FINANCIAL INDUSTRY REGULATORY AUTHORITY
OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT, Complainant, v. NEWPORT COAST SECURITIES, INC. (CRD No. 16944), DOUGLAS A. LEONE (CRD No. 2453784), and ANDRE V. LABARBERA (CRD No. 2072370), Respondents.	Disciplinary Proceeding No. 2012030564701 Hearing Officer—DMF **EXTENDED HEARING PANEL DECISION** **October 17, 2016**

Summary

(1) Respondents Leone and LaBarbera, and Respondent Newport Coast Securities, Inc., through Leone, LaBarbera and three other Registered Representatives, recommended quantitatively unsuitable trading in, and churned, the accounts of customers; (2) LaBarbera and Newport Coast, through LaBarbera and two other Registered Representatives, recommended qualitatively unsuitable investments to customers; (3) Newport Coast failed to properly supervise five Registered Representatives who recommended quantitatively unsuitable trading in, and churned, customer accounts; and (4) Leone conveyed inaccurate account values to a customer on several occasions.

For these violations, Newport Coast is expelled from FINRA membership and ordered to pay restitution and a fine; Leone is barred from association with any FINRA member firm and ordered to pay restitution and a fine; and LaBarbera is barred from association with any FINRA member firm and ordered to pay restitution and a fine. In addition, Respondents, jointly and severally, are ordered to pay hearing costs.

The additional charges that LaBarbera mismarked certain solicited trades as unsolicited and that Newport Coast failed to properly supervise the sale of Exchange Traded Products are dismissed.

Appearances

For the Complainant: Payne L. Templeton, Esq., Joel T. Kornfeld, Esq., Jill L. Jablonow, Esq., and John Luburic, Esq., Department of Enforcement, Financial Industry Regulatory Authority.

For Respondent Newport Coast Securities, Inc.: Richard Babnick, Jr., Esq., and Scott D. Furst, Esq., Sichenzi Ross Friedman Ference LLP, New York, New York.

For Respondent Douglas A. Leone: Dan A. Druz, Esq.

For Respondent Andre V. LaBarbera: *pro se*.

DECISION

I. Introduction

A. Procedural History

The Department of Enforcement filed the Complaint in this matter on July 28, 2014, naming eight Respondents: Newport Coast Securities, Inc., a FINRA member firm; two former registered principals of the firm, Marc A. Arena and Roman Tyler Luckey; and five former registered representatives ("RRs") of the firm, Douglas A. Leone, Andre V. LaBarbera, David M. Levy, Anthony Costanzo, and Donald A. Bartelt. The Complaint set out a total of nine causes of action against those Respondents. Arena and Luckey subsequently settled the charges against them, so those charges are not addressed in this Decision. Levy, Costanzo, and Bartelt defaulted. In accordance with FINRA Rule 9269, the Hearing Officer, rather than the Extended Hearing Panel, will issue a decision addressing the charges against the defaulting Respondents. Therefore, this Decision only addresses the charges in the Complaint against Newport Coast, Leone and LaBarbera. In order to resolve certain charges against Newport Coast that were based on the activities of all five Respondent RRs, however, the Panel was required to make findings and reach conclusions regarding some of the allegations against Levy, Costanzo, and Bartelt set forth in the Complaint.

This Decision addresses the following charges:

(1) Leone and LaBarbera, and Newport Coast through Leone, LaBarbera, Levy, Costanzo, and Bartelt, engaged in excessive trading in the accounts of certain customers, referred

to as “quantitative unsuitability,” in violation of NASD Rules 2310 and 2110 and IM-2310-2, and FINRA Rules 2111 and 2010;[1]

(2) Leone and LaBarbera, and Newport Coast through Leone, LaBarbera, Levy, Costanzo, and Bartelt, “churned” the accounts of certain customers, in violation of Section 10(b) of the Securities Exchange Act of 1934, Exchange Act Rule 10b-5, FINRA Rules 2020 and 2010, and NASD Rules 2120 and 2110;

(3) Newport Coast failed to adequately address red flags suggesting that the five Respondent RRs were excessively trading and churning customer accounts, and therefore failed to properly supervise the RRs, in violation of NASD Rules 3010 and 2110 and FINRA Rule 2010;

(4) LaBarbera, and Newport Coast through LaBarbera, Levy, and Costanzo, made qualitatively unsuitable recommendations of transactions involving leveraged or inverse Exchange Traded Products (“ETPs”) to certain customers, in violation of NASD Rules 2310 and 2110 and FINRA Rule 2010;

(5) Leone gave one customer inaccurate information overstating the value of the customer’s account on five occasions, in violation of FINRA Rule 2010;

(6) LaBarbera mischaracterized 22 trades in the account of one customer as “unsolicited” when in fact he solicited them, causing Newport Coast’s books and records to be inaccurate, in violation of NASD Rules 3110 and 2110 and FINRA Rule 2010; and

(7) Newport Coast offered structured products and inverse and/or leveraged ETPs without providing any training on those products to its RRs, and it lacked any system or procedure for flagging customer accounts that were unsuitably concentrated in structured products or inverse or leveraged ETPs, in violation of NASD Rules 3010(a) and (b) and FINRA Rule 2010.[2]

The hearing on these charges took place over 19 hearing days during November 2015 and January 2016. During the hearing, the Panel heard testimony from 32 witnesses, including Newport Coast customers and current and former associated persons of Newport Coast, and received hundreds of exhibits in evidence. At the conclusion of the hearing, the parties offered closing arguments and, at the request of the parties, they were offered an opportunity to file post-

[1] The conduct rules that apply to the allegations against Respondents are those that were in effect at the time of the alleged misconduct. The Complaint defines the relevant time period as September 2008 through May 2013. Complaint (“Compl.”) ¶ 1. During that period, several NASD rules that had applied to Respondents’ conduct were replaced by parallel FINRA rules, but there were no substantive changes in the applicable rules. Where different rules applied to Respondents’ conduct during the relevant time period, the period covered by each applicable rule is identified in the Panel’s conclusions on each charge addressed in this Decision.

[2] Enforcement’s investigation grew out of a 2011 sales practice examination that focused on Newport Coast’s Long Island, New York, branch office. Hearing Transcript (“Tr.”) 5093, 5095-96.

hearing briefs.[3] Having considered the evidence and arguments offered by the parties, the Extended Hearing Panel's findings and conclusions regarding each of the charges against Newport Coast, Leone and LaBarbera are set forth below.

B. Respondents

1. Newport Coast

At all relevant times, Newport Coast was a FINRA member firm.[4] Newport Coast was previously known as Grant Bettingen, Inc. Rubicon Financial Services acquired the firm in June 2008, and owned it throughout the relevant time period. The firm name changed to Newport Coast Securities, Inc. in the fall of 2009.[5] When the firm was acquired, it had about 30 RRs. By the end of 2010, the firm had 120-130 RRs. The firm's RRs worked from branch offices throughout the United States; in many cases, the RR's home was the branch office. In some cases, RRs were supervised by branch managers, but in many cases, the RRs were supervised by Newport Coast principals in the firm's headquarters in Irvine, California.[6]

On September 30, 2016, Enforcement filed with the Office of Hearing Officers a notice advising that:

> (i) Newport Coast's license, membership and registration with FINRA were cancelled on September 6, 2016, pursuant to FINRA Rule 9553, based on Newport Coast's failure to pay outstanding fees owed to FINRA, and (ii) Newport Coast on August 3, 2016, filed a full withdrawal registration termination request on Form BDW, the Uniform Request for Broker-Dealer Withdrawal. (footnotes omitted)

On October 6, 2016, Enforcement filed another notice advising that:

> effective October 2, 2016, the U.S. Securities and Exchange Commission ["SEC"] terminated Newport Coast's registration with the SEC. The effective date of the SEC's termination of Newport Coast's registration was 60 days after Newport Coast's filing of its broker-dealer full withdrawal (BDW) registration termination

[3] Enforcement filed a detailed post-hearing brief with proposed findings of fact and conclusions of law, as well as a post-hearing reply brief. On the date its post-hearing brief was due, counsel for Newport Coast filed a brief statement indicating that the firm would rest on its closing argument at the hearing and thereafter withdrew as counsel for Newport Coast. Counsel for Leone initially filed a brief that was not signed, did not address the evidence or the legal issues of the case, and appeared to be an incomplete draft. After being contacted by the Office of Hearing Officers, Leone's counsel filed a revised brief that was signed, but it still did not address the issues in the case. Although it was submitted after the due date, the Hearing Officer accepted the brief. Respondent LaBarbera, who was not represented by counsel, filed a post-hearing brief, *pro se*.

[4] Complainant's Exhibit ("CX-") 542.

[5] Tr. 3037-38 (Stipulation).

[6] Tr. 3910, 4500, 4530; CX-212; CX-260; CX-278.

> request on August 3, 2016. Similarly, all of the states in which Newport Coast earlier was registered to sell securities have terminated (or withdrawn) such registrations, with the final such termination made by the state of Virginia … on October 3, 2016. (footnotes omitted)

Newport Coast remains subject to FINRA jurisdiction for purposes of this proceeding pursuant to Article VI, Section 6 of FINRA's By-Laws.

2. Leone

Leone entered the securities industry in 1993 as an unregistered cold caller. He was first registered as a General Securities Representative with another firm in 1994, and moved frequently from firm to firm before becoming registered with Newport Coast in 2008. He left Newport Coast in 2013 and is currently registered through another FINRA member firm. During his career, he has been registered with approximately 14 member firms. While with Newport Coast, Leone was assigned to the firm's Long Island, New York, branch office but worked primarily from his homes, first in New York and then in Connecticut. Throughout his career, Leone has generated customers primarily through cold calling; indeed, he testified that during his entire career he has only met one of his customers in person.[7]

3. LaBarbera

LaBarbera was first licensed as a General Securities Representative in 1990. Like Leone, he was associated with many FINRA member firms over the succeeding years before becoming associated with Newport Coast in July 2008. He left Newport Coast in July 2012 and is currently associated with another FINRA member firm. During the period prior to associating with Newport Coast, he formed a partnership with defaulting Respondents Levy and Costanzo through which they shared commissions. Each of the partners, however, had his own customers and the Panel evaluated LaBarbera's conduct based solely on the evidence regarding his customers. Like Leone, throughout his career LaBarbera has obtained customers primarily through cold calling, and he did so while he was associated with Newport Coast.[8]

II. Quantitative Unsuitability

A. Facts

Enforcement alleged that each of the five RR Respondents engaged in quantitatively unsuitable trading of the accounts of certain specifically identified customers. The Panel considered the evidence against each RR separately.

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[7] CX-1; Tr. 1075-90.

[8] CX-115; Tr. 3429-30, 3435-37, 3454.

1. Leone

The Panel received testimony from eight of Leone's customers and documentary evidence regarding the trading in the customers' accounts, and also received testimony from Leone.

- DG is the president and part owner of a sheet metal company with about $3.5 million in gross receipts in 2008. He opened an account with Leone when Leone was at another FINRA member firm and moved his account to Newport Coast when Leone moved to Newport Coast in October 2008. Before opening his account with Leone, DG had an individual retirement account ("IRA"), but had no prior brokerage accounts. When he opened his Newport Coast account, his objective was to "[h]opefully make a little bit of money without working for it …." DG's Newport Coast new account documents were pre-completed when he received them and indicated that he had 20 years' experience investing in stocks; his investment objective was "Capital Appreciation (High Risk, capital growth invested primarily in stocks and options)"; his income was $250,000 to $499,999; his net worth was over $1 million; and his liquid net worth was $250,000 to $499,999. DG testified he did not read the documents closely before signing them, but he did change the amount of his liquid net worth to $65,000-$124,999, which was his actual net worth. He did not, however, note and correct the erroneous indication that he had 20 years' experience investing in stocks. DG testified that he never called Leone to place or suggest trades, and that he had no understanding as to what Leone was buying or selling in his account or what Leone's charges would be. DG testified he received statements and confirmations and opened them periodically, but was too busy running his business to closely monitor the account.

  In 2010, long after DG opened his account, he received and was asked to sign a Newport Coast "Active Trading Authorization" form stating, *inter alia*, "I am a sophisticated Investor with substantial personal experience in trading stocks." It also contained a list of objective or risk tolerance descriptors, of which "high risk" was circled when he received the form. He testified he signed the form and was preparing to fax it to Leone when he noticed the "high risk" indication and, because "I'm not a high risk person," he scratched a large "X" through the form with a pen and faxed the document to Leone. The copy of the form that Newport Coast provided to Enforcement during the investigation and that Enforcement offered in evidence at the hearing appears to include a large "X" that has been covered with white-out.[9]

  DG's account was open from October 2008 through April 2010. DG invested approximately $93,000 in his account and withdrew $30,000 from the account before closing it. Total purchases in his account were more than $6 million and total sales were also more than $6 million. Enforcement calculated an annualized turnover rate for DG's

[9] Tr. 59-164; CX-16A; CX-17; CX-18; CX-461.

account of 135.25 and an annualized cost-to-equity percentage of 166.57%. Total costs were more than $75,000 and total losses were nearly $115,000.[10]

- RER owns an office furniture company, an upholstery business, and a furniture restoration company. In 2009, when he opened his Newport Coast account, he was the only employee of his businesses. Prior to opening his Newport Coast account RER had an IRA and an individual account at another FINRA member firm in which he "had some regular stocks" that the broker at that firm recommended. RER opened his Newport Coast account after being cold-called by Leone, who told RER "that he knew the stock market, he was a professional broker, he knew how to invest in stocks and the right stocks, so that if I invested my money with him, he would make me money." RER testified that he did not believe his Newport Coast new account documents were completed when he received and signed them. He testified that he asked Leone about the information called for on the forms and was told that he should just sign where indicated. The new account documents indicate his investment objective was "Short term growth with high risk (Appreciation with acceptance of high risk)," but RER testified he told Leone he was "a moderate to low risk investor." The documents indicated his income was $65,000 to $124,999, his net worth was over $1 million, and his liquid net worth was $65,000 to $124,999. They also indicated that he had 10 years of experience investing in stocks. RER testified he did not ask Leone to open a margin account and did not even know what a margin account was, but the documents he signed included a "Customer Account, Margin and Short Account Agreement."

  RER testified that Leone recommended all the purchases and sales in his account and that he did not realize how much trading Leone was doing in his account. RER testified that Leone said he would be charging commissions of $75-$100, but in fact the confirmations show that Leone charged RER commissions as high as $1,000 for a single trade. Initially RER's account performed well and by the end of August 2009 its value had increased to $132,000. After that, however, there was only one profitable month, a small gain in May 2010, and the value of the account dropped steadily. Leone made all the investing decisions in the account. In March 2010, long after his account was opened, RER received a Newport Coast Active Trading Authorization form that contained a list of objective or risk tolerance descriptors, of which "growth" and "high risk" were circled. RER testified that Leone told him he needed to sign the document and return it, but he did not recall circling or signing anything and stated that he "would never have put growth or high risk on anything."[11]

  RER invested approximately $41,000 in his account, which was open from June 2009 through June 2010. RER withdrew $40,000 from his account while it was open and received an additional $33,000 when he closed the account, making him the only

[10] CX-547A, at 1.

[11] Tr. 261-407; CX-43; CX-44; CX-45; CX-465.

testifying customer who had a positive return. Total purchases in his account were more than $8.2 million and total sales were more than $8.4 million. Enforcement calculated an annualized turnover rate of 123.85 and an annualized cost-to-equity percentage of 145.86% for RER's account. Total costs were nearly $100,000.[12]

- JB is an independent sales representative for a shoe wholesaler who learned of Leone from RER. JB opened an account with Leone at Newport Coast in early 2010. Prior to that time his investing experience was limited to an IRA invested in mutual funds that he opened through a financial advisor at another FINRA member firm who had handled his parents' investments. He had never purchased individual stocks. He signed the Newport Coast pre-completed account opening documents when he received them without reading them carefully. The documents inaccurately stated that he owned the shoe wholesaler. The documents indicated that his annual income was $500,000 to $999,999, that his net worth was over $1 million, and that his investment objective was "Short term growth with high risk (Appreciation with acceptance of high risk)," but JB testified he never told Leone that was his objective, and in fact he "just wanted growth, I just wanted to … have the money make money." The documents also inaccurately stated that he had 10 years of experience investing in stocks, averaging 100 purchases a year with an average size of $10,000, and that he had 10 years of experience investing in bonds, averaging 10 purchases a year with an average size of $10,000.

