("Ans.") at 18.

<sup>4</sup> Ans. at 17.

<sup>5</sup> Ans. at 17.

<sup>6</sup> Ans. at 17.

<sup>7</sup> Ans. at Exhibit A.

<sup>8</sup> Ans. at 2.

<sup>9</sup> Ans. at 2.

<sup>10</sup> Ans. at 2-3. J. W. Korth contends that it provided its customers with access to information about approximately 45,000 bond offerings per day. Ans. at 3.

<sup>11</sup> Ans. at 3.

<sup>12</sup> Ans. at 4-5.

<sup>13</sup> Ans. at 6-7.

<sup>14</sup> J. W. Korth Amended Brief at 13 n.17.

#### IV. Conclusions of Law

FINRA's rules obligate FINRA member firms to deal fairly with customers. In particular, NASD Rule 2440 required member firms to sell securities at fair prices, taking into consideration all relevant circumstances.<sup>15</sup> MSRB similarly requires all MSRB members to sell municipal bonds to customers at prices that are fair and reasonable.<sup>16</sup> Thus, FINRA Rule 2010 and NASD Rule 2440, IM-2440-1, and IM-2440-2 apply to J. W. Korth's transactions in corporate bonds and CMOs.<sup>17</sup> MSRB Rules G-17 and G-30 apply to J. W. Korth's transactions in municipal bonds.<sup>18</sup>

"Determining whether a dealer charged customers markups that exceeded fair and reasonable prices requires a two-step analysis."<sup>19</sup> The first step is to determine the appropriate prevailing market price.<sup>20</sup> After determining the prevailing market price, "we must determine whether the markups [and markdowns], as calculated based on prevailing market price, were fair and reasonable."<sup>21</sup> In making this determination, we must take into consideration all relevant factors, including (1) the nature of the broker-dealer's business; (2) the availability of the security involved in the transaction; (3) the expense involved in effecting the transaction; (4) the value of the services rendered and the expertise provided by the broker-dealer; (5) that the broker-dealer is entitled to reasonable profit; (6) the total dollar amount of the transaction; (7) the best judgment of the broker-dealer as to fair market value at the time of the transaction; (8) the

---

<sup>15</sup> FINRA Rule 2121 superseded NASD Rule 2440, IM-2440-1, and IM-2440-2, effective May 9, 2014. *See* FINRA-2014-023, <http://www.finra.org/industry/rule-filings/SR-FINRA-2014-023>, Exchange Act Release No. 72208, 79 Fed. Reg. 30,675 (May 21, 2014). NASD Rule 2440, IM-2440-1, and IM-2440-2 were applicable during the relevant period. FINRA Rule 2010 requires member firms, in the conduct of their business, to observe high standards of commercial honor and just and equitable principles of trade. IM-2440-1 states that it shall be deemed a violation of Rules 2110 (now 2010) and 2440 for a member to enter into any transaction with a customer in any security at any price not reasonably related to the current market price of the security.

<sup>16</sup> MSRB Rule G-30. MSRB Rule G-17 requires municipal securities dealers to deal fairly with customers and not to engage in deceptive or unfair practices. "Inherent in this responsibility is that dealers charge fair prices in transactions with their customers." *Dep't of Enforcement v. SFI Invs. Inc.*, No. C10970176, 2000 NASD Discip. LEXIS 52, at \*42-43 (OHO Mar. 28, 2000) (citations omitted). Thus, a firm that charges unfair prices in sales of municipal securities violates both MSRB Rules G-17 and G-30.

<sup>17</sup> *See* IM-2440-2 (stating that IM-2440-1 applies to debt securities and IM-2440-2 supplements the guidance provided in IM-2440-1).

<sup>18</sup> The MSRB is the self-regulatory organization charged with rule-making authority for municipal securities activities. *See Anthony A. Grey*, Exchange Act Release No. 75839, 2015 SEC LEXIS 3630, at \*2 n.3 (Sept. 3, 2015). FINRA administers and enforces its members' compliance with MSRB Rules. *See* FINRA By-Laws, Art. IV, Sec. 1(a)(1); Art. V, Sec. 2(a)(1); Art. XIII, Sec. 1(b); FINRA Plan of Allocation and Delegation of Functions, Section II.A.1.b; Section 15B(c)(5) of the Securities Exchange Act of 1934.

<sup>19</sup> *Grey*, 2015 SEC LEXIS 3630, at \*17.

<sup>20</sup> *Id.*; *see also Mark David Anderson*, Exchange Act Release No. 48352, 2003 SEC LEXIS 3285, at \*23 (Aug. 15, 2003) (holding that a dealer charges excessive markups when he charges retail customers prices not reasonably related to the prevailing market price); MSRB Supplementary Material G-30.01(c) ("A 'fair and reasonable' price bears a reasonable relationship to the prevailing market price of the security.").

<sup>21</sup> *Grey*, 2015 SEC LEXIS 3630, at \*18.

resulting yield after the subtraction of the markup compared to the yield on other securities of comparable quality, maturity, and availability; (9) the maturity of the security; (10) the rating and call features of the security; and (11) the availability of material information about the security through established industry sources.<sup>22</sup>

Enforcement compiled and produced trade data for the securities J. W. Korth sold to its customers in each of the transactions at issue. Enforcement exported trade data from MSRB's Electronic Municipal Market Access system ("EMMA") (for municipal securities) and produced it in CX-5. Enforcement exported trade data from FINRA's Trade Reporting and Compliance Engine ("TRACE") (for corporate bonds and CMOs) through FINRA's Web Integrated Audit Trail ("WIAT") and produced it in CX-6.

#### **A. Determination of Prevailing Market Price for Markup and Markdown Calculations**

Enforcement contends that, in determining markups, for both municipal and corporate bonds and CMOs, the appropriate method for calculating the markup is the difference between the price charged to the customer and the current inter-dealer market, as represented by J. W. Korth's acquisitions of the bonds closely related in time to its sales to customers. As such, Enforcement relied on contemporaneous cost to calculate markups in all of the trades identified on Amended Schedules A and B to the Complaint.<sup>23</sup>

Courts and the Securities and Exchange Commission ("Commission") have widely held that, in markup cases, the best measure of prevailing market price is the dealer's contemporaneous cost for the securities.<sup>24</sup> "The Commission has repeatedly stated that quotations are generally not a reliable indication of market price."<sup>25</sup> Because quotations are not validated by comparison with actual inter-dealer transactions in the marketplace, their reliability as an indication of the prevailing market is highly suspect.<sup>26</sup> "When a dealer acquired the bonds

---

<sup>22</sup> IM-2440-1(b); MSRB Rule G-30; MSRB Supplementary Material G-30.02(a) and (b); *Grey*, 2015 SEC LEXIS 3630, at \*31-32; *Robert Marcus Lane*, Exchange Act Release No. 74269, 2015 SEC LEXIS 558, at \*27 (Feb. 13, 2015); MSRB Regulatory Notice 2014-11 (May 12, 2014), <http://www.msrb.org/~media/Files/Regulatory-Notices/Announcements/2014-11.ashx?n=1>; MSRB Regulatory Notice 2004-03 (Jan. 26, 2004), <http://www.msrb.org/Rules-and-Interpretations/Regulatory-Notices/2004/2004-03.aspx?n=1>; *MSRB Interpretation of Rule G-30, Pricing and Commissions* (Dec. 19, 2001), <http://www.msrb.org/Rules-and-Interpretations/MSRB-Rules/General/Rule-G-30.aspx?tab=2>.

<sup>23</sup> See CX-3; CX-4. For calculating markdowns, Enforcement relied on J. W. Korth's contemporaneous inter-dealer sale as a basis for calculating markdowns. See CX-4, nos. 9-12.

<sup>24</sup> *Grandon v. Merrill Lynch & Co.*, 147 F.3d 184, 189 (2d Cir. 1998); *Grey*, 2015 SEC LEXIS 3630, at \*17; *Lane* 2015 SEC LEXIS 558, at \*25.

<sup>25</sup> *Thomas F. White & Co.*, 51 S.E.C. 932, 935 (1994), *aff'd*, 68 F.3d 482 (9th Cir. 1995).