  JB testified Leone chose which stocks to buy in his account, when to buy or sell, and the amount of stock to buy or sell; JB rarely discussed the purchases or sales in the account with Leone. JB did not know what a markup was in the context of stock purchases and did not know he had been charged markups. His accountant advised him to close the account after receiving tax information from Newport Coast in spring 2011. JB tried to close the account but Leone persuaded him to leave it open for a short time to try to recoup losses. JB closed the account in May 2011. On cross examination he acknowledged that the money he invested with Newport Coast was "mad money," and that he hoped to replicate the gains that customer RER had reported.[13]

  JB invested $65,000 in his account, which was opened in March 2010 and closed in May 2011. Total purchases in his account were more than $4 million and total sales were also more than $4 million. Enforcement calculated that the annualized turnover rate was 144 and the annualized cost-to-equity percentage was 171.5% in JB's account. Total costs were nearly $50,000 and total losses were over $63,000.[14]

- CP is an independent representative selling business furniture and owns her own company. She opened an account with Leone after hearing of him from RER. She wanted

[12] CX-553, at 1.

[13] Tr. 164-260; CX-19; CX-20; CX-25.

[14] CX-548A, at 1.

money to pay for her daughter's education and wanted a better return than banks were paying. Her investment experience prior to opening a Newport Coast account was limited to an IRA worth about $200,000 that her late husband owned. In that account, the broker called her from time to time with recommendations and she always agreed because she trusted the broker. At Newport Coast she initially opened an individual account, but, at Leone's direction and for reasons she did not understand, her account was changed, first to a joint account with her young daughter and then to an account in the name of her business. CP testified that a friend told her not to open a margin account or to allow any short selling, so on the new account documents for her initial Newport Coast account she crossed out a pre-printed "yes" under "Margins Approved" and wrote, "I do not want to participate in any margin accts or short selling," although she did not understand what either of those terms meant. When her account was changed to a joint account with her daughter, who was 11 or 12 years old at the time, and then to an account in the name of her business, she had to execute new account opening documents and did not include the statement regarding margin accounts and short selling on those documents, believing she had already expressed her intentions clearly. In fact, the business account was opened as a margin account. CP testified that she told Leone she could not afford to lose her investment, and that her income in a good year was $60,000. The new account form for her business account, however, indicated that her income was $125,000-$249,999 per year, and that her investment objective was "Short term growth with high risk (Appreciation with acceptance of high risk)." It also indicated, incorrectly, that she had "10+" years of experience investing in stocks, averaging 50 purchases a year with an average value of $10,000. CP was not aware of the use of margin in her account and did not discuss trades with Leone before they were made.[15]

The account that was opened in the name of CP's business was open only from January 2010 through July 2010 and CP invested just $15,000 in the account. Total purchases in the account were approximately $385,000 and total sales were about $381,000. Enforcement calculated an annualized turnover rate in the account of 85.81 and an annualized cost-to-equity percentage of 105.22%. Total costs were more than $4,700 and total losses were nearly $9,000.[16]

- PH is RER's wife. When she opened her Newport Coast account in 2009, she owned and did the accounting and marketing for a dry cleaning business. At that time, the annual revenue of the business was about $1 million and her net income from the business was $60,000 to $70,000. She and her husband RER have separate finances except for a joint account they use to pay bills. After her first husband died in 1997, she opened accounts at another FINRA member firm using insurance money; she had no prior investing experience. Her accounts at the other member firm were handled by one local RR and another RR in New Jersey, and she invested based on their recommendations. As of

[15] Tr. 409-538; CX-39; CX-40; CX-464; CX-480; CX-481; CX-527.

[16] CX-551A, at 1.

2009, the value of those accounts was approximately $1.5 million. She never used margin in those accounts.

PH opened her Newport Coast account with Leone in October 2009, with a $20,000 investment, based on RER's description of Leone as a "good guy" who had been making RER a lot of money. Her new account documents listed her income as $65,000 to $124,999 and her net worth as "$1 million – over." She testified she wanted her money to grow, but did not understand until later the use of margin, the level of trading, or the amount of fees she paid in the account. Although her new account documents said "yes" under the heading "Margins Approved," PH testified that she is positive that Leone did not discuss the use of margin in her account with her because she would never have agreed to that. She testified that Leone told her to sign the new account forms and get them back quickly, so she signed without realizing that they authorized the use of margin, and that they mischaracterized her investment objectives as "Short term growth with high risk (Appreciation with acceptance of high risk)." PH testified that after she opened the account she began to receive confirmations and although she probably opened the first few, after that they began to pile up without her opening them. She does not believe she spoke to Leone from the time she opened the account until she closed it. She testified that sometimes she was in the room when RER spoke to Leone, but that she never spoke to Leone herself. She knew there was trading going on in her account because of the all the mail she was receiving, but she had "no clue … what he would buy, what he would sell, [I] just trusted him to be making me money." PH became aware that she was losing money in her account by checking the bottom line in her account statements. In June 2010 she and RER called Newport Coast together, with RER doing the talking, and instructed the firm to close their accounts.[17]

PH invested $20,000 in her account, which was open from October 2009 through June 2010. Total purchases in her account were more than $1 million and total sales were also more than $1 million. Enforcement calculated an annualized turnover rate in the account of 108.12 and an annualized cost-to-equity percentage of 147.69%. Total costs were nearly $14,000 and total losses were over $14,500.[18]

- LJC is a retired disabled veteran. After he left the military he worked for a transportation management company, starting as a terminal manager and eventually becoming the president of the company. He then owned a computer learning center for children, which he subsequently sold because the work was too rigorous. He also owned another computer business that he sold around 2007. LJC testified that when he was in the military, he and his wife were members of an investing club with nine other couples, paying dues of about $20 a month. They researched companies and invested, but were wiped out about a year after they started. As of 2010, LJC had an IRA with a value of

[17] Tr. 542-639; CX-41; CX-42; CX-462.

[18] CX-552, at 1.

about $100,000; it was managed and he does not know what it was invested in. He also had an individual account at a FINRA member firm with a value of about $40,000 in which he held five or six blue chip stocks.

LJC testified he received many cold calls from Leone in 2010 before agreeing to open a Newport Coast account. Leone's sales pitch was that he traded stocks of companies that were not well known so he could position himself to make money quickly based on movements in the price of those stocks. Leone told LJC that if he invested with Leone and did not make money, Leone would not charge him, which was very enticing to LJC. The pre-printed information in the Newport Coast new account documents he and his wife signed in October 2010 indicated their net worth was over $1 million; in fact, "if we had $500,000, we would be lucky," and that amount would include the value of their home. The documents indicated their yearly income was $125,000 to $249,999; in fact, it was about $3,000 per month. The documents indicated their investment objective was "Short term growth with high risk (Appreciation with acceptance of high risk)," but LJC testified that was not his objective because he "never … had enough money to accept high risk." Although the new account documents indicate "no" under the heading "Margins Approved" and LJC testified he told Leone he did not want to get involved with margin, LJC also acknowledged his signature on a Customer Margin and Short Account Agreement dated 10 days after the date of his new account form. He testified he did not recall signing it, and that the signature on the document purporting to be his wife's was not her handwriting.

Initially Leone called LJC every day to talk about his investing ideas and LJC tried to track his investments using Microsoft Stock Tracker, but some of the stocks were too small to show up in that application and he could not keep up with Leone's trading. Leone did not call him before making trades in his account. The margin balance in his account at the end of December 2010 was $150,000 and during that month alone total purchases in LJC's account were $1.7 million and total sales were $1.6 million. LJC testified that Leone made all the buy and sell decisions in the account. Leone would just tell LJC what he was buying and selling, not ask for his permission to make the trades. When LJC saw on one confirmation that he had been charged a $5,000 commission for a single trade he went ballistic, screaming at Leone over the telephone. In April 2011 he closed the account by transferring the holdings to another FINRA member firm.[19]

LJC invested approximately $82,000 in the account, which was open from October 2010 through April 2011. Total purchases in the account were nearly $5 million and total sales were also nearly $5 million. Enforcement calculated an annualized turnover rate in the account of 129.32 and an annualized cost-to-equity percentage of 173.92%. Total costs were more than $66,000 and total losses were more than $55,000.[20]

[19] Tr. 640-798; CX-27; CX-28; CX-32; CX-33; CX-34; CX-35; CX-467.

[20] CX-549A, at 1.

- MJ is a refrigeration technician who has owned a commercial refrigeration business since 2003. He has a high school education. Prior to investing through Leone, MJ had an account with another FINRA member firm in which he owned corporate bonds and mutual funds on a buy-and-hold basis. Leone told MJ that the other firm was a boiler room and that he was an experienced trader and would only make money if MJ did. MJ initially invested $5,000 in October 2010, explaining to Leone that he needed the money to be liquid for his business, and invested additional sums in the following months, some of which came from closing the other brokerage account. The Newport Coast new account documents indicated MJ's income was $125,000 to $249,999, his net worth (excluding primary residence) was over $1 million, and his liquid net worth was $65,000 to $124,999. The documents indicated MJ's investment objective was "Short term growth with high risk (Appreciation with acceptance of high risk)," but he testified that in fact he wanted to keep his money safe with some growth if possible. The new account documents also overstated his net worth and his investment experience. He signed the documents without noting those discrepancies. Although the new account documents included a "Customer Account, Margin and Short Account Agreement" authorizing the use of margin in the account, which he also signed, MJ testified that Leone never discussed the use of margin with him and that he was afraid of trading on margin because of the risk.

  MJ testified that Leone discussed trades in the account with him at the outset, but he did not recall very many discussions with Leone after that, and "he could not have called me on all of [the trades in the account]." He testified: "It's fair to say after he got my money I wasn't in contact with him." Around February 2011, as she was working on his taxes, MJ's accountant raised concerns about the level of trading in his account. MJ and the accountant tried to contact Leone without success, but after they called Newport Coast's home office, Leone called MJ and MJ told Leone to stop all trading in the account. Nevertheless, trading continued in the account for a time and the account value dropped further. MJ has never bothered to close the account, which now has a value of about $500.[21]

  MJ invested approximately $22,000 in his account, which was opened in September 2010 and never formally closed. Total purchases in the account were more than $880,000 and total sales were approximately $875,000. For the period from September 2010 through September 2011, when all the trading in the account took place, Enforcement calculated an annualized turnover rate of 151.91 and an annualized cost-to-equity rate of 280.14%. Total costs were more than $16,000 and total losses were approximately $21,000.[22]

- BDS is a CPA, a partner in an accounting firm. He opened his first account with another FINRA member firm in 1999, investing in mutual funds. Before and since opening his

[21] Tr. 800-97; CX-37; CX-38; CX-463; Respondent Newport Coast's Exhibit ("RX-") 41.

[22] CX-550A, at 1.

Newport Coast account, BDS has had other accounts, in some of which stocks were bought and sold within a single month. Immediately before opening his Newport Coast account he had closed an account in which he had incurred about $30,000 in losses from margin trades. He currently has two accounts at another firm, one account is invested primarily in indexes with covered calls and the other is a trading account invested in stocks. BDS has a broker who recommends investments in those accounts.

BDS opened a Newport Coast account with Leone in March 2011 during tax season, when he was working 60 to 80 hours a week. Leone told BDS that he invested in high market cap companies and used stop loss orders to prevent a loss of more than 10% in any investment. BDS told Leone he would need the money he invested in his Newport Coast account later in the year for tax obligations. BDS and Leone did not discuss the commissions Leone would charge, although BDS assumed Leone's commissions would be $200 to $500 per trade, depending on the magnitude of the trade, which BDS characterized as "typical" in his testimony. BDS signed the Newport Coast account opening documents, which indicated that that his annual income was over $1 million, his net worth was over $1 million, and his objective was "Short term growth with high risk (Appreciation with acceptance of high risk)." The documents also listed "Yes" in a box under the hearing "Margins Approved," but BDS testified he did not realize his account was approved for margin and that he and Leone had not discussed the use of margin. The documents also incorrectly indicated BDS had over 10 years of experience investing in stocks, averaging 100 trades a year with an average value of $25,000, and 10 years of experience investing in bonds, averaging 20 purchases a year with an average value of $100,000. In fact, his stock investments would not have been more than 20 purchases in a year and no more than $10,000 in any one purchase, and his bond investing experience was limited to about three bond issues and some bond mutual funds.

BDS was busy with his business after opening his Newport Coast account and did not focus on the account at all. He discussed the account with Leone on a weekly basis, talking about whether the account was up or down, but BDS was not aware of the level of trading in the account until he started receiving an unusual number of confirmations. Leone generally decided what, when and how much to buy and sell in the account, but Leone did contact BDS about initial purchases of a stock in his account and also contacted BDS if he was going to liquidate out of a security.

BDS received an Active Trading Authorization form from Newport Coast in May 2011 that, *inter alia*, asked him to verify his primary investment goals. On the form he indicated that his objectives were growth and capital appreciation, then signed the form and returned it to Newport Coast. After BDS returned the form he received a voice mail from Leone telling him he needed to re-submit the form with an indication that speculation was his goal. BDS did not re-submit the form, and he testified speculation was never his goal for the account. In June 2011, when BDS received his statement covering May, he was surprised to see that the value of his account was down by $30,000, and also surprised by the level of trading. When BDS could not reach Leone he called Newport Coast's headquarters and was told that the value of his account had dropped further to only about $30,000 and that the account was margined. BDS told the person he spoke to stop all trading in the account. In December 2011, BDS filed an arbitration claim that he later settled for less than the amount of his losses.[23]

BDS invested $77,700 in his account. The account was open from March 2011 through January 2012, but with the exception of the opening purchase in March and a few sales in July and August 2011 to close out positions in the account, all of the trading took place in a three-month period from April through June 2011, when BDS halted trading in his account. Total purchases in the account were more than $1.9 million and total sales were also more than $1.9 million. Focusing on the period from March 2011 through June 2011, when the trading in the account took place, Enforcement calculated an annualized turnover rate of 172.84 and an annualized cost-to-equity percentage of 120.12%. Total costs were more than $13,000 and total losses were more than $70,000.[24]

- Leone testified at the hearing about the trading in these eight customers' accounts. As noted above, Leone has been in the securities industry for more than 20 years, moving frequently from one member firm to another. He became associated with Newport Coast in October 2008 and left in March 2013. Leone's business has always involved cold-calling to obtain customers, and indeed he testified he spent about half of each business day cold-calling from lead lists seeking new customers. In spite of his years of prospecting for new customers, however, Leone testified that he had only about 15 to 20 active customers at any one time while he was at Newport Coast, and the evidence showed that the eight customers whose accounts are at issue in this proceeding accounted for a substantial portion of Leone's commissions during the relevant time period. For example, from December 2008 through May 2009, DG accounted for 25% to more than 50% of Leone's monthly commissions; from August 2009 through March 2010, RER accounted for 27% to more than 50% of Leone's monthly commissions; from April 2010 through September 2010, JB accounted for 27% to more than 58% of Leone's monthly commissions. Similar patterns appear with regard to the commissions in the accounts of LJC and BDS. In each case, Leone traded one customer account very heavily, generating substantial commissions, before moving his trading focus to another recently obtained customer account.[25]

  Leone set the commissions that he charged customers on trades in their accounts. Newport Coast had no commission schedule or policy, so Leone was free to charge any commission or markup he wished, so long as it did not exceed FINRA's "Five Percent

[23] Tr. 995-1071; CX-12A; CX-13; CX-14A; CX-15; CX-514. BDS testified that he did not receive his statement for April until after he received his statement for May, and that the envelope for the April statement looked as though it had been caught up in some sort of mail machine—it was torn up. Tr. 1044-45.

[24] CX-545, at 1.

[25] Tr. 1073, 1075-85, 1093, 1095, 1124, 1212, 1602; CX-544, at 2.