<sup>26</sup> *Dennis Todd Lloyd Gordon*, Exchange Act Release No. 57655, 2008 SEC LEXIS 819, at 847-48 (Apr. 11, 2008); *Dep't of Enforcement v. SFI Inv., Inc.*, 2000 NASD Discip. LEXIS 52, at \*45 ("[R]ecognizing that quotations are often the subject of negotiations, the SEC has noted that in thinly or inactively traded securities, such as municipal bonds, quotations may not accurately reflect the prevailing market price for the security.").

in inter-dealer trades closely related in time to the customer transactions,” contemporaneous cost is the best indicator of prevailing market price.<sup>27</sup>

Enforcement relies on the expert report of Charles Paviolitis (“Paviolitis”) for municipal bond trades<sup>28</sup> and the expert report of Vikram Kapoor (“Kapoor”) for corporate bond and CMO trades.<sup>29</sup>

Paviolitis states in his report that he reviewed the markets for the municipal bonds at issue in each of the 44 trades listed on Amended Schedule A and concluded that there were no inter-dealer trades that would reflect a contemporaneous market away from the firm’s inter-dealer purchase prices.<sup>30</sup> Paviolitis concludes that J. W. Korth’s contemporaneous cost was the best evidence of prevailing market price. We considered Paviolitis’s findings, but we also conducted our own review of reported trades in the same bonds during the time of J. W. Korth’s purchases and sales. As a result, we find that J. W. Korth’s contemporaneous purchases, most of which occurred one to two days prior to its sales to customers, reflect the best evidence of the

---

<sup>27</sup> *Grey*, 2015 SEC LEXIS 3630, at \*17; *see also Lane*, 2015 SEC LEXIS 558, at \*26 (“Absent countervailing evidence, the best indicator of the current market price is a member firm’s contemporaneous cost of acquiring the security, and the firm’s contemporaneous cost is the price upon which member firms should calculate their markup amounts.”); *Dep’t of Enforcement v. David Lerner Assoc., Inc.*, No. 20050007427, 2012 FINRA Discip. LEXIS 44, at 60 (OHO Apr. 4, 2012) (holding that, in the absence of countervailing evidence, a dealer’s contemporaneous cost in acquiring the security is the best evidence of the prevailing market); *Dep’t of Enforcement v. SFI Invs., Inc.*, 2000 NASD Discip. LEXIS 52, at \*43 (stressing reliability of contemporaneous cost as an indication of prevailing market price); *Dist. Bus. Conduct Comm. v. Int’l Trading Group, Inc.*, No. C07950058, 1998 NASD Discip. LEXIS 83, at \*6 (NAC July 2, 1998) (recognizing contemporaneous cost as best evidence of the prevailing market price); IM-2440-2(b)(1) (the presumptive prevailing market price for a debt security “is established by referring to the dealer’s contemporaneous cost as incurred, or contemporaneous proceeds as obtained, consistent with [FINRA] pricing rules”).

<sup>28</sup> Paviolitis has more than 38 years of experience in fixed income markets, with particular emphasis on municipal securities. CX-7, at 1. He has served in management positions at registered broker-dealers where he oversaw trading in municipal securities. He has also served as a retail municipal bond salesman. CX-7, at 6. J. W. Korth argues that we should not rely on Paviolitis because he does not have any experience working with a small fixed income dealer like J. W. Korth and that the firms with which he has been associated provide far fewer services to their customers. The firm also contends that Paviolitis did not address all of the factors for consideration under MSRB Rule G-30, particularly yield to customer. RX-2.

<sup>29</sup> Kapoor holds Series 7 and 63 licenses and has worked in the securities industry in a sales capacity for both institutional and retail customers. He specializes in quantitative finance. CX-8, at 1, 81. Kapoor has analyzed markups and markdowns on hundreds of securities sales, including corporate bonds and CMOs, and has consulted for global investment banks, large mortgage banks, financial guaranty insurers, and government regulators. CX-8, at 1, 81. J. W. Korth objects to Kapoor’s report because it relies heavily on other firms’ markups without providing a sufficient basis for doing so. J. W. Korth also argues that the transactions at issue occurred during a very volatile market, and Kapoor failed to take this into account in his report. RX-2.

<sup>30</sup> CX-7, at 9-10. Paviolitis also notes that J. W. Korth sold the majority of the bonds listed on Amended Schedule A on the same day or the next business day after it acquired the bonds in the inter-dealer market, and that in no instance did more than five business days elapse between J. W. Korth’s purchases of the bonds and sales to customers. CX-7, at 4. He notes that, in all of the trades listed on Amended Schedule A, no intervening inter-dealer trades occurred between the time of J. W. Korth’s purchase and the time of its sales to one or more customers. CX-7, at 55-64.

prevailing market for all but three trades listed on Amended Schedule A to the Complaint, particularly given that no intervening inter-dealer trades occurred.<sup>31</sup>

For trades 27, 33, and 34 on Amended Schedule A to the Complaint, we find that inter-dealer trading in the bonds at issue occurred close in time to J. W. Korth's customer sales. This suggests to us a possible shift in the market for the securities at issue. Thus, as discussed in more detail in section IV.B.1, we used those inter-dealer transactions as the basis for calculating markups on trades 27, 33, and 34 on Amended Schedule A to the Complaint.

Kapoor concludes in his report that J. W. Korth's contemporaneous cost was the best evidence of prevailing market price for each of the corporate bond and CMO transactions listed on Amended Schedule B to the Complaint.<sup>32</sup> Kapoor analyzed the market data for the trades listed on Amended Schedule B and found no inter-dealer transactions that may have moved the prevailing market away from J. W. Korth's cost.<sup>33</sup> Kapoor states that each purchase and corresponding sale occurred on the same day, generally no more than 30 minutes apart.<sup>34</sup> We considered Kapoor's findings, but also conducted our own review of reported trades in the same bonds during the time of J. W. Korth's purchases and sales. As a result, we conclude that J. W. Korth's contemporaneous purchases (for markups) and sales (for markdowns), all of which occurred on the same day as the firm's sales to customers, reflect the best evidence of the prevailing market for the trades listed on Amended Schedule B of the Complaint, particularly in light of the dearth of intervening inter-dealer trades.<sup>35</sup>

Once Enforcement presented evidence of the firm's contemporaneous cost, it became the firm's burden to overcome the presumption that contemporaneous cost represents the prevailing market price.<sup>36</sup> As countervailing evidence, J. W. Korth states that the firm put up its own capital to purchase bonds, without having a buyer in place, after conducting extensive research to locate underpriced bonds that offer sizeable returns. The firm states that it devotes such significant resources to research that contemporaneous cost does not reflect the true market value of the

---

<sup>31</sup> See CX-5, at 1-2, 4-5, 7-10, 18-26, 28, 33-38, 42.

<sup>32</sup> CX-8, at 3.

<sup>33</sup> CX-8, at 3.

<sup>34</sup> CX-8, at 3 n.3.

<sup>35</sup> See CX-6, at 2-4, 7, 16, 21, 27, 34-35, 48, 63-64, 67, 68.

<sup>36</sup> *Grey*, 2015 SEC LEXIS 3630, at \*17 (“When a dealer acquired the bonds in inter-dealer trades closely related in time to the customer transactions, we assume the dealer’s contemporaneous cost is the best measure of prevailing market price, and it is the dealer’s burden to overcome that presumption.”); *Lane*, 2015 SEC LEXIS 558, at \*26 (holding that once Market Regulation presents evidence of excessive markups, the burden shifts to the firm to “explain why contemporaneous cost is not an appropriate measure of the prevailing market price”); *David Lerner Assoc.*, 2012 FINRA Discip. LEXIS 44, at \*61 (“A broker’s contemporaneous cost is presumptively the fair market value, and Respondents have the burden to show otherwise.”). IM-2440-2(b)(2) states that “countervailing evidence of the prevailing market price may be considered only where the dealer made no contemporaneous purchases in the security or can show that in the particular circumstances the dealer’s contemporaneous cost is not indicative of the prevailing market price.”

securities, which its customers would not know about without the firm's efforts.<sup>37</sup> J. W. Korth contends that Enforcement's steadfast reliance on contemporaneous cost as the prevailing market price also fails to factor into consideration that J. W. Korth purchased relatively large blocks of smaller bond issues and took on considerable risk by allowing each individual customer to purchase less than the full block.<sup>38</sup> J. W. Korth argues that, for certain trades,<sup>39</sup> the best contemporaneous offer is a reliable indicator of prevailing market price.<sup>40</sup>

We reject Korth's suggestion that the markups and markdowns at issue should be calculated based on inter-dealer quotations. We find that J. W. Korth failed to submit documentation demonstrating that the market for the securities was best represented by inter-dealer quotations rather than its own contemporaneous costs.<sup>41</sup> J. W. Korth failed to provide evidence that it conducted extensive research and accepted risk positions such that inter-dealer quotations became a more reliable indicator of the market. The Commission and the National Adjudicatory Council ("NAC") have consistently rejected quotations as a reliable indicator of the prevailing market price, and J. W. Korth has not persuaded us to stray from this conclusion.<sup>42</sup> The burden rested with J. W. Korth to provide reliable evidence that its contemporaneous cost

---

<sup>37</sup> Ans. at 10-12.

<sup>38</sup> J. W. Korth Amended Brief at 6.

<sup>39</sup> On Amended Schedule A to the Complaint (CX-3), J. W. Korth disputes FINRA's use of contemporaneous cost as the basis for prevailing market price in the following trades: 1-7, 9, 14, 20-21, 29-44, and 51. On Amended Schedule B to the Complaint (CX-4), J. W. Korth disputes FINRA's use of contemporaneous cost as the basis for prevailing market price in the following trades: 1-4 and 6.