Policy."[26] Leone testified that he did not tell his customers what he was charging them unless they asked. His practice was to charge relatively small commissions on buy transactions while charging large commissions, sometimes several thousand dollars, on sell transactions if the position had been profitable and relatively small or no commissions where the position lost money. Regardless of the amount of commission he charged on individual transactions, however, the sheer volume of trading in the accounts, as evidenced by the turnover figures set forth above, generated substantial commissions for Leone. For example, in DG's account, during the period February 2009 through June 2009, Leone effected 112 transactions in a single stock with a weighted average holding period of 1.65 days, for which the total charges to DG were over $11,000. Similarly, in JB's account during the period March 2010 through September 2010, Leone effected 75 transactions in a single stock with a weighted average holding period of 3.95 days, for which the total charges to JB were over $9,000. And in RER's account during the period September 2009 through June 2010, Leone effected 108 transactions in a single security with a weighted average holding period of 2.85 days, for a total cost to RER of more than $10,500. Finally, in LJC's account during the period October 2010 through April 2011, Leone effected 204 transactions in a single stock with a weighted average holding period of 5.92 days, for a cost to LJC and his wife of approximately $39,000.[27]

Leone testified that all of the information he provided for the customers' new account documents had been provided by the customers. He also testified that his customers all wanted the type of trading he did in their accounts. Initially he claimed that he spoke to each customer and obtained his or her approval before every trade in their account, but his subsequent testimony was inconsistent and wavered from moment to moment as he was questioned about his contacts with the customers. At one point, he asserted that he called his customers early in the day to discuss strategy, establishing a "game plan" for trading during the day, such as identifying the companies he was following and how many shares and within what price range he would buy or sell, while acknowledging that he would chose the timing of the trade. Later he asserted that he spoke to each customer at the beginning of the day "telling them exactly what we are going to do" including "buying it at a certain price and once we see a good enough profit … I would intend to sell that stock …." According to Leone, when the stock reached the pre-established purchase price, he would buy it for all the customers he had spoken to, acknowledging that might entail dozens of trades. When it was pointed out to him that on numerous occasions he made multiple purchases of the same stock in a customer's account within a short period at different prices, Leone changed his testimony, asserting that he actually obtained authority from the customers to buy within a defined price range. Similarly, he initially claimed that in his early morning conversations with the customers they agreed

[26] *See* FINRA Rule 2121, "Fair Prices and Commissions," as well as the Supplemental Material thereunder, which explain the genesis and substance of FINRA's Mark-Up Policy.

[27] Tr. 1128-30, 1132, 1134-35, 1175-76; CX-543. *See Dep't of Enforcement v. O'Hare,* No. C9B030045, 2005 NASD Discip. LEXIS 39, at *15 (NAC Apr. 21, 2005) ("This type of in and out trading is very difficult to justify.").

on a specific price at which they would sell the stock. When pressed further, however, he claimed that the conversations included a range of prices at which the stock might be sold. When asked what he would do if the stock decreased in value instead of increasing, he claimed that during the morning telephone call he and the customer also agreed on a sales point if that happened. Leone could not explain why none of his customers recalled the marathon daily telephone calls that would have been required to cover all of these topics, ultimately asserting that they were lying. In the end, Leone contended that he obtained time and price discretion from his customers, but he acknowledged he did not indicate that he had such discretion on the trade tickets, as required by NASD Rule 2510(d).[28]

With respect to the customers who testified:

(1) As of April 2010, the total value of DG's account was approximately $30,000 and DG's investment objective was "Capital Appreciation (High Risk, capital growth invested primarily in stocks and options)" and he had not signed the firm's active trading letter. Nevertheless during that month there were total transactions of over $2 million—over $1 million in purchases and nearly $1 million in sales—in DG's account. When this was pointed out to Leone, he testified that he spoke to DG daily and knew what his objectives were, not just on a piece of paper but verbally, and DG wanted to trade the market and make money.[29] Having carefully observed and evaluated DG's testimony, the Panel rejects Leone's testimony regarding DG as not credible.

(2) Leone testified that RER "wanted me to actively trade the account; I did exactly what he wanted me to do," but when it was pointed out to him that that he executed over $16 million in transactions in RER's account, Leone stated he did not "realize it was $16 million in transactions." Leone testified that he spoke to RER "three, four, five times a day, I was in constant contact …." Leone testified that when he opened the account, RER told him that he had experience trading on margin. In his investigative testimony, however, Leone had stated that he did not know if RER had experience trading on margin. At the hearing, when reminded of his prior testimony, Leone responded that he "may have misunderstood the question at the time." [30] Having carefully observed and evaluated RER's testimony, the Panel rejects Leone's testimony regarding RER as not credible.

(3) Leone testified that JB was a very sophisticated, intelligent person who was very knowledgeable about what was going on in his account. Leone acknowledged, however, that JB never told him that he averaged 100 purchases of stock per year, as indicated on JB's new account documents, stating that JB only told him that he had owned stocks and

[28] Tr. 1153-54, 1160-61, 1164-65, 1169-70, 1614-17, 1634-37, 1651-52.

[29] Tr. 1202-07.

[30] Tr. 1455, 1458, 1460-62.

perhaps bonds. Leone acknowledged that he provided the customer information for new account documents to his supervisor, but he could not explain how the erroneous information had been entered on the new account documents. Leone claimed he could recall JB telling him he "wanted to trade in his account exactly the same way as" RER. But Leone also claimed he could only vaguely recall an email from JB's accountant questioning the activity in the account, or JB's follow-up email a few days later expressing the same concern. He said he did not recall that there were more than $4 million in purchases and $4 million in sales in JB's account while it was open. Leone claimed that he spoke to JB daily to discuss every trade in JB's account. But Leone could not explain why, if he was speaking to JB daily, JB was contacting him repeatedly by email to inquire about the value of the account, or why he was responding with emails of his own stating the value and describing the activity in the account.[31] Having carefully observed and evaluated RER's testimony, as well as the email evidence, the Panel rejects Leone's testimony regarding RER as not credible.

(4) Leone testified that RER told him that CP was "very, very wealthy … and that she wanted to trade the way he was trading in his account." He testified CP also told him "she wanted her account traded like [RER's] and she wanted to make money." Leone claimed that CP called him three to four times a day. He stated that when CP's account was down $2,000, he asked her if she wanted to close the account, but she refused, saying "Doug, I want you to work that money, I want you to make money like you did for [RER]." When shown CP's written note on her first Newport Coast account opening documents stating that she did not want to participate in margin accounts or short selling, Leone stated, "I do not remember that being written down." But at the same time, he asserted that CP "wanted to trade the account. I remember explaining it to her in detail and she set aside $20,000, she said that she understands the risk and she would like to do what [RER] is doing and, you know, she could sustain a loss if she had to." [32] Having carefully observed and evaluated CP's testimony, the Panel rejects Leone's testimony regarding CP as not credible.

(5) Leone testified that he recalled speaking with PH when she opened her account and that she told him "she specifically wanted to trade her account like [RER's], she wanted to get in and out of stocks …." Leone testified that he spoke to PH and RER two to four times a day, and that he spoke to PH personally about every transaction in her account. According to Leone, many times when he called RER, after they spoke RER handed the phone to PH and Leone spoke to her, explaining what they were doing in her account. When it was pointed out to Leone that he executed over $2 million of transactions in PH's account over the eight to nine months it was open, Leone stated he felt that was appropriate because he was trying to duplicate for her the success in RER's account. In fact, however, while PH's account was open, RER's account was steadily losing

[31] Tr. 1228-31, 1256-68, 1299, 1301-03.

[32] Tr. 1472, 1474-75, 1483, 1485.

money.[33] Having carefully listened to and evaluated PH's testimony, the Panel rejects Leone's testimony regarding PH as not credible.

(6) Although LJC's new account documents disclose that he was retired, Leone testified he traded the account like all his other accounts. Despite LJC testifying to the contrary, Leone insisted that the information on LJC's new account documents regarding LJC's income, net worth and investing experience was what LJC told him when he opened the account. Leone further testified that LJC told him he had other brokerage accounts and had worked with firms on Long Island, although Leone could not recall which ones. Leone claimed that he spoke to LJC three to five times a day and spoke to LJC before every trade in his account. And although Leone traded one stock in LJC's account more than 200 times, Leone insisted that was exactly what LJC wanted. When it was pointed out to Leone that during one month alone, he made over $1.7 million in trades in LJC's account, he insisted that was what LJC wanted, to trade the account to make money. In fact, however, during the month in question the value of LJC's account dropped from $128,000 to $50,000. [34] Having carefully listened to and evaluated LJC's testimony, the Panel rejects Leone's testimony regarding LJC as not credible.

(7) When questioned about MJ, Leone claimed to have detailed recollections of a lengthy conversation with MJ when he opened the account. Leone recalled that MJ wanted to be aggressive in order to recoup money he had lost at another firm. Leone testified that MJ told him that he lost the money by trading his account actively on margin at the other firm, and in particular that the use of margin there was what had gotten him in trouble. Nevertheless, Leone also insisted that MJ "knew that he was using margin [to trade in his Newport Coast account] and that's how he was going to make back his money." [35] Leone did not appear to perceive the illogic of his testimony: Why would a customer who had incurred significant losses at another firm by actively trading on margin have believed that the way to recoup those losses was to allow Leone to actively trade his Newport Coast account on margin? Having carefully observed and evaluated MJ's testimony, the Panel rejects Leone's testimony regarding MJ as not credible.

(8) Leone testified that he traded BDS's account like all of his other accounts and that he spoke to BDS before every trade. Leone testified he viewed the trading in BDS's account as consistent with BDS's capital appreciation objective.[36] Having carefully observed and evaluated BDS's testimony, the Panel rejects Leone's testimony regarding BDS as not credible.

[33] Tr. 1352, 1355-57, 1360, 1363.

[34] Tr. 1366-70, 1374-75, 1411-12.

[35] Tr. 1311-21, 1333.

[36] Tr. 1436-37, 1443, 1449-50.

2. LaBarbera

The Panel received testimony from three of LaBarbera's customers and documentary evidence regarding the trading in those customers' accounts, and also received documentary evidence regarding the trading in the account of a fourth customer who declined to testify. The Panel also received testimony from LaBarbera.

- DB owns a mechanic shop. In 2011, when he opened his Newport Coast account, his gross revenues were about $60,000 to $70,000, with a net income of about $40,000 to $45,000. He received a cold call from LaBarbera in 2011 while he was on his boat in a bass fishing tournament. LaBarbera told DB he had a good venture to go into where DB would make money and there was no possibility of losing money. LaBarbera told DB that he needed to make a quick decision because the investment was going to break open and go up fast. It was a drug company with a cancer drug that the FDA was about to approve, after which the stock would go up tremendously. DB's past investment experience was with a FINRA member firm through a local RR, and with two other firms through cold calls. The RRs made all the investment recommendations in those accounts and he had about $1 million in total in the accounts in 2011.

  LaBarbera sent DB the Newport Coast new account documents by FedEx, telling him to sign where indicated, as the forms were just a formality. The new account documents indicated his annual income was $75,000, his net worth (excluding primary residence) was $3 million, and his liquid net worth was $2.5 million. All those amounts were inaccurate and excessive. The documents listed his investment objective as "Aggressive Growth" and his risk tolerance as "Speculation." In fact, his risk tolerance was not speculation. Because of these inaccuracies he does not believe the new account documents were completed when he signed them. At the time he signed the new account documents, DB also signed a form letter that LaBarbera, Levy, and Costanzo prepared and utilized for their customers (the "Short Term Trading Letter"). The Short Term Trading Letter stated, *inter alia*, "we have been executing a strategy designed around short term trading. … [T]he risks involved in short term trading include but are not limited to significant principal losses, increased commission costs, and tax consequences." At the time he received and signed the letter, DB was just opening his account, not "executing a strategy," and the letter did not quantify the amount of "increased commissions" that DB might incur from short-term trading, or disclose that he might be charged markups or markdowns on trades.

  DB spoke to LaBarbera only when LaBarbera called to get DB's authorization for a trade; DB believes LaBarbera called him about every trade. Usually the trades involved the sale of an existing position and the purchase of a new stock, all on a very rushed basis. DB had no knowledge of the stocks that LaBarbera recommended and he never rejected any of those recommendations. LaBarbera did not discuss commissions and DB was unaware that he was being charged markups or markdowns. Although there were short sales in DB's account, DB does not believe LaBarbera ever discussed short selling with him and he is not sure what short selling is; he testified he thought it just meant selling a stock that had been held for a short period.[37]

DB invested approximately $63,000 in his Newport Coast account in July and August 2011. The account was actively traded through May 2012 and closed in July 2012. Total purchases from July 2011 through May 2012 were nearly $1.4 million and total sales were approximately $1.3 million. For the July 2011 through May 2012 period, Enforcement calculated an annualized turnover rate of 39.98 and an annualized cost-to-equity percentage of 142.07%. Total costs were nearly $50,000 and total losses were nearly $34,000.[38]

- CA manages a lumberyard and plant in Colorado. He has a college degree in industrial distribution. He was cold-called by LaBarbera in 2010. Prior to that, he had an account at another FINRA member firm that he believes was invested primarily in mutual funds, based on his broker's recommendations. LaBarbera told him that he had some hot stocks and gave him one to watch, and after a while CA opened an account. CA signed his new account documents in June 2010 after he had already made a purchase in the account at LaBarbera's recommendation. He was being pressured to sign the documents where they were marked with arrows and return them and payment for the stock as quickly as possible. The documents listed his income as $200,000, his net worth as $2 million, and his liquid net worth as $150,000, all of which were probably correct at that time. The documents also listed his investment objective as Aggressive Growth and his risk tolerance as Speculation. CA deposited funds in his account on several occasions from June 2010 through April 2011. CA's new account documents included a Customer Margin Account Agreement, and he identified his signature on the Agreement, although he does not recall signing it. The only time he recalls discussing margin with LaBarbera was when LaBarbera called him after the account was open, wanting CA to buy more stock. CA refused to invest more money and LaBarbera recommended buying the stock on margin.

  CA received account statements but opened only the first one, and he put the confirmations he received in a file without opening them. When CA opened his account his wife was hospitalized and she remained there for several months, so he was not focused on his Newport Coast account. LaBarbera discussed all the purchases in the account with CA, but not the sales, which were made without CA's knowledge. When LaBarbera called him to recommend purchases in the account, LaBarbera had already sold the prior positions to generate money for the new purchases. LaBarbera never discussed commissions with him. All of the trades in the account were based on

[37] Tr. 1804-50, 1986-2161; CX-126A; CX-135A; CX-137A; CX-138A; RX-57; RX-58; RX-59.

[38] CX-561A, at 1.

LaBarbera's recommendations. Like DB, CA signed a Short Term Trading Letter when he opened his account.[39]

CA invested approximately $57,000 in his account. The account was open from June 2010 until May 2012, but all of the trading in the account took place between June 2010 and October 2011. Total purchases during the active period were approximately $721,000 and total sales were approximately $667,000. For the active period from June 2010 through October 2011, Enforcement calculated an annualized turnover rate of 16.69 and an annualized cost-to-equity percentage of 67.23%. Total costs were approximately $29,000 and total losses were more than $50,000.[40]

- RG is a veterinarian in Colorado who owns his own practice, which currently has seven employees. Prior to opening his Newport Coast account, he had an IRA that was invested in mutual funds. His only prior experience investing in individual stocks was in 1988 when he invested $500 in the stock of a computer company. RG was cold-called by another Newport Coast RR, not LaBarbera, who recommended a stock. RG had some money in a money market account that was not earning anything so he decided to go along with the recommendation. After that call, LaBarbera took over his account.

  RG's Newport Coast new account documents listed his income as $85,000, his net worth (excluding primary residence) as $800,000 and his liquid net worth as $75,000. The documents listed his investment objective as Aggressive Growth and his risk tolerance as Speculation. According to the documents, he had 25 years of experience investing in equities. RG testified he did not tell anyone at Newport Coast that his objective was Aggressive Growth, or that his risk tolerance was Speculation, or that he had 25 years of experience with equities. RG did not realize he signed a Customer Margin Account Agreement as part of his new account documents, and he did not speak to anyone at Newport Coast about using margin in his account. RG had never traded on margin, but had a general understanding of what that meant.

  After RG's initial purchase, LaBarbera continued to call and recommend other stocks. LaBarbera told RG that he had been in the business for 20 years, so RG put his trust and faith in LaBarbera. LaBarbera made all the recommendations for subsequent purchases and sales in the account. LaBarbera did not discuss his charges or explain markups or markdowns, and RG did not understand he was paying markups on some purchases. After RG told LaBarbera he had no more money to invest, he realized that LaBarbera was continuing to make purchases on margin. RG did not call anyone at Newport Coast to complain, but he lost sleep about the account because, although he was not worried about

[39] Tr. 3179-3306; CX-126B; CX-129A; CX-130A; CX-131A; RX-63; RX-64.