<sup>40</sup> J. W. Korth argues that FINRA Supplemental Material 2121.02(b)(5)(C) supports its argument that inter-dealer offer and bid prices may be considered to determine prevailing market price. Ans. at 8. J. W. Korth is not correct. FINRA Supplemental Material 2121.02(b)(5)(C) states that, in instances where the dealer has established that its cost is no longer contemporaneous, or where the dealer has presented evidence to overcome the cost presumption, a member firm must consider as evidence of the prevailing market price—first, contemporaneous inter-dealer transactions; second, in the absence of contemporaneous inter-dealer transactions, prices of contemporaneous dealer purchases in the security in question from institutional accounts; and in the absence of the first two, contemporaneous quotations in an active market. Here, J. W. Korth ignores the firm's contemporaneous purchases and looks instead only to quotations. Furthermore, J. W. Korth has not demonstrated that it first considered contemporaneous inter-dealer transactions and, in the absence of contemporaneous inter-dealer transactions, prices of contemporaneous dealer purchases in the security in question from institutional accounts. FINRA Rule 2121 Supplemental Material therefore provides no support for J. W. Korth's argument. Finally, FINRA Supplemental Material 2121.02 does not apply to the municipal securities listed in Amended Schedule A. See FINRA Supplemental Material 2121.02, n.1 (stating that the interpretation does not apply to transactions in municipal securities).

<sup>41</sup> See *Dep't of Enforcement v. Grey*, No. 2009016034101, 2014 FINRA Discip. LEXIS 31, at \*19 (NAC Oct. 3, 2014 (relying on contemporaneous cost as the prevailing market price where respondent failed to demonstrate how market conditions had changed), *aff'd*, 2015 SEC LEXIS 3630; *LSCO Sec., Inc.*, 50 S.E.C. 518, 520 (1991) (stating that a dealer's contemporaneous cost represents market price absent a showing of a change in the market).

<sup>42</sup> *Lane*, 2015 SEC LEXIS 558, at \*43 (holding that quotations only propose a transaction and have little value as evidence of the current market); *Gordon*, 2008 SEC LEXIS 819, \*47-48 ("[W]e have held repeatedly that quotations that are not validated by comparison with actual inter-dealer transactions should not be relied on to establish the prevailing market price, in determining an appropriate retail markup."); *George Salloun*, 52 S.E.C. 208, 211 (1995) ("We note initially that it is well established that quotations merely propose transactions and, unless validated, do not establish the prevailing market price."); *Sacks Inv. Co.*, 51 S.E.C. 492, 496 (1993) (finding respondents reckless for charging customers markups based on unsubstantiated ask quotations).

was not indicative of the prevailing market. Korth failed to make such a showing for any of the trades at issue.

## **B. Fairness of Percentage Markups and Markdowns**

Enforcement alleges that markups and markdowns in excess of three percent are unfair. In support of this position, Enforcement offers the opinions of Paviolitis and Kapoor.

Paviolitis states that, in his opinion, J. W. Korth's markups and markdowns should not have exceeded an across-the-board two percent maximum.<sup>43</sup> We find that, in reaching this conclusion, Paviolitis failed to consider the many factors that both FINRA's and MSRB's markup guidance suggests that we consider, and displayed a lack of understanding of the nature of J. W. Korth's business. For instance, Paviolitis discussed maturity size, but not the number of years to maturity, which the Hearing Panel believes can be relevant to the fairness of markups.<sup>44</sup> We also reject Paviolitis's suggestion that the appropriate maximum for the trades at issue is two percent. Relevant case law suggests as a guideline a three percent maximum markup on debt securities.<sup>45</sup> As such, we place little reliance on Paviolitis's conclusions. We note, however, that he accurately indicates that there were no inter-dealer trades between J. W. Korth's purchases and its sales to customers, and we do consider his descriptions of the bonds at issue.<sup>46</sup> We also conducted our own review of the trade data included in CX-5.

Kapoor concluded that J. W. Korth "had a statistically significant higher markup on the securities at issue than the highest markup of the other dealers with a 95 percent degree of confidence."<sup>47</sup> Kapoor used a three percent threshold to calculate excessive markups and markdowns.<sup>48</sup> We find that reliance on a three percent maximum guideline is consistent with relevant case law.<sup>49</sup> We note, however, that the figures in Kapoor's report did not always comport with the trading records produced by Enforcement (CX-6). For instance, in Kapoor's individual trade analysis for CUSIP No. 40429CCW0, he discusses six sales to customers.<sup>50</sup> Four sales on Amended Schedule B involve the same security, but only two have the same sales volumes as the customer sales addressed in Kapoor's report. Thus, rather than rely exclusively

---

<sup>43</sup> CX-7, at 55-64.

<sup>44</sup> CX-7, at 56. We note that maturity or average life can be a significant consideration even with bonds that involve sinking funds.

<sup>45</sup> See, e.g., *Grey*, 2015 SEC LEXIS 3630, at \*35 (noting respondent's own concession that markups exceeding three percent are suspect and probably excessive); *Anderson*, 2003 SEC LEXIS 1935, at \*36 (noting that markups on debt securities of three to 3.5 percent may be excessive); *David Lerner Assoc.*, 2012 FINRA Discip. LEXIS 44, at \*23-24 (finding markups of 3.01 percent excessive).

<sup>46</sup> CX-7, at 55-64.

<sup>47</sup> CX-8, at 3.

<sup>48</sup> CX-8, at 94.

<sup>49</sup> See *supra* note 45.

<sup>50</sup> CX-8, at 94-96.

on Kapoor's report, we conducted our own review of trade data from the WIAT trade data included in CX-6.

Once Enforcement presented evidence that J. W. Korth's markups and markdowns exceeded three percent (Amended Schedules A and B to the Complaint, CX-5, and CX-6), the burden shifted to J. W. Korth to demonstrate that its markups and markdowns are fair and reasonable.<sup>51</sup> J. W. Korth argues that imposing a straight three percent rule is unfair to fixed income dealers and inconsistent with FINRA's and MSRB's published rules. J. W. Korth contends that markups in excess of three percent are justified by the exceptional services it provides to its customers and the unique expertise it brings to its recommendations.<sup>52</sup> The firm notes that it also offered every client the proprietary online service Shop4Bonds, which provided the clients significant market transparency free of additional charge. We have considered J. W. Korth's arguments about the nature of its services. With respect to many trades, J. W. Korth failed to substantiate this argument, as it is required to do to prove the fairness of the firm's markups.<sup>53</sup>

J. W. Korth also argues that its markups are justified by the time and expense devoted to each individual trade. J. W. Korth states that, "in reality, it takes hours and hours of market research, client hand holding, specific security research, expensive information sources, multiple offers and capital commitments and market risk" before it buys any debt security.<sup>54</sup> J. W. Korth argues that the firm is entitled to make a reasonable profit based on its business model and that its costs are very high because of the particularized services it renders.<sup>55</sup> We reject this argument. If a firm cannot be profitable by charging fair and reasonable markups, the solution is not to charge excessive markups, but rather to revise the firm's pricing practices.<sup>56</sup> Additionally, J. W. Korth has not proffered sufficient evidence to support its contention that it invested significant

---

<sup>51</sup> *First Honolulu Sec., Inc.*, 51 S.E.C. 695, 701 (1993); *Donald T. Sheldon*, 51 S.E.C. 59, 77 (1992), *aff'd*, 45 F.3d 1515 (11th Cir. 1995).

<sup>52</sup> Ans. at 10.

<sup>53</sup> *See Lane*, 2015 SEC LEXIS 558, at \*35-36 (rejecting argument that markups were justified by "extensive credit analysis and valuable services that were indirectly paid for only through bond transactions" because respondent failed to provide proof of the claim); *Gordon*, 2008 SEC LEXIS 819, at \*49 (rejecting argument that respondent's markups were justified by the extra effort that the firm devoted to executing the transactions at issue because respondent provided no documentation to validate the claim); *David Lerner Assoc.*, 2012 FINRA Discip. LEXIS 44, at \*71 (rejecting argument that respondent's exceptional services justified its markups because respondents did not introduce evidence that services provided were superior to those provided by other bond dealers).

<sup>54</sup> Ans. at 15.

<sup>55</sup> Ans. at 8-9. J. W. Korth states that many hours of research and "combing the markets" go into each trade. For each inventory position the firm takes, there may be 15 other bonds that the firm researched, but chose not to purchase. Ans. at 9-10.