[40] CX-559A, at 1.

losing the money he had invested, he was concerned about the risk of additional losses as a result of trading on margin.[41]

RG invested a total of approximately $17,000 in his account from January through April 2011. His account was open from January 2011 through May 2012, but the active trading in the account was done between January 2011 and August 2011, after which the only trades were sales of existing positions. Total purchases in his account from January 2011 through August 2011 were more than $173,000; total sales in the account, including those after August 2011, were approximately $160,000. Enforcement calculated an annualized turnover rate of 18.02 and a cost-to-equity percentage of 74.35% for the January through August 2011 period. Total costs for that period were approximately $7,200 and total losses were nearly $16,000.[42]

- The Panel received documentary evidence regarding the account of DR, who had settled an arbitration with LaBarbera and Newport Coast and declined to testify. DR's new account documents indicated that he was employed as a farmer; that his income was $200,000, his net worth (excluding his primary residence) was "1 Mil +," and his liquid net worth was $50,000; that he had 15 years of experience investing in equities and 15 years of experience investing on margin; and that his investment objective was Aggressive Growth and his risk tolerance was Speculation. DR invested approximately $122,000 in his account, which was open from September 2008 until December 2011. Total purchases were approximately $1.525 million and total sales were approximately $1.413 million. Enforcement calculated an annualized turnover rate of 20.39 and an annualized cost-to-equity percentage of 68.40%. Total costs were approximately $50,000 and total losses were nearly $120,000.[43]

- LaBarbera also testified at the hearing. As noted above, like Leone, LaBarbera has been in the securities industry for more than 20 years and has moved frequently among member firms. In 1998, he formed a partnership with Levy and Costanzo, East End Partners Limited. The partners moved together thereafter from firm to firm, becoming RRs at Newport Coast in July 2008. The partners all left Newport Coast in July 2012, moving together to another FINRA member firm, and they moved together to yet another firm in December 2012. Levy and Costanzo left that firm in 2015, and in fact both have been barred from association with any FINRA member firm for reasons not bearing on this proceeding. LaBarbera remains associated with a member firm.[44]

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[41] Tr. 3478-3560; CX-139A; CX-140A; CX-141A.

[42] CX-562A, at 1. For the entire period from January 2011 through May 2012, the annualized turnover rate was 14.51 and the annualized commission/markup to equity rate was 55.25%.

[43] CX-132A, at 1; CX-560A, at 1.

[44] Tr. 3430, 3436-46; CX-115.

LaBarbera obtained customers primarily through cold calling. He stated he did not recall his account-opening conversations with the specific customers at issue, but that any information he entered on the customers' new account documents would have come directly from the customers. He did not open any accounts that were not marked for Aggressive Growth and Speculation, except perhaps a specialty account such as an IRA.[45]

In the accounts of the customers at issue in this proceeding, LaBarbera executed trades either on a riskless principal basis, charging the customer a markup or a markdown, or on an agency basis, charging the customer a commission. The evidence indicated that LaBarbera often charged markups (or markdowns for short positions) on trades opening positions and generally charged commissions on trades closing out positions, but his practice in that regard was inconsistent. Under Newport Coast's policies, LaBarbera had discretion to decide whether to charge a markup/markdown or a commission on a trade and to determine the amount of markup/markdown or commission, so long as the markup/markdown or commission amount was below five percent. LaBarbera asserted that whenever he recommended a trade, he told the customer at that time what the cost of the trade would be, but he could not explain how he determined whether he would charge a markup/markdown or commission for a trade, or how he determined the amount of the markup/markdown or commission he would charge. LaBarbera claimed that his "normal process would be [a] markup of 55 cents a share," but the customers' confirmations show wide variations in the amounts of markups and markdowns he actually charged.

LaBarbera claimed that his normal practice was to tell the customers that he works on a markup and markdown basis, and that the customers "received the confirmations that stated very clearly what their percentage of markup was and the commissions on the transactions." In fact, however, the trade confirmations for riskless principal trades did not disclose the percentage of markup, or clearly disclose the markup or markdown charges in any manner. Rather, for those trades, the main body of the confirmation stated a "Price" that included the markup or markdown, and listed a "Transaction Charge" of $0.00. The fact that the Price included a markup or markdown could be determined only from information set forth well below that portion of the confirmation, under the heading "Additional Trade Information." There the confirmation disclosed the "Reported Trade Price" and the amount of "Markup/down" that had been charged per share. The confirmation did not disclose, however, either the percentage or total amount of the markup or markdown. As a result, only a knowledgeable and vigilant customer would note that there had been a markup or markdown, and such a customer could only determine the percentage and total amount of the markup or markdown by performing mathematical computations. In contrast, when a commission was charged, the Price listed on the confirmation was the reported price for the trade and the total amount of commission charged was clearly disclosed as the Transaction Charge. Under these

[45] Tr. 3466, 3468, 3475-76, 3568, 3571, 3579.

circumstances, inexperienced or unwary investors, such as DB, CA, and RG, could not be expected to understand that they were being charged markups or markdowns on riskless principal trades, or the amounts of those charges.[46]

LaBarbara claimed that his inconsistent use of markups and markdowns was for the benefit of his customers. According to LaBarbera, anyone in the industry would understand that using markups and markdowns benefits the customer's accounting, although he could not explain the supposed benefit in any coherent manner. The Panel rejected his justifications as inconsistent, nonsensical, and virtually incomprehensible. Enforcement's analyses of the charges in the customer accounts at issue in this proceeding show that where LaBarbera elected to charge a markup/markdown, the charges were higher both in absolute terms and as a percentage of the principal amount of the trade than when he charged a commission. The Panel noted that, for a large trade, a markup or markdown, which is calculated on a per-share basis, is likely to cost the customer more than a commission, which is calculated as a flat amount regardless of the size of the trade.[47]

LaBarbera asserted that Enforcement focused only on customers who lost money and that many of his customers did well with his trading recommendations, but he did not offer any evidence to support that assertion. LaBarbera claimed he relied on the information in each customer's new account documents, such as the customer's net worth in comparison to the amount the customer had invested in his or her Newport account, when making his recommendations. He did not attempt to explain, however, how those factors supported the turnover rates and cost-to-equity percentages in the accounts of DB, CA, RG, and DR. Rather, when pressed on his rationale for trades in the customers' accounts, he merely asserted that they had agreed to the trades. In that regard, he also pointed to the customers' signatures on the Short Term Trading Letter that LaBarbera, Levy, and Costanzo used with their customers. LaBarbera testified that the Letter was used "to confirm and acknowledge that the use of aggressive short-term trading … could incur higher charges …." He acknowledged, however, that while the Letter referred to a "risk" of "increased commission costs," the letter did not quantify the potential commission charges, and it did not mention markups or markdowns. Most importantly, the Letter did not even hint that the "higher charges" would rise to levels that would significantly reduce the likelihood that the customers' accounts could realize positive returns, even if the trades in their accounts generated gross trading profits.[48]

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[46] Tr. 3598, 3600, 3604-06, 3627; CX-130A, at 5 (riskless principal trade confirmation), 9 (agency trade confirmation); CX-559A; CX-560A; CX-561A; CX-562A. The Panel notes that in addition to a commission or markup/markdown—or even when no commission or markup/markdown was charged on a trade—the confirmations disclosed an "Activity Assessment" charge, which varied but was often around $45. That charge was in effect an additional commission that was imposed and received by Newport Coast and shared with the RRs.

[47] Tr. 3602-03, 3608-09; CX-559A, at 9; CX-560A, at 14; CX-561A, at 9; CX-562A, at 7.

[48] Tr. 3634; CX-126A.

3. Levy, Costanzo, and Bartelt

Although these three Respondents defaulted and did not testify, the Panel considered the evidence regarding the trading in their customers' accounts in order to determine whether Newport Coast recommended quantitatively unsuitable trading through their conduct.[49] The evidence regarding their customers was as follows:

- NK, a Levy customer, owns a water conditioning business that has one part-time employee, apart from him. In 2010, the gross revenues for the business were $130,000 to $140,000, with net revenues of approximately 20% of the gross. After a cold call, NK opened a Newport Coast account with Levy. Prior to that, NK's investing experience was limited to a one-time $3,500 investment in one stock, on which he lost about $1,000. NK did not recall having any prior brokerage accounts and he did not have any retirement accounts, but he did purchase some stock in a non-public company owned by a friend and in a cartoon network. He also invested in silver through a broker while his Newport account was open.

  Levy told NK that he could make a significant return if he trusted Levy. According to NK's new account documents, his annual income was $50,000, his net worth (excluding primary residence) was $500,000, and his liquid net worth, which NK added to the documents by hand, was $100,000. NK's liquid net worth consisted of an inheritance he had just received, and he used part of that money to fund his Newport Coast account. The new account documents listed NK's investment objective as Aggressive Growth and his risk tolerance as Speculation; NK testified his objective was simply to make money and that he told Levy he could take some risk, but not a lot. Initially NK invested just $1,700, which he quickly withdrew just to test whether he would be allowed to withdraw funds from his account. Once he succeeded, he invested additional funds totaling more than $60,000, but he also withdrew funds from the account on several occasions. NK testified he had very limited discussions with Levy about the investments in the account; Levy made the decisions.[50]

  NK invested approximately $64,000 in his account, but while the account was open he withdrew approximately $25,000. His account was open from January 2010 through June 2012, but nearly all of the trading in the account took place from July 2010 through June 2012. During that active period, total purchases in the account were about $894,000 and total sales were approximately $860,000. For the active period, Enforcement calculated

[49] In addition to the customers discussed below, the Panel received documentary evidence regarding Levy customer RH and Costanzo customer JM. *See* CX-93A; CX-94A; CX-95A; CX-156A; CX-157A; CX-158A; CX-554A. Although the trading in RH's and JM's accounts was consistent with the trading in the accounts of the Levy and Costanzo customers discussed below, neither RH nor JM testified at the hearing and, in light of the other evidence regarding Levy's and Costanzo's customers, the Panel finds it unnecessary to determine whether the trading in RH's and JM's accounts was quantitatively unsuitable.

[50] Tr. 1683-1804; CX-170A; CX-171A; CX-172A; CX-477.

an annualized turnover rate of 16.15 and an annualized cost-to-equity percentage of 66.30%. Total costs were over $36,000 and losses were nearly $37,000.[51]

- BNS, another Levy customer, is a psychiatrist. He invested with Levy following a cold call, making a small initial purchase for about $1,600. Levy told him there would be short-term trading in his account. BNS testified Levy also told him that both sides of his initial investment, buying or selling, would be without cost, "except for, I believe, a small brokerage fee." Later in 2010, BNS asked about cost, and he complained to Levy that the cost of one trade was exorbitant. The charges for that trade were reduced somewhat but BNS otherwise received no response to his inquiries about costs. At the time, most of BNS's investments were through his employer and he had a small IRA, so he wanted to be a bit more aggressive in his Newport Coast account, but he told Levy he would need the money later in the year so he wanted to keep the risk low. BNS's prior investing experience included a brokerage account that allowed him to do his own trading in 1999 and 2000. The value of that account started at $25,000, increased to about $100,000, and then decreased to about $25,000 again. In addition, some years earlier, he had invested $5,000 through a broker, but lost it all. He told Levy about that experience, saying it was traumatic, and Levy said it was unlikely to happen in his Newport account. On cross-examination, BNS admitted he had purchased two or three private placements about 15 years ago. He also testified he had traded his own account in 1999 and 2000, and believed he had NASDAQ Level 2 access when doing so.

  The new account documents were already completed when BNS received them. They indicated that his annual income was $300,000, his net worth was $3 million, and his liquid net worth was $500,000. The stated net worth on the new account form of $3 million was high; it should have been $1 million, which was mostly in retirement accounts. But BNS signed the documents without changing that amount. The documents indicated that his investment objective was Aggressive Growth and his risk tolerance was Speculation, but in reviewing the documents BNS scratched out Speculation and checked "Aggressive" as his risk tolerance. He signed a margin agreement as a "just in case" option, but they did not plan to use it. He also signed the Short Term Trading Letter used by LaBarbera, Levy and Costanzo.

  BNS testified he received and reviewed his account statements and confirmations until he took a trip to Brazil in August 2010. Some of the confirmations he reviewed included disclosures that he had been charged markups and markdowns, but BNS testified he does not recall that registering with him and he was not familiar with the concepts of markups and markdowns at that time; he only learned about markups and markdowns from FINRA when they contacted him during the investigation. BNS does not believe he discussed any of the trading in the account with Levy after he returned from his trip in

[51] CX-565A, at 1 (There was no meaningful difference between the turnover rate and cost-to-equity percentage for the active trading period and the turnover rate and cost-to-equity percentage for the entire period that the account was open.).

September 2010, but Levy continued to trade the account actively. After his trip, BNS decided it was too stressful to follow his account, because he was obsessing on the trading, so he did not open any more statements until he gave them to his accountant at tax preparation time in 2011. He did not close his account at that time because his statements showed he had a profit in his account for 2010. He continued to avoid looking at the account statements and confirmations he received in 2011 until tax time in 2012, by which time his account had incurred substantial losses. BNS closed his account in April 2012.[52]

BNS invested approximately $33,000 in his Newport account, which was open from January 2010 through April 2012. Purchases totaled more than $647,000, with total sales of more than $627,000. Enforcement calculated an annualized turnover rate of 14.42 and an annualized cost-to-equity percentage of 68.82%. Total costs were almost $31,000 and total losses were over $27,000.[53]

- JS, a Levy customer, was employed in stage craft (building stages and erecting sound systems) for more than 40 years. He started his retirement in 2009, although he continued working on some small jobs before fully retiring in 2010. Before opening his Newport Coast account through Levy in 2010, after a cold call, he had never owned any individual stocks or bonds. Levy did not discuss his investment strategy or ask about JS's investment experience, risk tolerance, or objectives.

  When JS received his new account documents, they indicated where he was to sign, so he signed and returned them. The documents stated that his income was $50,000, his net worth (excluding primary residence) was $1 million, and his liquid net worth was $50,000. They indicated his investment objective was Aggressive Growth, but he testified he does not know what that means, and they indicated his risk tolerance was Speculation, but he testified he is "not a speculator … not a gambler." His new account documents indicated that he was retired. The documents that JS signed included a "Customer Margin Account Agreement" and the Short Term Trading Letter used by LaBarbera, Levy, and Costanzo. JS testified he did not understand a margin account and did not know why Levy would want to put him on margin. Although the "Account Information Form" in JS's new account documents did not list any prior investing experience, the documents also included a "Customer Option Agreement" that indicated JS had 20 years of experience investing in options, with a usual size trade of "15," and that he had 30 years of experience investing in stocks and bonds, with a usual size trade per year of "30." In fact, JS did not have any such experience. The Customer Option Agreement also indicated that the anticipated options transactions included covered calls, but JS testified he did not know what covered calls are.

[52] Tr. 1859-1985; CX-164A; CX-165A; CX-166A; CX-479.

[53] CX-563A, at 1.

Levy recommended all the purchases in JS's account. JS testified that sometimes Levy would call him about purchases in his account and sometimes he did not. There were short sales in his account, but JS testified he does not even know what a short sale is and Levy never explained to JS why he was doing short selling in JS's account. Levy never told JS that he was paying markups or markdowns on purchases in his account and JS did not know what markups or markdowns were, or what a riskless principal transaction was. In May 2012 he transferred his Newport account balance to a local broker at another FINRA member firm.[54]

JS invested over $75,000 in his Newport account, which was open from March 2010 through May 2012. Purchases totaled over $1.345 million, with sales of nearly $1.32 million. Enforcement calculated an annualized turnover rate of 11.81 and an annualized cost-to-equity percentage of 50.7%. Total costs were nearly $58,000, with losses of almost $37,000.[55]

- DS, a Costanzo customer, has owned his own fuel oil distribution company since 1990; in 2011 the company had about six employees. DS opened a Newport Coast account in the name of his company in February 2011 after receiving a cold call from Costanzo. At that time he had an account at another FINRA member firm, in which he had invested since he was young, with a value of about $100,000, invested primarily in mutual funds recommended by the RR for that account.

  DS's Newport Coast new account documents indicate his annual income was $100,000, his net worth (not including primary residence) was $2 million, and his liquid net worth was $175,000. The documents indicate that he had 25 years of experience investing in equities, and they state that his investment objective was Aggressive Growth and his risk tolerance was Speculation. The new account documents also included a Customer Margin Account Agreement and the Short Term Trading Letter used by LaBarbera, Levy, and Costanzo.

  After opening his Newport Coast account, DS only glanced at his account statements and did not open them all; he opened confirmations just to see what he had bought and the price. He had no discussions with Costanzo about commissions or markups. Although he now understands he was paying markups, he did not discuss that with Costanzo at the time. There were short sales in his account, but he does not have a good understanding of what a short sale is. He closed the account in November 2011. On cross-examination, DS acknowledged that he had opened other accounts based on cold calls both before and after he opened his Newport Coast account; that he understood Costanzo was being paid somehow for the trades in his account; and that short-term trading and the use of margin in his account was acceptable to him if recommended by Newport Coast. DS testified that

[54] Tr. 3313-3426; CX-159A; CX-160A; CX-161A; CX-162.