<sup>56</sup> *See Inv. Planning, Inc.*, 51 S.E.C. 592, 597 (1993) ("Nor, in seeking a profit, could [respondents] pass along to the customer their expenses if the total would unreasonably exceed the prevailing wholesale price."); *Dist. Bus. Conduct Comm. v. Century Capital Corp. of S. Carolina*, No. C07900003, 1992 NASD Discip. LEXIS 73, at \*34 (NBCC Mar. 30, 1992) (restating Board of Governors' position that if a firm "cannot be profitable within the guidelines of the Markup Policy, the solution is not to violate the policy"), *aff'd*, 50 S.E.C. 1280 (1992), *aff'd*, 22 F.3d 1184 (D.C. Cir. 1994) (Table).

time and energy into each of the bond sales at issue. The firm could have offered as evidence research documents, documentation related to its investigations of various bonds, and records maintained of the time that it devoted to particular customers. The firm did not produce evidence of unusual expenses, and its arguments therefore fail.<sup>57</sup>

J. W. Korth also faults FINRA for cherry picking trades and notes that this case focuses on 62 trades out of the universe of approximately 18,000 trades that it executed during the relevant three-year period. Even if J. W. Korth's remaining transactions from this period did not involve unfair prices, "that does not excuse the markup violations in the [trades] at issue."<sup>58</sup> We have considered each trade individually and in many instances concur with Enforcement's assertion that the appropriate markup is three percent.<sup>59</sup> For some trades, however, we find that a higher markup is fair and reasonable given the many factors at play.

### 1. Amended Schedule A—Municipal Bonds<sup>60</sup>

In Amended Schedule A (CX-5), we reviewed the first seven trades, which involved J. W. Korth's purchases and sales of bonds (identified by CUSIP No. 880443BG0) during a period of three days. J. W. Korth purchased 300,000 bonds between 3:00 and 4:00 p.m. on April 21, 2009, and sold the bonds to eight customers (only seven of which are alleged to include excessive markups) on April 22, 2009, between 4:30 and 4:40 p.m., at markups of 4.12 to 5.58 percent.<sup>61</sup> There was intermittent trading in this bond during the days leading up to these trades.<sup>62</sup> The Hearing Panel concurs with Paviolitis's assessment that this was not a particularly obscure bond, but found that he failed to give sufficient consideration to the fact that this bond

---

<sup>57</sup> See *Grey*, 2015 SEC LEXIS 3630, at \*37-38 (rejecting respondent's argument that markups were justified by the firm's transaction costs and other expenses because respondent did not introduce evidence to prove the claim, "as was his burden if he wished to justify the markups on that basis"); *Inv. Planning, Inc.*, 51 S.E.C. 592, 597 ("However relevant the extent of risk and the cost of doing business may be in some circumstances to a determination of whether unfair prices have been charged, such factors do not justify retail prices higher than those at which the same securities are generally available to investors through other dealers who operate in the same market."); *Staten Sec. Corp.*, 47 S.E.C. 766, 768 (1982) (rejecting time and expense to justify markups because the evidence did not establish that, in effecting the transactions at issue, respondent incurred any unusual expense).

<sup>58</sup> *Dep't of Market Regulation v. Lane*, No. 20070082049, 2013 FINRA Discip. LEXIS 34, at \*37 (NAC Dec. 26, 2013), *aff'd*, 2015 SEC LEXIS 558.

<sup>59</sup> FINRA's markup rule provides a maximum five percent guideline and states that a markup of less may be considered unfair and unreasonable. IM-2440-1(a)(4). FINRA and the Commission have consistently held that a significantly lower markup is customarily charged in the sale of debt securities. *Anderson*, 2003 SEC LEXIS 1935, at \*24; *First Honolulu Sec.*, 51 S.E.C. at 698; *Dep't of Enforcement v. SFI Invs., Inc.*, 2000 NASD Discip. LEXIS 52, at \*46. MSRB rules provide no percentage guideline as to what constitutes a reasonable markup or markdown, but FINRA and the Commission repeatedly have held that markups on debt securities should fall below five percent except in exceptional circumstances. *Grey*, 2015 SEC LEXIS 3630, at \*33; *Inv. Planning*, 51 S.E.C. at 595 (finding excessive markups above four percent on sales of corporate and municipal bonds); *David Lerner Assoc.*, 2012 FINRA Discip. LEXIS 44, at \*17 (crediting expert testimony that "municipal bond markups had to be substantially less than" five percent, and that markups greater than three percent "would be subject to regulatory scrutiny").

<sup>60</sup> A copy of Amended Schedule A to the Complaint (CX-3) is attached as Schedule A to this decision.

<sup>61</sup> CX-5, at 1-2.

<sup>62</sup> CX-5, at 1-2.

had a 20-year average maturity and the effect of this on yield to the customers. Based on the Hearing Panel members' experience in the municipal bond industry, we find that 3.5 percent would have been an acceptable markup for this bond, given its yield and maturity. J. W. Korth exceeded this amount and its own internal guideline of 3.9 percent. We find that J. W. Korth's markups on trades one through seven of Amended Schedule A were not fair and reasonable to the extent that they exceeded 3.5 percent.<sup>63</sup>

J. W. Korth argues that, when Enforcement calculated markups, it failed to consider the average markup per customer, which the firm contends would demonstrate that it treats its customers fairly.<sup>64</sup> J. W. Korth states that, for each customer, it executes some trades with little or no markups and others with more standard markups and that Enforcement's method of pulling one trade out of many does not accurately illustrate the firm's actual profits. As to trades one through seven on Amended Schedule A, Korth submitted information that included, for each of the seven customers, all bond trades the firm executed for each customer.<sup>65</sup> This information demonstrates that the firm charged minimal or no commissions on some sales. It also shows that the firm's average markup for each customer over the course of the firm/customer relationship was less than 2.2 percent.<sup>66</sup> A markup on one transaction cannot, however, be justified by a smaller or no markup on another transaction.<sup>67</sup> The Commission rejected a similar argument in *Grey*, where it held that "a firm may not charge excessive markups to compensate for losses in other transactions."<sup>68</sup> We reject this defense.

In trade eight, J. W. Korth purchased 150,000 bonds (identified by CUSIP No. 76363PAC9) at 11:05 a.m. on May 5, 2009, and sold 110,000 to five customers three or more hours later.<sup>69</sup> Enforcement alleges that one sale of 50,000 bonds at a markup of 3.9 percent was excessive. There was minimal trading in this bond during the days leading up to these trades.<sup>70</sup> The bond is not rated and involves a smaller issue size.<sup>71</sup> Based on the Hearing Panel members' experience in the municipal bond business, we find that the firm's markup was not excessive.

---

<sup>63</sup> J. W. Korth argues, with respect to trade seven, that the firm held the bonds for two nights and that the inter-dealer market changed during that period. Ans. at 22. We reviewed the trading in this bond during that period (CX-5, at 1-2), and find that the firm did not meet its burden of demonstrating a change in the market. See *David Lerner Assoc.*, 2012 FINRA Discip. LEXIS 44, at \*61-62 (holding that respondent has the burden to demonstrate evidence of a change in the market price that would contradict reliance on contemporaneous cost for calculating markups).

<sup>64</sup> J. W. Korth Amended Brief at 6.

<sup>65</sup> RX-4.

<sup>66</sup> RX-4.

<sup>67</sup> *Lane*, 2015 SEC LEXIS 558, at \*36; *F. B. Horner & Assoc., Inc.*, 50 S.E.C. 1063, 1068 (1992), *aff'd*, 994 F.2d 61 (2d Cir. 1993).

<sup>68</sup> *Lane*, 2015 SEC LEXIS 558, at \*36. See also *Thomas F. White*, 51 S.E.C. 932, 936 ("a reasonable markup on some transactions for a customer cannot justify excessive markups on others"), *aff'd*, 68 F.3d 482 (9th Cir. 1995); *F.B. Horner*, 50 S.E.C. at 1068 (same).

<sup>69</sup> CX-5, at 4.

<sup>70</sup> CX-5, at 4.

<sup>71</sup> CX-7, at 56.

Because this bond was not rated and involved a smaller issue size, the Hearing Panel members' experience suggests that more research would have been required to locate, sell, and service this bond. Additionally, we do not believe that this particular security could have been easily purchased at more general, less-specialized dealers. Given these factors, we hold that J. W. Korth's sales price was fair and reasonable. We dismiss the allegations as to trade eight on Amended Schedule A.

In trade nine, J. W. Korth purchased 150,000 bonds (identified by CUSIP No. 722045BE0) at 10:24 a.m. on May 19, 2009, and sold them to two customers in less than 15 minutes.<sup>72</sup> There was no trading in this bond during the days leading up to these trades.<sup>73</sup> Enforcement alleges that one sale of 50,000 bonds with a markup of 3.28 percent was excessive. We disagree. This bond also had a small issue size<sup>74</sup> which, in the experience of the Hearing Panel members, suggests that more research would have been required to locate, sell, and service this bond. We also considered the size of the trade. Given these factors, and our consideration of other factors, we hold that J. W. Korth's sales price was fair and reasonable. We dismiss the allegations as to trade nine on Amended Schedule A.

In trade 10, J. W. Korth bought 170,000 bonds (identified by CUSIP No. 54241AAW3) in two trades at approximately 4:00 p.m. on May 28, 2009, and sold 85,000 to a customer at 10:00 a.m. the next day at a 3.65 percent markup.<sup>75</sup> Some trading occurred during the days leading up to these trades.<sup>76</sup> This bond had a large issue size and an average amount of liquidity. Given the short amount of time that the firm held these bonds, and the reasonable size of the customer trade, we find that the firm's 3.65 percent markup was not fair and reasonable to the extent that it exceeded three percent.