[55] CX-564A, at 1.

he depends on the broker to make recommendations about what to do and focuses his attention on his business.[56]

DS invested more than $254,000 in his Newport account, although he also withdrew $150,000 while the account was open and received approximately $61,000 when he closed the account. During the period February 2011 through November 2011, purchases in DS's account totaled nearly $1.6 million, with sales of over $1.5 million. Taking into account DS's withdrawal of $150,000 in April 2011, Enforcement calculated an annualized turnover rate of 27.41 and an annualized cost-to-equity percentage of 104.72%. Total costs were over $60,000, with losses of over $43,000.[57]

- RS, a Costanzo customer, owned a dental technician business, which he sold in 2010 for $1 million. The terms of the sale required that he stay on for at least three years full time, drawing a salary of about $120,000. He also owned the building in which the business was located and rented it to the business. Before he opened his Newport Coast account, RS's primary investing experience involved buying blue chip stocks, as well as gold bullion, to fund his retirement, but in 1999 he was forced to sell all his investments when his business was destroyed by a flood and he needed the funds to rebuild. He acknowledged that he had an account at another FINRA member firm while his Newport account was open, but he did not recall the value of that account and was not asked what his investments were in that account.

  RS opened his Newport Coast account after a cold call from Costanzo. According to RS, Costanzo did not explain what investments he was recommending or his strategy, but said it was supported by Newport Coast. RS's new account documents indicated that his annual income was $100,000, his net worth (excluding primary residence) was $1 million and his liquid net worth was $100,000. The documents list Aggressive Growth as his objective and Speculation as his risk tolerance, but RS testified that was not his actual objective or risk tolerance. Rather, he was looking to invest on a long-term basis for his retirement. RS's new account documents also included a Customer Margin Account Agreement and he signed the Short Term Trading Letter used by LaBarbera, Levy and Costanzo. RS testified that he and Costanzo never discussed what Costanzo's charges would be, and that Costanzo made all the purchase and sale decisions in the account. RS had never used margin in the past and was not aware that margin was being used in his account. He recalls speaking to Costanzo once or twice but after that Costanzo did not contact him about trades in the account.[58]

  RS invested over $15,000 in his Newport account, which was open from March 2011 through February 2012. Purchases totaled over $210,000, with sales of nearly $200,000.

[56] Tr. 2308-99; CX-84A; CX-85A; CX-86; CX-96.

[57] CX-556A, at 1.

[58] Tr. 2499-2566; CX-88A; CX-89A; CX-90A; CX-106.

Enforcement calculated an annualized turnover rate of 23.18 and an annualized cost-to-equity percentage of 110.38%. Total costs were over $10,000, with losses of approximately $14,600.[59]

- AB, a Costanzo customer, is a retired engineer. In the 1980s and 1990s he obtained an insurance license as well as Series 6 and Series 63 securities licenses for a side business, but that business did not work out for him so he did not use those licenses. He and his wife later learned about FOREX currency trading by joining a club and then became clients of a Canadian company that provided training and technical assistance, initially investing $5,000 to $10,000. They are still doing FOREX trading. AB testified that at the time his Newport Coast account was open, he had probably four or five mutual funds, which he selected, with about $50,000 invested. He and his wife also invested in some pre-IPO private placements, but apart from the private placements he had no experience investing in individual stocks before opening his Newport Coast account. He also had a net investment of about $400,000 in real estate and about $25,000 to $30,000 invested in silver when he opened his Newport Coast account in 2011.

  AB opened his account in response to a series of cold calls from Costanzo in which Costanzo urged him to make a small investment in a particular stock. AB's new account documents indicate that his income was $125,000, his net worth was $500,000 and his liquid net worth was $40,000. The documents listed his objective as Aggressive Growth and his risk tolerance as Speculation. AB's new account documents included a Customer Margin Account Agreement and he also signed the Short Term Trading Letter used by LaBarbera, Levy, and Costanzo. AB testified that his objective with his Newport Coast account was to find a short-term opportunity to make a little money—"short term" being less than a year—and that he viewed the investment as riskier than normal. He acknowledged that the objective and risk tolerance shown on his new account form were accurate for the $2,500 he initially agreed to invest.

  After AB's initial investment, Costanzo called with another great opportunity—a company that had a new drug that had almost completed FDA studies—and he invested an additional $10,000. Costanzo called again urging him to buy more of the same company and he invested another $15,000. AB thinks he took a signature loan from his credit union to obtain that money. After a while the stock Costanzo had recommended was not doing well, but Costanzo called again and persuaded him to buy more of the stock on margin. When the company continued to not do well, Costanzo recommended selling that stock and moving the money to a different stock and AB agreed, but told Costanzo to get rid of the margin in his account because he did not want to pay margin interest. AB testified that Costanzo did not talk to him about other purchases and sales in his account in November 2011. When AB realized transactions he had not authorized were occurring he tried to call Costanzo without success, so he called Newport's general

[59] CX-555, at 1.

number and spoke to someone who told AB that he would look into the matter and get back to him. AB did get a return call and spoke to the person, whose name he does not recall, on several occasions. AB's primary concern was the continued use of margin in his account. At some point, seeing his account value dropping, AB called Newport and asked to have trading in the account frozen, and then closed the account. Costanzo did not explain riskless principal trading and AB does not know what that is; similarly, Costanzo did not discuss markups or markdowns. He did not understand short sales when he received confirmations indicating they had been made in his account.[60]

AB invested approximately $28,000 in his Newport Coast account, which was open from January 2011 through March 2012. Purchases totaled over $600,000, with sales of nearly $590,000. Enforcement calculated an annualized turnover rate of 24.66 and an annualized cost-to-equity percentage of 100.02%. Total costs were over $24,000, with losses of nearly $20,000.[61]

- MZ, a Costanzo customer, is an 81-year-old retired teacher. In 2010, when he opened his Newport Coast account, his income was $1,100 per month in social security and a pension of $1,700 per month. At that time, he had a small account with another FINRA member firm worth about $2,000 to $3,000, which he opened after taking an investing course at that firm. But he never picked stocks in any of his accounts himself; they were always recommendations from the RR.

  While MZ's testimony was not clear, it appears that MZ may have done business with Costanzo when he was associated with another FINRA member firm prior to associating with Newport Coast. In any event, MZ opened his Newport Coast account in January 2010. He received pre-completed new account documents, but corrected a number of items in the documents before returning them to Newport Coast. As corrected by MZ, the documents indicated that his income was $35,000, his net worth (excluding primary residence) was $500,000, and his liquid net worth was $25,000. The documents, as corrected by MZ, also indicated that his primary source of wealth was "Retirement Funds" and that the source of funds to fund his Newport Coast account was also "Retirement Funds." The pre-completed documents listed his objective as Aggressive Growth and his risk tolerance as Speculation, but MZ changed Speculation to "Medium." MZ also signed a Customer Margin Account Agreement and the Short Term Trading Letter used by LaBarbera, Levy, and Costanzo. MZ funded his Newport account with cash and with stock transferred from his account at another FINRA member firm. MZ testified that Costanzo made the investment decisions in his account. Costanzo never

[60] Tr. 2163-2307; CX-101A; CX-102A; CX-103A; CX-104.

[61] CX-557A, at 1.

discussed charges with him and MZ does not know the meaning of markups or markdowns or riskless principal trades.[62]

MZ invested approximately $21,500 in his Newport Coast account, including the value of the stock he transferred into the account, which was open from January 2010 through August 2011. Purchases totaled almost $437,000, with sales of over $427,000. Enforcement calculated an annualized turnover rate of 26.9 and an annualized cost-to-equity percentage of 120.71%. Total costs were over $19,000, with losses of over $19,000.[63]

- MG, a Bartelt customer, is an 87-year-old widow who retired in 1990. When she was employed, she was an executive assistant. Her late husband, who was a purchasing agent, met Bartelt at a securities class, and he and Bartelt were the only two members of the class who subsequently obtained securities licenses. Her husband only worked in the securities business for a couple of months before returning to his work as a purchasing agent. MG's husband took care of their investments before he was diagnosed with Alzheimer's disease in about 2007; he died in 2009. Bartelt and MG's husband were very close friends and spoke every morning. MG and her husband moved their investments to Bartelt before her husband died and she continued with Bartelt after that. When MG's husband died she received $100,000 in life insurance, and after giving $10,000 to each of her daughters she invested the remaining $80,000 through Bartelt. She had no experience with investments apart from listening to her husband and Bartelt discuss them.

  MG had three Newport Coast accounts: an individual account, an IRA, and a trust account. The new account documents for all three accounts list her annual income as $65,000 to $124,999 and her net worth as $250,000 to $499,999. The documents for her individual and IRA accounts listed her objective as "long term growth with greater risk—Aggressive Growth (trade volatile securities that have wide change in price)," while the documents for her trust account listed her objectives, inconsistently, as both "long term growth with safety (long term capital appreciation with relative safety of principal)" and as "short term growth with high risk (appreciation with acceptance of high risk)." In fact, MG testified she wanted "growth but minimal risk." MG testified that Bartelt made all the investment decisions in all three accounts.[64]

  MG's individual account was opened in June 2010 with a transfer of approximately $22,000 from Bartelt's prior firm. During the period from June 2010 through December 2012, when the account was actively traded, purchases totaled more than $436,000 and sales totaled more than $445,000. For this period, Enforcement calculated an annualized turnover rate of 22.74 and an annualized cost-to-equity percentage of 52.96%. Total costs

[62] Tr. 2567-2695; CX-107; CX-108A; CX-109A; CX-110A; CX-112; CX-113.

[63] CX-558A, at 1.

[64] Tr. 2400-90; CX-292A; CX-293A; CX-294A; CX-295; CX-296; CX-454; CX-458; CX-459; CX-460; CX-482.

were over $10,000 and losses totaled over $22,000, virtually the entire value of the account. MG's Newport Coast IRA was also opened in June 2010 with a transfer of approximately $60,000. For the active trading period from June 2010 through November 2012, purchases and sales each totaled approximately $3 million. Enforcement calculated an annualized turnover rate for the active period of 27.60 and an annualized cost-to-equity percentage of 57.42%. Total costs were more than $63,000 and total losses were nearly $45,000. During the same period, in her trust account, which was opened with a transfer of approximately $46,000, total purchases were approximately $2.9 million and total sales were approximately $3 million. For the active period, Enforcement calculated an annualized turnover rate of 31.01 and an annualized cost-to-equity percentage of 67.26%. Total costs were more than $63,000 and total losses were almost $42,000.[65]

- LW, a Bartelt customer, is MG's daughter. She is 57, has a college degree in accounting, and worked as a bookkeeper before retiring in 1999 to care for her daughter, who is ill. She had some money in an IRA with another FINRA member firm that she transferred to Bartelt before he joined Newport Coast. The value of the securities that LW transferred into her Newport Coast IRA was approximately $6,000, plus a non-marketable Real Estate Investment Trust investment worth about $4,000. She had no experience in personally managing or selecting her investments before investing through Bartelt.

  After Bartelt moved to Newport Coast, LW signed her Newport Coast IRA new account documents without reading them closely because she trusted Bartelt. According to the documents, her income was $65,000 to $124,999 and her net worth was $125,000 to $249,999. Those amounts were correct only if the income figure applied to her husband's income—she was retired—and if the net worth amount included the value of the house she and her husband owned. The new account documents listed her objective as "long term growth with greater risk—Aggressive Growth (trade volatile securities that have wide change in price)," but in fact she wanted long-term growth with stability. Bartelt made all the trading decisions in her IRA account. He did not discuss the trades with her and she did not review her IRA statements or confirmations when she received them. Around tax time in 2012, after she realized that Bartelt was making a lot of trades in her account because of the number of confirmations she was receiving, she asked him to stop trading her account. Bartelt continued to trade in her account, however, and because she does not like confrontations she did not challenge him. In January 2013 she again asked Bartelt to stop trading her account because "he was bleeding me dry," and after that Bartelt stopped trading her account.[66]

  LW's Newport Coast IRA account was actively traded from June 2010 through January 2013. During that period, purchases were nearly $357,000 and sales were more than

[65] CX-567B, at 1; CX-568A, at 1; CX-569A, at 1.

[66] Tr. 897-988; CX-290A; CX-291.

$368,000. For this period, Enforcement calculated an annualize turnover rate of 18.93 and an annualized cost-to-equity percentage of 60.86%. Total costs were more than $11,500 and total losses were approximately $8,000.[67]

- LAC, a Bartelt customer, is a software engineer. He met Bartelt at a restaurant where Bartelt's sister worked and they became casual, friendly acquaintances. LAC invested with Bartelt before Bartelt moved to Newport Coast and continued to invest with him there.

  LAC had both an IRA and an individual account at Newport Coast. LAC's Newport Coast new account documents indicated his income was $125,000 to $249,999 and his net worth was $500,000 to $999,999. Neither of those figures was accurate. The documents also indicated that he had over 10 years of experience investing in stocks, averaging 10 purchases a year, and over 10 years of experience investing in bonds, averaging two purchases a year. In fact, his only investing experience prior to Bartelt was purchasing some stock of an employer, at an employee discount, between 1987 and 1990, and investing in retirement funds offered in his 401k plan. The documents for both accounts listed his objective as "long term growth with greater risk—Aggressive Growth (trade volatile securities that have wide change in price)," but he testified he wanted long-term growth with some aggressiveness, but not wide changes in price. The new account documents for LAC's individual account also included the word "yes" under "Margins Approved," but there was no evidence that LAC signed a separate margin agreement and he testified he did not recall Bartelt discussing margin with him. LAC does not believe he spoke to Bartelt after opening his Newport Coast accounts and he did not discuss the trades in his accounts with Bartelt. LAC testified he did not realize the extent of the losses in his accounts until FINRA staff contacted him.[68]

  LAC transferred $42,000 from another account to fund his Newport Coast IRA. During the active period from June 2010 through May 2013, purchases totaled over $2 million and sales also totaled over $2 million. Enforcement calculated an annualized turnover rate of 28.48 and an annualized cost-to-equity percentage of 60.35%. Total costs were almost $46,000, with total losses of nearly $40,000. LAC transferred approximately $8,000 in June 2010 to fund his individual account at Newport Coast. Bartelt did not trade the account until May 2011, by which time the value of the transferred investments had increased to more than $11,000. From May 2011 through December 2011, purchases totaled over $200,000 and sales also totaled over $200,000. For that period, Enforcement calculated an annualized turnover rate of 72.22 and an annualized cost-to-equity

[67] CX-572A, at 1.

[68] Tr. 2802-66; CX-286A; CX-287A; CX-288A; CX-289A; CX-456; CX-457.

percentage of 200.49%. Total costs were approximately $5,700 and total losses were over $10,000.[69]

- Although Levy, Costanzo, and Bartelt defaulted and did not appear or testify at the hearing, the Panel received in evidence portions of their investigative testimony designated by the parties. None of that testimony contradicted or was otherwise inconsistent with the testimony of their customers or the documentary evidence regarding the trading in their customers' accounts. As noted above, Levy and Costanzo were in a partnership with LaBarbera and although each partner had his own customers, they conducted their business in the same manner. Each recommended the same securities during the same time periods, and each employed riskless principal trading with large markups or markdowns, most often on opening positions, and charged smaller commissions, most often on closing trades. Each used the same Short Term Trading Letter which was sent to their customers with the customers' new account documents. Bartelt stands apart from the other RRs only because he did not obtain his customers at issue in this proceeding through cold calling but through personal relationships.[70]

B. Conclusions Regarding the Quantitative Unsuitability Charge

1. Standards

FINRA, and previously NASD, has long required that member firms and their associated persons have a reasonable basis for believing that recommended investment transactions are suitable for their customers. This requirement represents a specific application of the general requirement, currently set forth in FINRA Rule 2010 and previously in NASD Rule 2110, that member firms and their associated persons "observe high standards of commercial honor and just and equitable principles of trade." Traditionally, and during the relevant time period, the suitability requirement applied to each transaction recommended by a firm or its RRs, and mandated a customer-specific evaluation of the suitability of the transaction for that customer, based on "the facts, if any, disclosed by such customer as to his other security holdings and as to his financial situation and needs."[71] This requirement is referred to as "qualitative suitability."

In addition, the suitability rules have long been interpreted to prohibit "quantitative unsuitability," which looks at the frequency and cost of recommended trading, rather than the qualities of the particular investments being recommended, to identify excessive trading in customer accounts initiated by the firm or its RRs. The quantitative unsuitability prohibition reflects concern that recommendations leading to frequent, high-cost trading are more likely to

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[69] CX-570A, at 1; CX-571A, at 1.