We also find that J. W. Korth's markup of 3.89 percent on trade 11 was excessive to the extent that it exceeded three percent. On June 10, 2009, J. W. Korth purchased 45,000 bonds (identified by CUSIP No. 6459162E6) at \$93.75 and, within six minutes, sold the bonds to a customer at 97.40.<sup>77</sup> At a similar time on the same day, another firm purchased 10,000 bonds (identified by CUSIP No. 6459162E6) at a higher price, \$94, yet sold them to a customer at \$94.10, which is lower than J. W. Korth's retail sales price.<sup>78</sup> Based on Hearing Panel members' municipal bond experience, we find that the firm's 3.89 percent markup on trade 11 was excessive to the extent that it exceeded three percent.

---

<sup>72</sup> CX-5, at 5.

<sup>73</sup> CX-5, at 5.

<sup>74</sup> CX-7, at 56.

<sup>75</sup> CX-5, at 7-8.

<sup>76</sup> CX-5, at 7-8.

<sup>77</sup> CX-5, at 9.

<sup>78</sup> CX-5, at 9.

Trades 12 through 14 on Amended Schedule A to the Complaint involve a bond issue in which there was no other trading during the relevant days. On July 14, 2009, J. W. Korth purchased 25,000 bonds (identified by CUSIP No. 458761BE2) and sold them to a customer one minute later at a 3.48 percent markup.<sup>79</sup> On July 21, 2009, the firm purchased an additional 25,000 bonds (identified by CUSIP No. 458761BE2) and sold them to a customer ten minutes later at a 3.86 percent markup. On July 23, 2009, J. W. Korth bought another 60,000 bonds (identified by CUSIP No. 458761BE2) and sold them to a customer approximately 24 hours later at 5.47 percent markup.<sup>80</sup> Although the firm held some bonds overnight on July 23, it did not demonstrate any change in the market during that time, and nothing in the trade data suggests that a change occurred. With no evidence to suggest that J. W. Korth provided exceptional services or incurred significant costs so as to justify its markups, we find that a three percent markup would have been fair and reasonable. We find that the firm's markups on trades 12 through 14 were excessive to the extent that they exceeded three percent.

Trades 15 through 19 occurred on July 31, 2009. J. W. Korth purchased 95,000 bonds (identified by CUSIP No. 38122NPA4) at 11:27 a.m.<sup>81</sup> Less than 20 minutes later, the firm sold 50,000 bonds to two customers at a markup of 3.79 percent.<sup>82</sup> At approximately 12:30 p.m., the firm sold an additional 25,000 bonds at a 3.79 percent markup.<sup>83</sup> J. W. Korth purchased an additional 200,000 bonds (identified by CUSIP No. 38122NPA4) at 1:45 p.m. and immediately sold 185,000 to a customer at a 3.1 percent markup.<sup>84</sup> At 1:56 p.m., the firm purchased 180,000 bonds and sold them at 2:05 p.m. at a 3.1 percent markup. We note that the firm appeared able to buy and sell these bonds quickly and that two of the firm's sales were substantial in size (185,000 and 180,000). This was a large issue with active trading during July 2009.<sup>85</sup> With no evidence to suggest that J. W. Korth provided exceptional services or incurred significant costs so as to justify its markups, we find that a three percent markup would have been fair and reasonable, and that J. W. Korth charged excessive markups.

Trades 20 and 21 occurred on September 3 and 4, 2009.<sup>86</sup> At 12 noon on September 2, 2009, J. W. Korth purchased 45,000 bonds (identified by CUSIP No. 86657MAL0). There is no other trading in the same bonds at or around that time.<sup>87</sup> At 4:00 p.m. on September 3, the firm

---

<sup>79</sup> CX-5, at 10.

<sup>80</sup> CX-5, at 10.

<sup>81</sup> CX-5, at 18-20.

<sup>82</sup> CX-5, at 18. J. W. Korth also sold 40,000 additional bonds to two customers, but Enforcement has not alleged that the firm charged excessive markups on these sales. CX-5, at 19.

<sup>83</sup> CX-5, at 19. J. W. Korth also sold 25,000 additional bonds to a customer, but Enforcement has not alleged that the firm charged an excessive markup on the sale. CX-5, at 19.

<sup>84</sup> CX-5, at 19. J. W. Korth also sold 15,000 additional bonds to a customer, but Enforcement has not alleged that the firm charged an excessive markup on the sale. CX-5, at 19.

<sup>85</sup> CX-5, at 11-42; CX-7, 59.

<sup>86</sup> CX-5, at 21.

<sup>87</sup> CX-5, at 21.

sold 20,000 bonds at a markup of 8.33 percent. At approximately 11:00 a.m. on September 4, the firm sold 25,000 bonds at an 8.33 percent markup. These trades involved a small issue.<sup>88</sup> In July 2009, the Internal Revenue Service commenced an investigation into the tax exempt status of the bonds.<sup>89</sup> We have considered the size of the issue, the limited trading in the bond, the nature of the bond at issue, the size of J. W. Korth's sales to its customers, and the fact that the firm did not buy and sell these bonds within hours or even on the same day. We find that J. W. Korth's 8.33 percent markups were not fair and reasonable, but also conclude that, in these two instances, markups of 3.5 percent would have been fair. Thus, we find that the firm's markups on trades 20 and 21 were excessive to the extent that they exceeded 3.5 percent.

Trades 22 through 27 on Amended Schedule A to the Complaint occurred on January 28 and 29, 2010, and February 1, 2010. On January 28, 2010, J. W. Korth purchased 250,000 bonds (identified by CUSIP No. 196458MN0) at 3:50 p.m.<sup>90</sup> At 4:10 p.m., it sold 70,000 bonds to four customers.<sup>91</sup> Enforcement alleges that markups on two of the sales, which were 3.71 percent, were excessive. On January 29, 2010, between 10:30 a.m. and 10:42 a.m., the firm sold an additional 120,000 bonds (identified by CUSIP No. 196458MN0) to five customers.<sup>92</sup> Enforcement alleges that markups on two of the sales, which were 3.71 percent, were excessive. At 10:53 a.m., J. W. Korth purchased an additional 280,000 bonds (identified by CUSIP No. 196458MN0), 100,000 of which it sold five minutes later at a 3.71 percent markup. The following business day, February 1, 2010, the firm sold 200,000 bonds to a customer at a 3.71 percent markup.<sup>93</sup> This bond was not heavily traded during the days at issue, and the issue size was small.<sup>94</sup> During the course of two days, the firm committed its capital to purchase in excess of 500,000 bonds, part of which it held for two days. J. W. Korth has not, however, demonstrated and documented the work that the firm undertook to purchase and sell the bonds in trades 22 through 26. With no evidence to suggest that J. W. Korth provided exceptional services or incurred significant costs so as to justify its markups, we find that a three percent markup would have been fair and reasonable in trades 22 through 26. As such, we find that the firm's markups in excess of three percent were not fair and reasonable in trades 22 through 26.

Trade 27 on Amended Schedule A is J. W. Korth's sale of 200,000 bonds (identified by CUSIP No. 196458MN0) on February 1, 2010, at 10:48 a.m.<sup>95</sup> On February 3, 2010, an inter-dealer transaction occurred at \$89.50.<sup>96</sup> On Amended Schedule A, Enforcement calculated J. W.

---

<sup>88</sup> CX-7, at 59.

<sup>89</sup> CX-7, at 59.

<sup>90</sup> CX-5, at 22-23.

<sup>91</sup> CX-5, at 22-23.

<sup>92</sup> CX-5, at 22-23.

<sup>93</sup> CX-5, at 23. J. W. Korth also sold 15,000 additional bonds to a customer, but Enforcement has not alleged that the firm charged an excessive markup on the sale. CX-5, at 22-23.

<sup>94</sup> CX-7, at 60.

<sup>95</sup> CX-5, at 23.

<sup>96</sup> CX-5, at 23.

Korth's markup based on the firm's January 29, 2010 cost of \$86.71. The February 3 inter-dealer trade (identified by CUSIP No. 196458MN0) at a higher price suggests to us that the market was moving upward, and we have determined to calculate the firm's markup on trade 27 based on the inter-dealer price of \$89.50 rather than the firm's cost. Based on this calculation, we find that J. W. Korth charged a 2.79 percent markup on trade 27, which we find is fair and reasonable. We therefore dismiss Enforcement's allegations as to trade 27.

Trades 29 through 34<sup>97</sup> on Amended Schedule A occurred in February 2010. At 9:02 a.m. on February 17, 2010, J. W. Korth purchased 600,000 bonds (identified by CUSIP No. 74514LJU2) at \$74, and sold 440,000 bonds to seven customers at \$77 between 9:15 a.m. and 11:25 a.m.<sup>98</sup> Enforcement alleges that J. W. Korth charged excessive markups of 4.05 percent on four of the sales (trades 29 through 32 of Amended Schedule A). On February 23, 2010, the firm sold 50,000 bonds (identified by CUSIP No. 74514LJU2) at 8:30 a.m. and 30,000 bonds at 9:35 a.m. to two customers (trades 33 and 34 on Amended Schedule A).<sup>99</sup> On Amended Schedule A, Enforcement calculated J. W. Korth's markups on the February 23, 2010 sales to customers based on the firm's February 17, 2010 cost of \$74. A February 22, 2010 sale from J. W. Korth to another broker-dealer at a higher price (\$77), however, suggests to us that the inter-dealer market was moving upward.<sup>100</sup> We therefore calculated the firm's markup on trades 33 and 34, which occurred on February 23, 2010, based on the inter-dealer market of \$77 rather than the firm's cost of \$74. Based on these calculations, we find that J. W. Korth charged fair and reasonable prices on trades 33 and 34. We therefore dismiss Enforcement's allegations as to trades 33 and 34.

As to trades 29 through 32, we considered the level of trading in these bonds,<sup>101</sup> and the fact that they are floating-rate bonds linked to the Consumer Price Index. These factors could suggest that J. W. Korth expended additional time and manpower on researching and locating buyers for these bonds. J. W. Korth, however, has not demonstrated and documented the efforts that the firm undertook to purchase and sell these bonds. In the absence of such evidence, given the size of the issue and based on our review of trading, we conclude that three percent would be a fair markup on these trades. We find that J. W. Korth's markups on trades 29 through 32 in excess of three percent were not fair and reasonable.

In trade 35, J. W. Korth purchased 100,000 bonds (identified by CUSIP No. 574205FK1) on March 2, 2010, and sold the bonds on March 3, 2010, at a markup of 5.87 percent, which we find excessive.<sup>102</sup> The firm's purchase and sale occurred approximately one hour apart, and there

---

<sup>97</sup> Enforcement withdrew trade 28.

<sup>98</sup> CX-5, at 24.

<sup>99</sup> CX-5, at 25.

<sup>100</sup> CX-5, at 25.

<sup>101</sup> Paviolitis's report states that these bonds were actively traded. CX-7, at 60. The trading information contained on CX-5, however, suggests otherwise during the period at issue. CX-5, at 24-25.

<sup>102</sup> CX-5, at 26.

is no evidence that the market moved during that time. The firm's markup significantly reduced the customer's yield, and J. W. Korth has not produced evidence to substantiate the reasonableness of its markup. We find that J. W. Korth's markup in excess of three percent was not fair and reasonable.

In trade 36, J. W. Korth purchased 60,000 bonds (identified by CUSIP No. 696507PF3) on March 12, 2010, and sold the bonds five days later on March 17, 2010, at a markup of 6.82 percent.<sup>103</sup> No inter-dealer trading occurred during the intervening five days.<sup>104</sup> This bond was a small issue. On March 17, 2010, the day of J. W. Korth's sale, a material event occurred—rating agency Fitch changed the credit outlook for the bonds from negative to stable and affirmed the rating of BBB-.<sup>105</sup> In order for us to determine with certainty what effect, if any, the March 17 event had on trading, we would need to review trade data for trading days subsequent to March 17, 2010. Without this evidence, we have determined that, giving due consideration to the material event that occurred on March 17, a markup of 3.5 percent would have been fair and reasonable. We find that J. W. Korth's markup on trade 36 of Amended Schedule A was not fair and reasonable to the extent that it exceeded 3.5 percent.

In trade 42,<sup>106</sup> J. W. Korth purchased 1,805,000 bonds (identified by CUSIP No. 69671TCE7) for \$25.143 at 3:29 p.m. on April 22, 2010.<sup>107</sup> It sold 50,000 bonds to a customer at 8:25 a.m. on April 23, 2010, at \$26.185, which resulted in a markup of 4.14 percent.<sup>108</sup> Later in the day on April 23, inter-dealer trades (identified by CUSIP No. 69671TCE7) occurred at \$26.205, \$26.50, and \$26.145, and another firm sold to a customer at \$26.60.<sup>109</sup> These trades suggest to us that a change in the market for this bond occurred at a time when J. W. Korth continued to hold a significant amount of these bonds in inventory. Based on the Hearing Panel members' experience in the municipal securities markets and in light of the trades that occurred on the same day as J. W. Korth's customer sale, we do not find that the record is sufficient to enable us to conclude whether J. W. Korth's price on trade 42 was fair or excessive. We therefore dismiss Enforcement's allegations as to trade 42 on Amended Schedule A to the Complaint. Our dismissal, however, is not a finding that the firm's 4.14 percent markup was fair and reasonable. Rather, we find that Enforcement failed to meet its burden of proof on this trade.

We next turn to trades 43 and 44. J. W. Korth purchased 195,000 bonds (identified by CUSIP No. 130178FP6) on May 5, 2010, and sold the bonds on May 7, 2010, at a markup of 5.63 percent, which we find excessive.<sup>110</sup> J. W. Korth purchased an additional 75,000 bonds

---

<sup>103</sup> CX-5, at 28.

<sup>104</sup> CX-5, at 28.

<sup>105</sup> CX-7, at 61.

<sup>106</sup> Enforcement withdrew trades 37 through 41.

<sup>107</sup> CX-5, at 33.

<sup>108</sup> CX-5, at 33-34.

<sup>109</sup> CX-5, at 33-34.

<sup>110</sup> CX-5, at 35.

(identified by CUSIP No. 130178FP6) on May 11, 2010, and sold the bonds on May 12, 2010, at a markup of 3.31 percent, which we also find excessive.<sup>111</sup> The firm's purchases and sales occurred rather quickly, and nothing in the trading records suggests changes in the market for this security. The firm's markup reduced the customer's yield, and J. W. Korth has not produced evidence to substantiate the reasonableness of its markups. We find that J. W. Korth's markups in excess of three percent were not fair and reasonable.

Next we consider trades 45 through 49. On July 19, 2010, J. W. Korth purchased 300,000 bonds (identified by CUSIP No. 589664AU5) at 3:35 p.m.<sup>112</sup> It sold those bonds the next day, July 20, 2010, between 9:43 a.m. and 1:25 p.m. to nine customers.<sup>113</sup> Enforcement has alleged that markups in five of the sales, which were 3.60 percent, were excessive. We agree. The firm's purchases and sales occurred rather quickly, and nothing in the trading records suggests changes in the market for this security. The firm's markups reduced the customers' yield, and J. W. Korth has not produced evidence to substantiate the reasonableness of its markups. Furthermore, other firms sold to customers the day before J. W. Korth's sales at significantly lower prices.<sup>114</sup> We find that J. W. Korth's markups in excess of three percent were not fair and reasonable.

We next consider trade 51 on Amended Schedule A to the Complaint.<sup>115</sup> J. W. Korth purchased 270,000 bonds (identified by CUSIP No. 26822LGS7) on December 8, 2011, and sold 100,000 on December 9, 2011, at a markup of 4.72 percent, which we find excessive.<sup>116</sup> The firm's purchase and sale occurred approximately one day apart, and there is no evidence that the market moved during that time. With no evidence to suggest that J. W. Korth provided exceptional services or incurred significant costs so as to justify its markup, we find that a three percent markup would have been fair and reasonable. We find that J. W. Korth's markup in excess of three percent was not fair and reasonable.

## **2. Amended Schedule B—Corporate Bonds and CMOs<sup>117</sup>**

With respect to trades one through four on Amended Schedule B to the Complaint, J. W. Korth purchased 300,000 bonds (identified by CUSIP No. 40429CCW0) at 3:11 p.m. on April 8, 2009.<sup>118</sup> The firm sold 285,000 bonds on the same day to six customers and an additional 85,000 to a customer the following day.<sup>119</sup> Based on trade volume, we are able to match up to the WIAT

---

<sup>111</sup> CX-5, at 35.

<sup>112</sup> CX-5, at 36-38.

<sup>113</sup> CX-5, at 37-38.

<sup>114</sup> CX-5, at 37-38.

<sup>115</sup> Enforcement withdrew trade 50.

<sup>116</sup> CX-5, at 42.

<sup>117</sup> A copy of Amended Schedule B to the Complaint (CX-4) is attached as Schedule B to this decision.

<sup>118</sup> CX-6, at 2.

<sup>119</sup> CX-6, at 2.

trade data only trades two and four on Amended Schedule B. Trade one is a sale of 35,000 bonds (identified by CUSIP No. 40429CCW0) to a customer after two hours and five minutes in inventory. Trade three is a sale of 85,000 bonds (identified by CUSIP No. 40429CCW0) after two hours and five minutes in inventory. We are unable to locate these trades in the WIAT trade data.<sup>120</sup> As such, we hold that Enforcement failed to meet its burden of proof with respect to trades one and three on Amended Schedule B to the Complaint. We therefore dismiss Enforcement's allegations as to trades one and three on Amended Schedule B.