[70] CX-626; CX-627; CX-628.

[71] NASD Rule 2310 (in effect during most the relevant time period); *cf.* FINRA Rule 2111 (current suitability rule).

serve the interests of the firm and its RRs than the customers, and therefore are inconsistent with the "fair dealing" standard embodied in the rules.[72]

The National Adjudicatory Council ("NAC") has explained: "To demonstrate excessive trading, or quantitative unsuitability, requires proof of two elements. The first element is broker control over the account in question. The second element is excessive trading activity inconsistent with the customer's financial circumstances and investment objectives."[73]

The first element, that the RR exercised c*ontrol* over trading in the customer's account, represents a significant distinction from qualitative unsuitability, which requires only that the RR have *recommended* an unsuitable investment. An RR exercises control over a customer's account if the RR makes the trading decisions, either because the RR has formal discretionary authority, or because the RR makes trades without obtaining prior authorization from the customer. Even if the RR does obtain the customer's authorization for every trade, however, the SEC has held that:

> a broker's de facto control over an account may be established when the customer relies on the representative such that the representative controls the volume and frequency of transactions. Alternatively, de facto control exists where a customer routinely follows a registered representative's recommendations. In that context, we have considered whether the customer had sufficient understanding to make an independent evaluation of the broker's recommendations.[74]

The second element, excessive trading activity, focuses on the frequency and cost of trading. For that reason, the SEC and the NAC have considered the rate of turnover of the account and the costs incurred by the customer as compared to the value of the account as the key considerations in determining whether the trading was excessive. High turnover is viewed as inconsistent with traditional investment guidance, while high cost-to-value makes it less likely that the customer can profit from the trading and more likely that the firm and the RR will be the primary beneficiaries. These considerations are typically expressed as numerical values, the annualized turnover rate and the annualized cost-to-equity percentage. As the SEC recently explained:

> The turnover rate represents the number of times in one year that a portfolio of securities is exchanged for another portfolio of securities and is calculated by dividing the total account purchases by the average account equity and

[72] NASD IM-2310-2(b)(2); *John M. Reynolds*, 50 S.E.C. 805, 809 n.13 (1991).

[73] *Dep't of Enforcement v. Davidofsky*, No. 2008015934801, 2013 FINRA Discip. LEXIS 7, at *27 (NAC Apr. 26, 2013) (internal quotation marks and footnotes omitted).

[74] *Ralph Calabro*, Exchange Act Release No. 75076, 2015 SEC LEXIS 2175, at *18 (May 29, 2015) (internal quotation marks and footnotes omitted); *see also Dep't of Enforcement v. Medick*, No. E9B2003033701, 2009 FINRA Discip. LEXIS 7, at *34 (NAC July 20, 2009) ("*De facto* control is established when the client routinely follows the broker's advice because the customer is unable to evaluate the broker's recommendations and to exercise independent judgment.") (internal quotation marks and footnote omitted).

> annualizing the number. The cost-to-equity ratio measures the amount an account has to appreciate annually just to cover commissions and other expenses and is obtained by dividing total expenses by average monthly equity. While there is no definitive turnover rate or cost-to-equity ratio that establishes excessive trading, we have held that a turnover rate of 6 or a cost-to-equity ratio in excess of 20% generally indicates that excessive trading has occurred. … Other relevant factors in determining the existence of excessive trading include the number and frequency of trades; the client's investment objectives and financial condition, age, and retirement status; and the existence of unauthorized trades.[75]

2. Credibility

Enforcement was required to prove the charges in the Complaint by a preponderance of the evidence.[76] In determining whether Enforcement met its burden, the Panel considered the weight to ascribe to the testimony of the customer witnesses and the testimony of Leone and LaBarbera, where the testimony conflicted. In addition, the Panel considered the credibility of the customer witnesses insofar as their testimony conflicted with the information contained in account documents that they signed and provided to Newport Coast.

In general, the Panel finds the testimony of all the customer witnesses to be highly credible. Some of the customers testified in person while others testified by telephone, which is common practice in FINRA proceedings, but regardless of the mode, the Panel had ample opportunity to assess the credibility of each customer. All of the customers answered all questions directly, with apparent candor; the testimony of each witness was generally internally consistent and consistent with the relevant documentary evidence; and the testimony of all customers of the same RR was generally consistent. While the Panel discounted the accuracy of some details of certain customers' testimony, because of the uncertainty of the customers' recollections regarding those details considering the passage of time since the events occurred, the Panel finds no reason to believe that any customer witness was disingenuous or seeking to mislead the Panel. Indeed, nearly every customer witness accepted some responsibility for their willingness to trust the Newport Coast RR with whom the customer dealt, their failure to closely scrutinize the Newport Coast new account documents, their failure to exercise closer oversight of their accounts, or their failure to take more decisive action when they realized the nature and extent of the trading that was occurring in their accounts.

The Panel did not find either Leone or LaBarbera to be a credible witness. In contrast to the customers, neither Leone nor LaBarbera answered questions directly, and neither accepted any responsibility for trading the customers' accounts at extraordinary cost to the customers. As discussed in greater detail above, both Leone and LaBarbera offered inconsistent testimony

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[75] *Calabro*, 2015 SEC LEXIS 2175, at *32-34 (internal quotation marks, footnotes, and citations omitted); *see also Davidofsky*, 2013 FINRA Discip. LEXIS 7, at *30 and nn.29, 30, and cases cited therein.

[76] *See generally David M. Levine*, 53 S.E.C. 50, 73 n.42 (2003) (holding that preponderance of the evidence is the standard of proof in a self-regulatory organization's disciplinary proceedings).

regarding their interactions with their customers. Leone initially professed an inability to recall specific contacts with the customers, given the passage of time, but then proceeded to "recall" self-serving aspects of his interactions with the customers. In addition, his testimony regarding the manner in which he supposedly obtained the customers' prior approval for trades in their accounts changed repeatedly during the course of his testimony. LaBarbera's purported justifications for using riskless principal trades with markups and markdowns rather than commissions, supposedly for the benefit of his customers, were nonsensical, and his claims that he had fully disclosed his compensation to the customers were inconsistent and implausible.

The Panel also credited the customers' testimony regarding their financial circumstances and investing experience where their testimony conflicted with the information contained in their new account documents, as well as the testimony of customers who stated that they did not realize they had authorized the use of margin in their accounts and had not intended to do so. Finally, the Panel credited the testimony of customers who stated that they had not read and understood the active trading letters used by Newport Coast and by LaBarbera, Levy, and Costanzo to purportedly obtain the customers' agreement to the trading in their accounts. The manner in which the customers presented themselves and the objective evidence regarding their business and investing experience was consistent with their testimony on each of these points. Further, the testimony of Leone's customers, in particular, was consistent in reflecting that their new account documents exaggerated their income, net worth, liquid net worth, and investment experience levels. The Panel concludes that Leone deliberately exaggerated those levels in an effort to justify the type of trading he planned to do in the customers' accounts.

3. Control

As explained above, the first issue in determining whether there was quantitatively unsuitable trading is whether the RRs controlled the customers' accounts. In this case, none of the RRs exercised formal discretionary authority over any of the accounts at issue—indeed, Newport Coast prohibited its RRs from exercising formal discretionary authority over any customer account—but a number of the customer witnesses testified that the RRs made trades in their accounts without obtaining their prior authorization. The Panel fully credited the testimony of those customers; the Panel therefore rejected the testimony of Leone and LaBarbera that they spoke to all of the customers before each trade. Where an RR makes trades without first obtaining the client's approval, he exercises de facto control over the account.[77]

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[77] *See, e.g.*, *Sandra K. Simpson*, 55 S.E.C. 766, 796 (2002) ("De facto control was shown by the many unauthorized transactions and the customers' general lack of investment knowledge and sophistication, which left control of the account in the hands of [the RR],"); *Frederick C. Heller*, 51 S.E.C. 275, 278 (1993) (finding an RR exercised *de facto* control over a customers' account where the customers "were not consulted, nor typically even made aware of, the particular trades executed in their account until well after the fact"); *see also Calabro*, 2015 SEC LEXIS 2175, at *18 n.20 (citing *Simpson* and *Heller*, and stating: "Where a broker engages in unauthorized transactions, he operates as though he has been delegated discretionary authority (and thus formal control) by the client, although he has not been.").

Insofar as the RRs did obtain the customers' authorizations before making the trades, the Panel finds they still exercised de facto control over the accounts because the customers relied on the RRs to such a degree that the RRs controlled the volume and frequency of transactions in the customers' accounts, and because the customers routinely followed the RRs' recommendations. All of the customers testified, credibly, that they relied entirely on the RR and that the RR selected each of the securities that were purchased in their accounts, and decided when the security should be purchased, how much of the account should be invested in the security, and when the security should be sold. None of the five RRs, either in testimony at the hearing, in the case of Leone and LaBarbera, or in their investigative testimony, in the case of Levy, Costanzo, and Bartelt, claimed that the customers initiated any of the trading in their accounts.

Further, even insofar as the customers were aware of the trading in their accounts, they did not have "sufficient understanding to make an independent evaluation of the broker's recommendations." Most of the customers were inexperienced, naïve investors. Of Leone's eight customers, only BDS could reasonably be described as an experienced or sophisticated investor, but BDS was unaware of the volume of trading in his account until he received his account statement for May 2011. After he saw the level and results of Leone's trading, he immediately halted trading in his account and there were no more purchases after June 2011. None of the three LaBarbera customers who testified was an experienced, knowledgeable investor who was aware of and able to evaluate LaBarbera's trading.[78] Of the Levy, Costanzo, and Bartelt customers who testified, BNS might be described as a knowledgeable investor, based on his past investing experience, but the Panel credited his testimony that from September 2010 on, Levy traded the account on his own, without obtaining BNS's approval of the trades.[79] As a result,

[78] Although LaBarbera customer DR did not testify, the Panel concludes that LaBarbera exercised control over his account. In that regard, the Panel notes that LaBarbera did not claim that he traded DR's account differently than the other accounts at issue or that DR initiated any of the trading in his account. Nevertheless, in concluding that LaBarbera engaged in quantitatively unsuitable trading of customer accounts and in determining what sanctions to impose for that violation, the Panel has not relied on LaBarbera's trading of DR's account.

[79] Costanzo customer AB had experience investing in other arenas, but had never before invested in individual stocks, and the Panel did not find him to be capable of independently evaluating Costanzo's recommendations. Moreover, the Panel credited AB's testimony that much of the trading in his account was undertaken by Costanzo without AB's prior approval.

Levy exercised control over the account. The Panel finds, therefore, that the control element is satisfied.[80]

4. Excessive Trading

The Panel also finds that the trading activity in all of the customer accounts at issue was excessive and inconsistent with the customers' financial circumstances and investment objectives. As noted above, the SEC and the NAC have indicated that a turnover rate of over six and a cost-to-equity percentage in excess of 20% are indications of excessive trading. For Leone's eight customers, the turnover rates in their accounts ranged from 85.81 to 172.84, while the cost to equity percentages ranged from 105.22% to 280.14%. The figures for the other RRs were less egregious, but still far exceeded the levels cited by the SEC and the NAC. For LaBarbera's four customers, the turnover rate ranged from 16.69 to 39.98 and the cost-to-equity percentage ranged from 67.23% to 142.07%; for Levy's three customers, the turnover rate ranged from 11.81 to 16.15 and the cost-to-equity percentage ranged from 50.7% to 68.82%; for Costanzo's four customers, the turnover rate ranged from 23.18 to 27.41 and the cost-to-equity percentages ranged from 100.02% to 120.71%. Finally, for Bartelt's three customers' six accounts, the turnover rate ranged from 18.93 to 72.22 and the cost-to-equity percentage ranged from 52.96% to 200.49%.[81]

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[80] *See Calabro*, 2015 SEC LEXIS 2175, at *21 and n.23 (finding that the RR "exercised de facto control over [the customer's] account because [the customer] routinely followed [the RR's] recommendations. [The customer] deferred to [the RR] with respect to establishing (and altering) account strategy, selecting securities, and determining when and in what quantities to trade them. When [the RR] informed [the customer] of transactions that [the RR] selected or had already implemented, [the customer] felt he could not object to them because of his lack of knowledge and expertise"); *see also Michael David Sweeney*, 50 S.E.C. 761, 766 (1991) (finding control where "[w]ith few exceptions, the customers did not initiate the transactions in their accounts, nor did they fully understand the trading therein. When the customers decided to effect the transactions at issue, they were relying totally on the [RRs]. Indeed, the [RRs'] consultations with their customers on investment choices were merely a formality, since the customers invariably followed their recommendations"); *Richard G. Cody*, Exchange Act Release No. 64565, 2011 SEC LEXIS 1862, at *43 (May 27, 2011), *aff'd*, 693 F.3d 251 (1st Cir. 2012) (finding that respondent "maintained *de facto* control because the Customers did not independently evaluate his recommendations but rather acquiesced in his trades"); *Joseph J. Barbato*, 53 S.E.C. 1259, 1277 (1999) (concluding that the RR exercised de facto control where the customer "testified that he placed his trust and confidence in [the RR] and allowed him to decide what to buy or sell in the account").

[81] At the hearing, Newport Coast counsel challenged the methodology used by FINRA staff witnesses to calculate the turnover rates and cost-to-equity percentages for the customers' accounts, but Respondents offered no calculations of their own. Upon review, the Panel finds that FINRA staff employed the correct methodologies and accepted their calculations. The Panel notes that for some customers, FINRA staff calculated turnover rates and cost-to-equity percentages for alternative time periods, and also offered percentage calculations using only commissions and markups/markdowns, rather than total costs. None of the alternative calculations resulted in figures that were materially different than those cited herein. Regardless of the methodology selected or the time periods used, the turnover rates and costs were far in excess of the levels that have been found in the past to reflect excessive trading. *Cf. Dep't of Enforcement v. Merhi*, No. E072004044201, 2007 NASD Discip. LEXIS 9, at *11 n.6 (NAC Feb. 16, 2007) ("Enforcement's calculation of a 94.17% cost-to-equity ratio was slightly less than the actual rate of 94.85%. This difference is immaterial to our finding that [respondent] traded excessively.").

Respondents contend that the trading that generated these turnover rates and cost-to-equity percentages was consistent with the customers' financial circumstances and investment objectives as set forth in their new account documentation. And they claim that the customers wanted the type of trading they did, pointing to active trading letters that some of the customers signed. They also suggest that the customers knew that they were signing on for active, risky trading, and that in some cases the customers acknowledged that they invested modest amounts, considering their overall finances, that they understood they could lose.

A threshold issue is whether trading with the turnover rates and especially the cost-to-equity percentages that the RRs generated in the customer accounts at issue could be suitable for any customer, regardless of the customer's financial circumstances and investment objectives. The Panel acknowledges that active trading leading to turnover rates well above six could conceivably be suitable for certain sophisticated customers who understand the risks associated with such trading. The Panel can conceive of no customers, however, for whom turnover rates coupled with cost-to-equity percentages at the levels found in this proceeding would be suitable. Leone's customers would have had to earn annualized returns of 105.22% to 280.14% simply to break even on Leone's trading in their accounts. For LaBarbera's customers, the break-even annualized returns were 67.23% to 142.07%; for Levy's, 50.7% to 68.82%; for Costanzo's, 100.02% to 120.71%; and for Bartelt's, 52.96% to 200.49%. No customers, regardless of their financial circumstances and investment objectives, would make a rational decision to invest on such a basis because they would know they would be highly unlikely to profit from the trading, and that the trading would primarily benefit the RR and the firm.[82]

Looking to the financial circumstances and investment objectives of the customers at issue in this proceeding, the Panel finds that the amounts many of them invested were important to their future financial well-being. CP, for example, invested money that she needed for her daughter's education; LJC, a disabled veteran, invested money he and his wife needed for retirement; JS, who was retired and of modest means, invested and lost more than the entire amount of his liquid net worth, as reflected in his Newport Coast new account documents; MZ, also retired and of modest means, similarly invested and lost most of his liquid net worth as shown in his Newport Coast new account documents. MG, an elderly widow, lost nearly all of her IRA, trust and individual account funds, and her daughter lost nearly all of her IRA investment as a result of Bartelt's excessive trading in their accounts. All of these customers were inexperienced, naïve investors who did not understand the manner in which their accounts would be handled, and the level and cost of trading in their accounts was clearly unsuitable for them.