Trades two and four involve sales to customers after approximately two hours in inventory of 20,000 and 100,000 bonds (identified by CUSIP No. 40429CCW0), respectively. We observed little other trading in this security and note that another inter-dealer trade occurred on April 8, 2009, at the same price as J. W. Korth's purchase. Other dealers' sales to customers on April 8, 2009, occurred at significantly lower prices than J. W. Korth retail sales prices.<sup>121</sup> J. W. Korth has not presented any evidence to substantiate a change in the market or other circumstances that would justify the firm's 5.30 percent markups on trades two and four. We find that J. W. Korth's markups in excess of three percent were not fair and reasonable.

Trades five through eight on Amended Schedule B involve J. W. Korth's sales of bonds in April, May, and June 2009.<sup>122</sup> In each trade, the firm sold after holding the bonds in inventory for less than 30 minutes.<sup>123</sup> J. W. Korth charged the customers 3.48, 5.56, 3.90, and 3.47 percent markups on these trades. We reviewed the trading in these securities on the relevant days, considered other inter-dealer transactions on those days, and looked at other dealers' sales to customers.<sup>124</sup> J. W. Korth has not presented any evidence to substantiate a change in the market, a change in ratings, additional services that the firm provided, or other circumstances that would justify markups in excess of three percent. We find that J. W. Korth's markups in excess of three percent were not fair and reasonable for trades five through eight on Amended Schedule B.

---

<sup>120</sup> The WIAT trade data does not identify customers by name or initials, so we are not able to identify by customer which trades on CX-6 match up with customer trades on Amended Schedule B. The WIAT trade data lists J. W. Korth's sales to customers on April 8, 2009, as follows: a sale of 50,000 bonds (identified by CUSIP No. 40429CCW0) to a customer at 3:59 p.m.; a sale of 25,000 bonds (identified by CUSIP No. 40429CCW0) to a customer at 4:06 p.m.; a sale of 10,000 bonds (identified by CUSIP No. 40429CCW0) to a customer at 4:36 p.m.; a sale of 20,000 bonds (identified by CUSIP No. 40429CCW0) to a customer at 5:02 p.m.; a sale of 80,000 bonds (identified by CUSIP No. 40429CCW0) to a customer at 5:15 p.m.; and a sale of 100,000 bonds (identified by CUSIP No. 40429CCW0) to a customer at 5:15 p.m. CX-6, at 2. Trade 1 on Amended Schedule B is a sale of 35,000 bonds (identified by CUSIP No. 40429CCW0) to a customer on April 8, 2009. Trade 3 on Amended Schedule B is a sale of 85,000 bonds (identified by CUSIP No. 40429CCW0) to a customer.

<sup>121</sup> CX-6, at 2.

<sup>122</sup> Trade five is a sale of 36,000 bonds (identified by CUSIP No. 12626PAE3) on April 21, 2009. Trade six is a sale of 400,000 bonds (identified by CUSIP No. 01903QAA6) on April 24, 2009. Trade seven is a sale of 25,000 bonds (identified by CUSIP No. 02003MAF1) on May 15, 2009. Trade eight is a sale of 25,000 bonds (identified by CUSIP No. 78442FEH7) on June 24, 2009.

<sup>123</sup> CX-6, at 4, 7, 16, 21.

<sup>124</sup> CX-6, at 3-4, 7, 16, 21.

Trades nine through 12 on Amended Schedule B allege excessive markdowns.<sup>125</sup> In these trades, J. W. Korth purchased bonds from customers and simultaneously (or within three minutes) sold them in inter-dealer transactions.<sup>126</sup> J. W. Korth charged the customers markdowns of 3.75, 3.65, 3.57, and 3.75 percent. J. W. Korth has not presented any evidence to substantiate a change in the market, a change in ratings, additional services that the firm provided, or other circumstances that would justify markdowns in excess of three percent. We find that J. W. Korth's markdowns in excess of three percent were not fair and reasonable.

Trades 13 and 14 involve sales of bonds on October 14, 2010. J. W. Korth bought 40,000 bonds (identified by CUSIP No. 420122AB9) and sold 20,000 each to two customers approximately one minute later at a 3.75 percent markup.<sup>127</sup> Inter-dealer trading on October 14 occurred at the same price as J. W. Korth's purchase.<sup>128</sup> We reviewed the trading in these securities on the relevant days, considered other inter-dealer transactions on those days, and looked at other dealers' sales to customers.<sup>129</sup> J. W. Korth has not presented any evidence to substantiate a change in the market, a change in ratings, additional services that the firm provided, or other circumstances that would justify markups in excess of three percent. We find that J. W. Korth's markups in excess of three percent were not fair and reasonable.

Trades 15, 16, and 17 involve J. W. Korth's sales of CMOs on December 2 and 6, 2011, at markups of 3.27 percent and 3.30 percent.<sup>130</sup> We do not find that these markups are excessive. Based on the Hearing Panel members' industry experience, CMOs generally trade less fluidly than other debt securities and the market is not as transparent. A markup in excess of three percent may be fair and reasonable in sales of CMOs.<sup>131</sup> We do not find that Enforcement has demonstrated that J. W. Korth's markups on these trades were excessive. We dismiss Enforcement's allegations as to trades 15, 16, and 17 on Amended Schedule B.

Trade 18 involves a December 7, 2011 sale of 50,000 bonds (identified by CUSIP No. 90400XAC8) to a customer at a 3.24 percent markup. J. W. Korth purchased 100,000 bonds

---

<sup>125</sup> Trade nine is a purchase of 50,000 bonds (identified by CUSIP No. 78442FAX6) on January 22, 2010. Trade 10 is a purchase of 65,000 bonds (identified by CUSIP No. 345370BM1) on March 1, 2010. Trade 11 is a purchase of 50,000 bonds (identified by CUSIP No. 02687QBW7) on March 12, 2010. Trade 12 is a purchase of 75,000 bonds (identified by CUSIP No. 345370BM1) on March 16, 2010.

<sup>126</sup> CX-6, at 27, 34, 35, 48.

<sup>127</sup> CX-6, at 63.

<sup>128</sup> CX-6, at 63.

<sup>129</sup> CX-6, at 3-4, 7, 16, 21.

<sup>130</sup> Trade 15 is a sale of 5,000,000 bonds (identified by CUSIP No. 38373AAV8) on December 2, 2011. Trade 16 is a sale of 100,000 bonds (identified by CUSIP No. 38377R2F1) on December 6, 2011. Trade 17 is a sale of 100,000 bonds (identified by CUSIP No. 38377R2F1) on December 6, 2011.

<sup>131</sup> See *David Lerner Assoc.*, 2012 FINRA Discip. LEXIS 44, at \*34 (noting Enforcement's expert's testimony that markups on CMOs should be less than four percent to be fair to customers); *Dist. Bus. Conduct Comm. v. MMAR Group, Inc.*, No. C05940001, 1996 NASD Discip. LEXIS 66, at \*35 (NBCC Oct. 22, 1996) (stating that markups on sales of CMOs generally should be less than five percent); *F.B. Horner & Assoc.*, 50 S.E.C. 1063, 1067 (finding markups in excess of five percent excessive).

(identified by CUSIP No. 90400XAC8) on December 7, 2010, and sold 50,000 to a customer less than one hour later.<sup>132</sup> All other inter-dealer transactions that day occurred at or below J. W. Korth's purchase price.<sup>133</sup> We reviewed the trading in these securities on the relevant days, considered other inter-dealer transactions on those days, and looked at other dealers' sales to customers.<sup>134</sup> J. W. Korth has not presented any evidence to substantiate a change in the market, a change in ratings, additional services that the firm provided, or other circumstances that would justify a markup in excess of three percent. We find that J. W. Korth's markup in excess of three percent was not fair and reasonable.

### **C. Summary of Findings**

Amended Schedule A to the Complaint contains 44 municipal bond sales.<sup>135</sup> We dismiss Enforcement's allegations as to trades 8, 9, 27, 33, 34, and 42. We find that J. W. Korth's markups in excess of three percent were not fair and reasonable as to trades 10 through 19, 22 through 26, 29 through 32, 35, and 43 through 51. We find that J. W. Korth's markups in excess of 3.5 percent were not fair and reasonable in trades one through seven, 20, 21, and 36.

Amended Schedule B to the Complaint contains 11 corporate bond sales, three CMO sales, and four corporate bond purchases. We dismiss Enforcement's allegations as to trades one, three, and 15 through 17. We find that J. W. Korth's markups in excess of three percent were not fair and reasonable as to trades 2, 4 through 14, and 18.