Even for those customers who invested only money that they were prepared to lose, and who understood that their accounts would be invested in speculative securities, the trading that actually occurred in their accounts was excessive. Those customers understood that they were accepting market risk, that is, the possibility that the securities they invested in might decrease in

[82] *See Clyde J. Bruff*, 53 S.E.C. 880, 885 (1998) ("where a trading strategy results in costs so high as to make the generation of any profit unlikely, the trading is excessive").

value, costing them the funds they had invested. But in fact the customers' losses were not primarily attributable to market risk, but rather to the RRs' greed in trading the customers' accounts for their own benefit. Indeed, in some of the customers' accounts there was little or no net loss on the trades themselves; rather those customers lost significant amounts of money because of the extraordinary amounts, including commissions, markups and markdowns, and other costs, that they were charged for the trades.[83] None of the customers, even those for whom the funds they invested were insignificant to their total financial circumstances, intended that their investments serve primarily to benefit Newport Coast and the RR through whom they invested.

The Panel also considered that the customers signed Newport Coast new account documents stating financial means, investment experience, and high-risk investment objectives and risk tolerance that many of the customers now disavow. In addition, some of the customers signed active trading letters provided by Newport Coast or by LaBarbera, Levy and Costanzo, purporting to approve of active trading in their accounts.

Responsible FINRA member firms and their RRs collect and document customer information and provide written disclosures in order to better serve their customers and to help them fulfill their responsibilities under FINRA rules, including the suitability rule. Those firms and RRs take pains to ensure that their customers understand the significance of the information they are asked to provide and the importance of confirming its accuracy, and they are careful to convey important disclosures clearly and unambiguously. In those circumstances, it is incumbent upon customers to take equal pains to provide accurate information to assist the firms and RRs in serving them.

In this case, however, the customers uniformly and credibly testified that they were provided with various forms containing a variety of data and disclosures without any explanations as to their significance; rather, they were simply instructed to sign where indicated and return the documents promptly. Further, there is no indication that either Newport Coast or the RRs actually used the information on the customer documents to serve the customers. Customers whose documents disclosed modest means or limited experience or more conservative investment goals or who indicated that they did not want to trade on margin had their accounts traded, generally on margin, just as aggressively as those who signed documentation supporting more aggressive trading. It is clear to the Panel that Newport Coast and the RRs attempted to use the customer documentation to justify the excessive trading in the customers' accounts rather than in any good faith effort to determine what type of investing was suitable for the customers. Under such circumstances, the Panel concludes that the mere fact that unwary customers signed the documents did not provide a defense to the quantitatively unsuitable trading of their accounts.

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[83] *See* cost and loss figures for customers PH, LJC, DB, NK, BDS, JS, DS, AB, MZ, MG (IRA and trust accounts), LW, and LAC (IRA account) set forth above.

The customers' credibility is not undercut by their routinely signing documents when requested to do so. The Panel notes that in our society we all are barraged with forms requiring our signatures or other indications of acceptance, and many of us signify our acceptance as a matter of course. The alternative would be to spend much of our days attempting to absorb boilerplate information and disclosures. But in any event, even if the customers were held to the information and disclosures they signed, it would not justify the trading in their accounts. The SEC has stated:

> Even if we were to assume that the customers authorized the [respondents] to manage their accounts aggressively, they did not authorize them to deplete those accounts through commissions, markups and margin charges. There is a difference between aggressive investing and excessive trading. A primary test for excessive trading is the relationship between the net amount of money invested and the transaction costs that are incurred.[84]

As explained above, the cost-to-equity figures in this case dwarf those found to be excessive in prior cases and clearly evince the RRs' excessive trading of the customers' accounts for their own benefit.

Accordingly, the Hearing Panel concludes that each of the five RRs—Leone, LaBarbera, Levy, Costanzo, and Bartelt—engaged in quantitatively unsuitable trading in customer accounts. The Panel further concludes that Respondents Leone and LaBarbera violated NASD Rule 2310 and IM-2310-2 (for conduct during the period September 2008 through July 8, 2012), FINRA Rule 2111 (for conduct after July 8, 2012), NASD Rule 2110 (for conduct through December 14, 2008) and FINRA Rule 2010 (for conduct after December 14, 2008).[85]

5. Newport Coast's Liability for Quantitative Unsuitability

Enforcement argues that Newport Coast can be found to have engaged in quantitatively unsuitable trading in the customers' accounts through the actions of its RRs, citing the legal principal of "respondeat superior." As explained in the Restatement of Agency:

> The doctrine of respondeat superior is fundamental to the operation of the tort system in the United States. The doctrine establishes a principle of employer liability for the costs that work-related torts impose on third parties. Its scope is limited to the employment relationship and to conduct falling within the scope of that relationship because an employer has the right to control how work is done.
> …

[84] *Sweeney*, 50 S.E.C. at 765.

[85] As noted above, Levy, Costanzo, and Bartelt's liability for their quantitatively unsuitable trading will be addressed in a separate default decision.

> Viewed as a doctrine within the law of agency, respondeat superior is a basis upon which the legal consequences of one person's acts may be attributed to another person. Most often the doctrine applies to acts that have not been specifically directed by an employer but that are the consequence of inattentiveness or poor judgment on the part of an employee acting within the job description. Most cases applying the doctrine involve negligence resulting in physical injury to a person or to property.[86]

The doctrine of respondeat superior has been cited in some cases as applicable to circumstances that go well beyond those cited in the Restatement, including violations of the securities laws and NASD rules.[87] As explained in the Restatement, however, it is unnecessary to resort to respondeat superior to hold Newport Coast responsible for the excessive trading of the customers' accounts by the five RRs because Newport Coast gave the RRs "actual authority" to engage in the excessive trading.

> Actual authority is a consequence of a principal's expressive conduct toward an agent, through which the principal manifests assent to be affected by the agent's action, and the agent's reasonable understanding of the principal's manifestation. An agent's actions establish the agent's consent to act on the principal's behalf, as does any separate manifestation of assent by the agent. When an agent acts with actual authority, the agent's power to affect the principal's legal relations with third parties is coextensive with the agent's right to do so, which actual authority creates.[88]

The Restatement sets forth the following general principal of law:

> A principal is subject to liability to a third party harmed by an agent's conduct when the agent's conduct is within the scope of the agent's actual authority or ratified by the principal; and (1) the agent's conduct is tortious, or (2) the agent's conduct, if that of the principal, would subject the principal to tort liability.[89]

This formulation is consistent with general FINRA practice and case law. Member firms, by definition, can only act through their associated persons. Were member firms not held responsible for the conduct of their associated persons acting within the scope of their actual authority, the firms would be effectively excused from their duties under FINRA rules. A firm's responsibility to "observe high standards of commercial honor and just and equitable principles of trade" finds expression only through the conduct of its associated persons. Similarly, a firm's

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[86] Restatement (Third) of Agency, § 2.04 (2006).

[87] *See, e.g.*, *vFinance Investments, Inc.*, Exchange Act Release No. 62448, 2010 SEC LEXIS 2216, at *36-37 n.25 (July 2, 2010); *Dep't of Mkt. Regulation v. Yankee Fin. Group, Inc.*, No. CMS030182, 2006 NASD Discip. LEXIS 21, at *58-62 & n.37 (NAC Aug. 4, 2006).

[88] Restatement (Third) of Agency, § 2.01.

[89] Restatement (Third) of Agency, § 7.04.

duty to recommend only suitable investments, including quantitatively suitable investments, can only be exercised by its RRs and other associated persons.

In this case, it is undisputed that the five RRs, Leone, LaBarbera, Levy, Costanzo, and Bartelt, were registered with Newport Coast; Newport Coast gave the RRs actual authority to solicit customers, and Newport Coast ratified their solicitations of the customers at issue by establishing Newport Coast accounts for them; Newport Coast gave the RRs actual authority to solicit securities transactions from the customers and to decide the amount of commissions or markup/markdowns to charge for those transactions; and Newport Coast ratified all trading and all charges in all the customers' accounts by entering those trades and charges in the firm's books and records. In addition, Newport Coast was the direct beneficiary of all the commissions, markups, markdowns, and other charges incurred by the customers for the excessive trading in their accounts; Newport paid out a portion of those commissions, markups, markdowns, and other charges to the RRs based on individual agreements between Newport Coast and the RRs.

Therefore, the Panel concludes that Newport Coast, acting through the five RRs, engaged in quantitatively unsuitable trading in customer accounts and thereby violated NASD Rule 2310 and IM-2310-2 (for conduct during the period September 2008 through July 8, 2012), FINRA Rule 2111 (for conduct after July 8, 2012), NASD Rule 2110 (for conduct through December 14, 2008) and FINRA Rule 2010 (for conduct after December 14, 2008).[90]

III. Churning

Quantitative unsuitability is a violation of FINRA rules, while churning is a type of fraudulent conduct that violates Section 10(b) of the Securities Exchange Act and Rule 10b-5. Nevertheless, the standards applicable to both are essentially the same, with one exception. As with quantitatively unsuitable trading, a finding of churning requires proof that the RR controlled trading in the customer's account, either formally or de facto, and that the trading was excessive. In addition, however, churning requires that the RRs acted with scienter, which "requires proof that a respondent intended to deceive, manipulate, or defraud, or acted with severe recklessness involving an extreme departure from the standards of ordinary care."[91] In a recent churning case finding scienter, the NAC noted that "[t]he cost-to-equity ratio and turnover rate for [the customer's] account were so high that [the respondent] must have known that he was acting in reckless disregard of [the customer's] interests – [the customer] had to earn nearly 45 percent per

[90] Conduct that violates a specific NASD or FINRA standard, or a provision of the securities laws or regulations, also violates the requirement that member firms and associated persons "observe high standards of commercial honor and just and equitable principles of trade" set forth in NASD Rule 2110 and FINRA Rule 2010. *See, e.g.*, *Wendell D. Belden*, 56 S.E.C. 496, 505 (2003).

[91] *Davidofsky*, 2013 FINRA Discip. LEXIS 7, at *31-32 (internal quotation marks and footnotes omitted). A finding of a violation of Section 10(b) and Rule 10b-5 also requires proof that the Respondents used "any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange." 17 C.F.R. § 240.10b-5. This requirement is plainly satisfied here because the RRs communicated with the customers by telephone and the excessive trades were effected through various means of interstate commerce and the facilities of national securities exchanges.

year simply to break even." The NAC also stated that "the amount of commissions that [the respondent] generated from trading [the customer's] account demonstrates that he acted with scienter."[92]

Application of the NAC's reasoning to the facts of this case leads inevitably to the conclusion that Leone, LaBarbera, Levy, Costanzo, and Bartelt acted with scienter. The cost-to-equity ratios and turnover rates for all the customers in this case were astronomical and for most of the customers far above the levels found to indicate churning in prior cases. In all of the customer accounts at issue, the benefits to the RR far outstripped any likely return to the customers from the trading, making it manifest that the RRs were trading for their own benefit without regard to the interests of the customers. Accordingly, the Panel concludes that Leone, LaBarbera, Levy, Costanzo, and Bartelt acted in willful and reckless disregard of the customers' interests. The Panel therefore concludes that Leone and LaBarbera churned customer accounts in violation of Section 10(b) and Rule 10b-5. Furthermore, their violations of Section 10(b) and Rule 10b-5 were also violations of NASD Rules 2120 and 2110 (for conduct through December 14, 2008) and FINRA Rules 2020 and 2010 (for conduct after December 14, 2008).[93]

Enforcement again relied on the principal of respondeat superior as a basis for finding Newport Coast liable for the RRs' churning violations. For the reasons set forth above, the Panel concludes that under principles of agency law and FINRA precedent, whether articulated as respondeat superior or as the RRs' exercise of actual authority ratified by Newport Coast, the firm is responsible for the RRs' churning of the customer accounts at issue.

Enforcement also relied on Section 20(a) of the Securities Exchange Act, which provides:

> Every person who, directly or indirectly, controls any person liable under any provision of this chapter or of any rule or regulation thereunder shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable … unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action.

Enforcement cited *Department of Enforcement v. L.H. Ross & Co.* to support its application of Section 20 here. In *L.H. Ross* the Hearing Panel stated: "As a matter of law, a broker-dealer is a control person under Section 20(a) with respect to its registered representatives and is liable for their violations of Section 10(b) of the Exchange Act, even if they are

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[92] *Davidofsky*, 2013 FINRA Discip. LEXIS 7, at *33.

[93] NASD Rule 2120 provided, and FINRA Rule 2020 provides: "No member shall effect any transaction in, or induce the purchase or sale of, any security by means of any manipulative, deceptive or other fraudulent device or contrivance." The churning of customer accounts is a violation of these rules, and a violation of these rules is a violation of NASD Rule 2110 or FINRA Rule 2010, for conduct that occurred while each respective rule was effective. *See, e.g., Davidofsky*, 2013 FINRA Discip. LEXIS 7, at *26 n.27.

'independent contractors.'"[94] But we note that the Hearing Panel's interpretation of Section 20 in *L.H. Ross* was set forth in a footnote as an alternative holding. Further, even if applied in this case, Section 20 would only provide an alternative basis for holding Newport Coast liable for the RRs' violations of Section 10(b) of the Securities Exchange Act and Rule 10b-5, because Section 20 does not apply to violations of FINRA or NASD rules. Therefore, although the Panel agrees that Newport Coast was a control person of the RRs, the Panel finds it unnecessary to rest its conclusion that Newport Coast is responsible for the RRs' churning of customer accounts on Section 20.[95]

Accordingly, the Panel concludes that Newport Coast, acting through the five RRs, churned customer accounts in violation of Section 10(b) of the Securities Exchange Act and Rule 10b-5, as well as NASD Rules 2120 and 2110 (for conduct through December 14, 2008) and FINRA Rules 2020 and 2010 (for conduct after December 14, 2008).

IV. Supervision

A. Facts

In the Complaint, Enforcement alleged that "[t]here were multiple red flags suggesting that Leone, Costanzo, Levy, LaBarbera, and Bartelt were excessively trading, churning, and generally making unsuitable recommendations." Enforcement asserted that these red flags included:

- the volume of trading in the accounts;
- the concentration of the accounts in single securities and the use of high margins;
- in-and-out trading in the accounts;

[94] No. CAF040056, 2005 NASD Discip. LEXIS 56, at *30 n.23 (OHO Jan. 14, 2005).

[95] *See Dep't of Enforcement v. Ahmed*, No. 2012034211301, 2015 FINRA Discip. LEXIS 45, at *80, 85-86 (NAC Sept. 25, 2015) (holding firm a "primary violator" of the antifraud provisions based on respondeat superior principles, and declining to find Section 20 control person liability because "[c]ontrol person liability applies when an individual or entity is held secondarily liable for another individual's or entity's primary violation of the securities laws.").

Section 20 would exempt Newport Coast from control person liability if it "acted in good faith and did not directly or indirectly induce the act or acts constituting the violation…." *Id.* at *85. Although the Panel finds it unnecessary to rely on Section 20, the Panel concludes that, if Section 20 were applied, Newport Coast would not be entitled to the exemption. Newport Coast did not act in good faith because, as set forth in detail below, in dereliction of the firm's supervisory responsibilities, the firm's senior management, compliance department, and supervisory staff ignored or failed to respond reasonably to numerous red flags indicating that the RRs were, or might be, excessively trading and churning customer accounts. And by failing to recognize or respond to the red flags, Newport Coast indirectly induced the RRs to excessively trade and churn the customers' accounts for the financial benefit of the firm and the RRs.

- breaking transactions into multiple orders executed within minutes, with multiple commissions and activity fees;

- the total commissions charged on individual accounts relative to total account value;

- cost-to-equity values in excess of 100%;

- turnover rates over 100;

- the appearance of some customer accounts on exception reports many times;

- large losses in some customer accounts; and

- the use of riskless principal and agency trading in the same account, with high-cost trades executed on a riskless principal basis and lower-cost trades executed on a an agency basis.[96]

The evidence established that all of the circumstances Enforcement cited as "red flags" were present. In the section above addressing quantitative unsuitability, the Panel made findings regarding the excessive trading in the customers' accounts, including the amount of trading in relation to the size of the accounts, the amount of commissions and other charges in comparison to the value of the accounts, the cost-to-equity percentages and turnover rates, and the amounts of the losses in all the accounts but one. In addition, as discussed above, LaBarbera, Levy, and Costanzo used both riskless principal trades, with higher payouts to the RRs, typically when opening positions, and agency trades, with lower payouts, most often when closing out positions. Although not discussed at length above, the customers' account records showed that the accounts were often highly concentrated; there was a great deal of in-and-out trading; margin balances were often very high in comparison to the account values; and in many cases positions were established or liquidated through multiple executions generating multiple charges.[97] Furthermore, all of these circumstances were evident from Newport Coast's own records. None of the trades or charges were hidden from the firm.