### **V. Sanctions**

We order J. W. Korth to pay restitution to the customers identified on Amended Schedules A and B to the Complaint (copies of which are attached as Schedules A and B to this decision) in the approximate amount of \$29,268,<sup>136</sup> as follows:

- On Amended Schedule A, the amount of the firm's markup in excess of three percent on trades 10 through 19, 22 through 26, 29 through 32, 35, and 43 through 51, which we calculate to be approximately \$15,479.
- On Amended Schedule A, the amount of the firm's markup in excess of 3.5 percent on trades 1 through 7, 20, 21, and 36, which we calculate to be approximately \$6,159.

---

<sup>132</sup> CX-6, at 71.

<sup>133</sup> CX-6, at 71-72.

<sup>134</sup> CX-6, at 71-72.

<sup>135</sup> Numbered 1 through 27, 29 through 36, 42 through 49, and 51.

<sup>136</sup> Amended Schedule A lists the full dollar amount of J. W. Korth's markups. It does not list the amount of the markup in excess of three percent for trades 10 through 19, 22 through 26, 29 through 32, 35, and 43 through 51, or the markup in excess of 3.5 percent for trades seven, 20, 21, and 36. Thus, the restitution dollar amounts indicated in this decision are approximate. For each trade, J. W. Korth is directed to calculate the excess markup as indicated in this decision in conjunction with Enforcement and to pay restitution accordingly.

- On Amended Schedule B, the amount of the firm’s markups and markdowns in excess of three percent on trades 2, 4 through 14, and 18, which we calculate to be approximately \$7,630.<sup>137</sup>

J. W. Korth is ordered to pay restitution to the customers identified on Amended Schedules A and B to the Complaint in the amounts indicated, plus interest at the rate set forth in Section 6621(a) of the Internal Revenue Code, 26 U.S.C. § 6621(a)(2), from the date of the customer sale until the date that restitution is paid. J. W. Korth is ordered to pay the restitution within 60 days of the effective date of this decision. J. W. Korth is required to provide Enforcement with proof of payment of restitution with interest to each customer listed on Amended Schedules A and B. If J. W. Korth is unable to locate a customer, the firm must provide Enforcement with proof that it has made a bona fide attempt to locate the customer. Any restitution that J. W. Korth is not able to pay to a customer must be paid to FINRA (without interest) as a fine.

In lieu of a fine, we order that J. W. Korth retain an independent consultant with experience in establishing pricing procedures for sales and purchases of debt securities to review the firm’s pricing procedures with a view towards ensuring, going forward, that J. W. Korth does not charge prices in excess of what is fair and reasonable, taking into consideration all relevant factors. The independent consultant must be an individual who is acceptable to Enforcement, and the firm must provide Enforcement with proof that it has in fact retained the individual.

To craft these sanctions, we considered that FINRA’s Sanction Guidelines (“Guidelines”) for excessive markups and markdowns recommend a fine of \$5,000 to \$146,000 and restitution. The Guidelines also recommend that we consider requiring demonstrated corrective action with respect to the firm’s pricing policies and, in egregious cases, a suspension.<sup>138</sup> Enforcement argues that there are numerous aggravating factors. We do not agree. We conclude that this case involves serious misconduct, but we do not consider it egregious.

The principal considerations in determining sanctions suggest that we consider a number of factors.<sup>139</sup> Enforcement argues that J. W. Korth acted intentionally and that the misconduct was pervasive. We do not find that to be the case. Over the course of two and one-half years, Enforcement has alleged that the firm charged excessive markups or markdowns in 62 trades, 11 of which we have dismissed. J. W. Korth contends that during that same period, the firm executed approximately 18,000 trades. The price that a broker-dealer charges its customers must be fair and reasonable for every trade,<sup>140</sup> and the fact that J. W. Korth charged excessive markups in any trades, regardless of the number, is a violation of FINRA and MSRB Rules. As to

---

<sup>137</sup> Amended Schedule B indicates the amount of J. W. Korth’s markups and markdowns in excess of three percent for each trade.

<sup>138</sup> FINRA Sanction Guidelines at 89 (2016), [http://www.finra.org/sites/default/files/Sanctions\\_Guidelines.pdf](http://www.finra.org/sites/default/files/Sanctions_Guidelines.pdf).

<sup>139</sup> See Guidelines at 6-7.

<sup>140</sup> See Lane, 2013 FINRA Discip. LEXIS 34, at \*36 (“A markup may not be justified, however, on the grounds that it helps pay the costs incurred in other transactions.”).

sanctions, however, we do not find that the firm exhibited a pattern of charging excessive markups. We find that this misconduct is aberrant and not reflective of the firm's overall compliance record.<sup>141</sup>

We also reject the argument that J. W. Korth's rule violations were intentional or reckless. We do not find that the firm intentionally or recklessly overcharged its customers. It had in place a policy for determining markups that it openly explained to FINRA and reliably implemented. Although misguided on some of the trades at issue, we do not find that the firm exhibited a pervasive and deliberate intent to charge excessive markups. To the contrary, we find that the firm attempted to calculate fair markups, although it did not achieve this across the board.<sup>142</sup>

Enforcement also argues that J. W. Korth has not accepted responsibility for its misconduct and has instead chosen to claim that its focus on profits was proper.<sup>143</sup> While we agree that it is aggravating when a respondent refuses to accept responsibility for its misconduct, we do not find that J. W. Korth's actions should be so characterized. J. W. Korth launched a vigorous defense and contested the allegations against it. Through Korth, its managing partner, the firm provided a detailed explanation of the nature of its business and the many factors that it considers in making pricing determinations. Korth also explained the multiple layers of oversight that the firm employs for its pricing practices. While none of these facts excuse the firm's prices on the 42 violative trades, we will not hold against the firm that it defended its practices.<sup>144</sup>

We find that J. W. Korth's misconduct is serious and aggravated by the fact that it resulted in the firm's monetary gain and losses to customers.<sup>145</sup> Although J. W. Korth has demonstrated efforts to comply going forward,<sup>146</sup> to remediate the firm's misconduct, we order that the firm pay restitution to the firm's customers. To ensure that the firm does not repeat this misconduct, in lieu of a fine, we order the firm to retain an independent consultant to review the firm's pricing policies and practices.

---

<sup>141</sup> Guidelines at 6-7 (Principal Consideration Nos. 8, 9, 16, 18).

<sup>142</sup> Guidelines at 7 (Principal Consideration No. 13).

<sup>143</sup> Guidelines at 6 (Principal Consideration No. 2).

<sup>144</sup> See *Clinger & Co., Inc.*, 51 S.E.C. 924, 926 n.7 (Dec. 23, 1993) ("Persons charged with violations are entitled to pursue the procedural and substantive remedies provided by the [FINRA] and Commission rules."); *Dep't of Enforcement v. Bullock*, No. 2005003437102, 2011 FINRA Discip. LEXIS 14, at \*60 (NAC May 6, 2011) (rejecting respondent's "hearty defense" that respondent was entitled under FINRA's rules to fully defend himself against the allegations of the complaint).

<sup>145</sup> Guidelines at 6-7 (Principal Consideration Nos. 11, 17).

<sup>146</sup> J. W. Korth currently adheres to a three percent maximum guideline for markups and markdowns. J. W. Korth Amended Brief at 18.

## VI. Order

Under cause one of the Complaint, we find that J. W. Korth violated MSRB Rules G-30 and G-17 by charging excessive markups in 38 sales of municipal securities. We find under cause two that the firm violated NASD Rule 2440, IM-2440, and FINRA Rule 2010 by charging excessive markups in nine sales of corporate debt securities and excessive markdowns in four purchases of corporate debt securities.<sup>147</sup> We dismiss allegations as to three sales of collateralized mortgage obligations, six sales of municipal bonds, and two sales of corporate bonds.

For this misconduct, we order Respondent J. W. Korth to pay restitution to the customers identified on Amended Schedules A and B to the Complaint (copies of which are attached as Schedules A and B to this decision) in the approximate amount of \$29,268, as indicated in this decision, plus interest at the rate set forth in Section 6621(a) of the Internal Revenue Code, 26 U.S.C. § 6621(a)(2), from the date of the customer sale until the date that restitution is paid. J. W. Korth is ordered to pay the restitution within 60 days of the effective date of this decision and to provide Enforcement with proof of payment of restitution. If J. W. Korth is unable to locate a customer, the firm must provide Enforcement with proof that it has made a bona fide attempt to locate the customer. Any restitution that J. W. Korth is not able to pay to a customer must be paid to FINRA (without interest) as a fine.

J. W. Korth must also retain an independent consultant with experience in establishing pricing procedures for sales and purchases of debt securities to review the firm's pricing procedures with a view towards ensuring that J. W. Korth does not charge prices in excess of what is fair and reasonable, taking into consideration all relevant factors. The independent consultant must be an individual who is acceptable to Enforcement, and the firm must provide Enforcement with proof that it has in fact retained the individual. The fine shall be payable on a date set by FINRA, but not sooner than 30 days after this decision becomes FINRA's final disciplinary action.

---

Carla Carloni  
Hearing Officer  
For the Hearing Panel

---

<sup>147</sup> The Hearing Panel considered and rejected without discussion all other arguments by the parties.