In spite of this, Newport Coast contended that it either reasonably failed to detect red flags indicating that the RRs were engaged in quantitatively unsuitable trading, or reasonably responded to the red flags it did detect. The evidence does not support those contentions.

The evidence regarding Newport Coast's supervision of the five RRs included testimony from settled Respondent Arena, who supervised Leone; KK, who served as the firm's Chief Operating Officer ("COO") during the relevant time period and remains in that position; SW, who served as Newport Coast's Chief Compliance Officer ("CCO") during part of the relevant time period; and Leone and LaBarbera. The evidence also included numerous exhibits detailing

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[96] Compl. ¶ 425.

[97] *See* CX-543; CX-573 through CX-591.

Newport Coast's written supervisory procedures ("WSPs"), and its implementation of those WSPs, during the relevant time period.

As noted above, Leone was assigned to Newport Coast's Long Island, New York, office, but worked from his home. Newport Coast assigned Arena to supervise 10 RRs, including Leone, as the branch manager for the Long Island office in March 2009. Although Arena had no prior supervisory experience when he was appointed, Newport Coast gave him no training regarding his supervisory responsibilities. His compensation, as established by Newport Coast, included overrides on the business conducted by Leone and the other RRs he supervised. Arena testified that although Newport Coast's WSPs called for him to review monthly customer account statements for suitability, he did not do that and no one at Newport Coast directed him to review the statements or checked to see if he was doing it. Arena testified that he did not attempt to verify any of the information collected by any of his RRs for new account forms, and he never contacted any of Leone's customers regarding the activity in their accounts or modified or restricted any activity in Leone's customers' accounts. He received reports from Newport Coast each day showing trading by his RRs for the prior day, but the reports did not allow him to look at any patterns of trading over a period of time, and Newport Coast did not provide any cumulative reports from which trading patterns might have been detected.[98]

KK, Newport Coast's COO, was not formally part of the firm's compliance department, but had compliance responsibilities. Among other things, he approved all new account documentation and, at least through 2010, he reviewed all of the exception reports generated by Newport Coast's clearing firms.

KK testified that when evaluating whether a new account was suitable for the sort of trading Leone, LaBarbera, Levy, and Costanzo conducted, he considered the customer's investment objective and risk tolerance, experience, the size of the account and the customer's age. He could not, however, describe any financial circumstances that would have led him to reject a new account for active trading and the use of margin, and there is no evidence that KK or anyone else at Newport Coast ever rejected any new account that any of the five RRs submitted.[99] Indeed, KK approved the new account documents for Levy customer JS, including a margin agreement, even though the new account documents indicated that JS was 65 years old and retired, that his income was $50,000 and his liquid net worth was also $50,000, and his Account Information Form listed no prior investing experience.[100] KK approved this account in spite of his understanding that "more or less you don't do business with [Levy's] office unless you wanted short-term trading in stocks." When asked if that meant "[a]ggressive growth and

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[98] Tr. 2871-74, 2879, 2883-86, 2890, 2892, 2899, 2901, 2911-12, 2916-17.

[99] Tr. 4753-58.

[100] CX-159A, at 1, 2, 4-6. Although JS's Account Information Form did not indicate that he had any prior investing experience, the new account documents included a Customer Option Agreement indicating that JS had 20 years' experience investing in options and 30 years' experience investing in stocks. KK signed both forms and there is no indication that he questioned the inconsistency between the two forms.

speculation," he responded, "Exactly."[101] As noted above, Levy excessively traded and churned JS's account causing him to lose more than his entire liquid net worth as indicated in the new account documents that KK signed.

Similarly, KK approved the new account documents for MZ, a Costanzo customer, again including a margin agreement, even though the documents disclosed that MZ was 75 years old and retired, his income (corrected by MZ) was just $36,000, his liquid net worth was just $25,000, and his risk tolerance (also corrected by MZ) was "medium."[102] When signing off on MZ's new account documentation, KK was undoubtedly aware that, as with his other customers, Costanzo would trade MZ's new account actively, on margin, in speculative securities, which, of course, is precisely what Costanzo did, costing MZ most of his liquid net worth.[103]

Newport Coast also had ample evidence of the red flag circumstances from the exception reports it received from its clearing firms. At all relevant times, Newport Coast elected to use two different clearing firms, with each of Newport Coast's RRs having discretion to decide which clearing firm to use for his or her customers. Both clearing firms made available to Newport Coast management a variety of exception reports that could be used to identify possible compliance issues, but the firms used different parameters to identify exceptions and provided different data in their reports.

One of the clearing firms that Newport Coast used, Wedbush Securities Inc., provided monthly active account reports on accounts that traded outside of defined parameters for a variety of criteria such as the number of trades in the account, the amount of losses, or the turnover rate. The reports provided information by RR for each customer account trading outside of the parameters. For example, LaBarbera customer DR appeared on the Wedbush monthly active account reports 13 times from March 2009 through August 2011; LaBarbera customer CA appeared on the reports nine times from September 2010 through September 2011; LaBarbera customer DB appeared on the reports five consecutive months from November 2011 through March 2012; and LaBarbera customer RG appeared on the reports three times from May through

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[101] Tr. 4752.

[102] CX-108A. KK testified that Newport Coast performed a branch audit of Costanzo in 2010 during which the firm reviewed accounts including MZ's. KK also testified that in reviewing such accounts, "We're looking for anything on the new account documentation that could be different with what the broker had initially sent to the client to what actually came back." Tr. 4783, 4789-90. Nevertheless, nothing in the report of the audit indicated that the auditor noticed that MZ had corrected his income, lowering it to $35,000; the source of his wealth and of the funds he was investing, changing it to "retirement"; and his risk tolerance, changing it to "medium." MZ had initialed most of the changes, which should have made them obvious to anyone who reviewed the documents. RX-97; CX-108A, at 1.

[103] KK explained his understanding of the firm's suitability obligation: "[T]he suitability obligation is to see that [the customers have] filled out their paperwork to such an extent that very active high risk trading that has high cost and high turnovers … would be suitable. So you would want to see a level of income and net worth, a level of investment experience, and the most important criteria would be obviously the risk tolerance and investment objectives." Tr. 4594-95. On this basis, it should have been clear to KK when presented with MZ's new account documentation that margin was not suitable for MZ and that the trading Costanzo did as a matter of course in his customers' accounts would not be suitable for MZ.

August 2011. Levy customer JS appeared on the reports 17 times from April 2010 through December 2011; Levy customer NK appeared on the reports 13 times from July 2010 through February 2012; and Levy customer BNS appeared on the reports nine times from September 2010 through October 2011. Costanzo customer MZ appeared on the reports eight times from April 2010 through May 2011; Costanzo customer DS appeared on the reports nine times from March 2011 through January 2012; Costanzo customer AB appeared on the reports seven times from May 2011 through February 2012; and Costanzo customer RS appeared on the reports four consecutive times from May through August 2011. In spite of this, there is no evidence that Newport Coast imposed any limitations on trading in these accounts.[104]

Leone and Bartelt chose to clear their customers' accounts through Newport Coast's other clearing firm, which, for much of the relevant time period, was Penson Financial Services. A number of Leone's customers appeared on Penson's exception reports because of a high volume of trades or commissions for the month.[105] For example, a Penson Customer Account Surveillance exception report for April 2009 showed 97 trades in DG's account that month, generating more than $5,000 in commissions, and 191 trades in the account year-to-date, generating more than $15,000 in commissions; the report for May 2009 showed 42 trades for the month in DG's account, and 233 trades in the account year-to-date, generating more than $18,000 in commissions; the report for August 2009 showed 109 trades in RER's account and 41 trades in DG's account that month; in December 2009, the report showed 78 trades in RER's account that month, generating more than $6,000 in commissions, and 619 trades for the year, generating more than $61,000 in commissions.[106] Leone's customers appeared on other Penson exception reports as well.[107] Again, there is no evidence that Newport Coast imposed any restrictions on Leone's trading in his customers' accounts.

Newport Coast's response to the information it received in the exception reports was indifferent at best. According to KK, Newport Coast focused on only a limited subset of the information available in the reports—the number of trades and, to a lesser extent, the commissions charged in the particular month covered by the report.[108] The reports, however, provided much more meaningful data. Most significantly, Wedbush exception reports, in addition to providing information on the number of trades, commissions and loss of equity for the month, also included turnover rates and commissions-to-equity percentages for the month, the prior three months, and the prior 12 months.[109] Yet, even though KK acknowledged that these figures would be important in identifying possible excessive trading, he also testified that

[104] CX-594A.

[105] *See* CX-545, at 18; CX-547A, at 63; CX-548A, at 42; CX-549A, at 41-43; CX-550A, at 19-22; CX-551A, at 14; CX-552, at 25; CX-553, at 98-99.

[106] CX-433, at 1, 2, 5, 9.

[107] *See* CX-434 through CX-440.

[108] Tr. 4535, 4547, 4549, 4568-69 (investigative testimony).

[109] CX-525; Tr. 2726-27, 2734-63.

Newport Coast ignored them when reviewing Wedbush exception reports. According to KK, Newport Coast was trying to be consistent in its review of the two clearing firms' reports, so, because the Penson exception reports did not include turnover rates and commission-to-equity percentages, Newport Coast ignored this critical compliance data that was contained in the Wedbush exception reports.[110]

In fact, however, Newport Coast did not apply the same review to Wedbush and Penson exception reports. On the contrary, Newport Coast's supplemental WSPs established different action thresholds for the two firms' exception reports. For Penson reports, the supplemental WSPs directed: "Review Report for accounts with frequent trading (15 or more) for suitability, (20 or more) send active trading letter and (over 30) for activity letter [sic]."[111] In contrast, for Wedbush exception reports the supplemental WSPs directed: "Accounts with frequent trading (20 or more), over 10 trades with $5,000 in commission or loss of 25% equity, will be reviewed."[112] These distinctions reflected the different criteria and parameters used by the two clearing firms to identify exceptions. Given that Newport Coast in fact used different action thresholds for reviewing each clearing firm's reports, there would have been nothing "inconsistent" in reviewing the cumulative data on turnover rates and commissions-to-equity percentages in the Wedbush reports.

In addition to defining when accounts appearing on the firms' exception reports would be reviewed, Newport Coast's supplemental WSPs addressed the steps that could be taken in conducting that review. First, they directed a review of the suitability of the trading, but provided no guidance as to what factors should be considered or what standards should be applied in performing that review.[113] KK testified that in performing such reviews he looked at the customer's age, investing experience, investment objectives, risk tolerance, and financial information, but he did not identify any instance in which such a review led him to conclude that the trading had been unsuitable, and there is no indication that Newport Coast imposed any

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[110] Tr. 4580-81.

[111] CX-229, at 5. The testimony indicated that this language, nearly incomprehensible on its face, should be interpreted to mean that for accounts with 15 or more trades in the month, Newport Coast would review the account documents to evaluate whether the trading was suitable; for accounts with 20 or more trades in the month, Newport Coast would send a negative-option letter, also referred to by the witnesses as a "happiness letter," suggesting that the customer contact the RR or the firm if the customer was not happy with the trading in the account; and for accounts with 30 or more trades in the month, Newport Coast would send the customer an Active Trading Authorization requiring a signature from the customer confirming his or her investment objectives and risk tolerance. Tr. 4085-90, 4535-36, 4558-60.

[112] CX-229, at 5.

[113] CX-229, at 5-6. Under Newport Coast's supervisory procedures, the compliance department, which was responsible for reviewing exception reports, also had the principal responsibility for determining whether trading in a customer's account was suitable. Tr. 3971.

limitations on trading in any of the customer accounts at issue in this proceeding based on the firm's suitability review when the accounts appeared on exception reports.[114]

Newport Coast's WSPs authorized, but did not require, a variety of possible steps if the suitability review of an account appearing on an exception report raised concerns.[115] One option was to send the customer what the witnesses described as a "happiness letter." The letter indicated that the customer's account had been selected as part of an effort "to provide better service to you on an ongoing basis." It encouraged the customer to "visit with" their RR and advised that "[u]nless notified by you, we assume you are satisfied with the way your investment portfolio has been handled." The letter does not suggest that the trading in the account may have been excessive or otherwise indicate any concerns about the suitability of the trading in the customer's account. Such a letter, expressing no concern about trading in the account, was sent to Leone customer LJC and his wife in December 2010.[116] The prior month, November 2010, there had been 55 trades in the account with commissions of more than $19,000, and in December there were 140 trades with commissions of more than $20,000.[117]

Another option was to send the customer an Active Trading Authorization, which, among other things, stated: "We want to be sure that you understand that short-term trading of stocks ("active trading") of your account exponentially increases the commission charges to you without necessarily increasing your investment returns." The Active Trading Authorization further asked the customer to sign a statement indicating, "I am a sophisticated investor with substantial personal experience in trading stocks," and to verify their "primary investment objectives" by circling them on the Agreement. It appears that, unlike the happiness letters, which were sent by Newport Coast's compliance department, Newport Coast delegated responsibility for sending the Active Trading Authorizations to the RR who had been trading the account. Thus, in March 2010, well over a year after his account was opened and excessively traded, Leone sent an Active Trading Authorization to DG, who struck a large "X" through the form before faxing it back to Leone on March 12, 2010. The "X" was somehow covered with white-out before the Active Trading Authorization was placed in Newport Coast's files and the

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[114] For example, Costanzo customer MZ appeared on the reports eight times from April 2010 through May 2011. Any reasonable suitability review of the factors listed by KK, including MZ's age, revised risk tolerance, and revised financial information, would have led to the conclusion that the trading in MZ's account was quantitatively unsuitable. Similarly, Levy customer JS appeared on the reports 17 times from April 2010 through December 2011, and as with MZ any reasonable suitability review of the factors listed by KK, including JS's age, income, liquid net worth, and investment experience would have led to the conclusion that the trading in his account was quantitatively unsuitable. Nevertheless, Newport Coast allowed the trading in both accounts to continue, month after month, and exception report after exception report.

[115] CX-225, at 5-6.

[116] CX-29, at 2; Tr. 4629.

[117] CX-549A, at 41. This was apparently consistent with Newport Coast's supervisory practices. When asked what the appropriate action would have been in response to an exception report showing 97 trades in DG's account in a single month with $5,300 in commissions (CX-433, at 1), KK testified that "we would have reviewed the suitability in the file, potentially talked to the branch manager and potentially sent out a happiness letter." Tr. 4615-16.

trading in DG's account proceeded apace until DG closed the account in April 2010.[118] In March 2011, KK sent Arena and Leone an email indicating that BDS's account was "excessively [t]raded." Rather than restricting further trading in the account, KK directed Arena and Leone to have BDS execute an Active Trading Authorization "for Speculation and High Risk." At some point, BDS did sign an Active Trading Authorization, but he circled investment objectives "growth" and "capital appreciation," rather than "speculation" or "high risk," before returning the Active Trading Authorization in late-May 2011. Nevertheless, the excessive trading continued in his account until mid-June 2011, when BDS instructed Newport Coast to freeze trading in his account.[119]

Newport Coast contended that any failure to identify the red flags raised by the RRs' trading in their customer accounts was reasonable given that Newport Coast had over 100 RRs and thousands of customer accounts. KK acknowledged, however, that Leone, LaBarbera, Levy, Costanzo, and Bartelt "were some of the most active traders in the entire firm …."[120] With respect to LaBarbera, Levy and Costanzo, he testified, "they do one thing, they do short term trading and high risk stocks."[121]

SW was the firm's CCO from January 2011 through the end of the relevant time period. SW, KK, and KM, the firm's CEO, were all part of the management of Brookstreet Securities Corporation, a FINRA member firm that went out of business in 2007 as a result of net capital deficiencies, before associating with Newport Coast. LaBarbera, Levy, and Costanzo were also associated with Brookstreet before becoming associated with Newport Coast, and SW knew of them from that association and that their business model was challenging to manage. Among other things, SW knew that they had actively traded their customers' accounts at Brookstreet and that their business model had led to problems with their customers.[122] SW testified that as CCO he was aware that Leone, LaBarbera, Levy, and Costanzo were concentrating their customers' accounts in single securities, and that some of those concentrated accounts were on margin, yet Newport Coast allowed those practices to continue.[123] SW also testified that he was aware of accounts being charged markups on purchase transactions but commissions on sales, and that Newport Coast allowed that to occur.[124] He testified that he was aware that Newport Coast was

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[118] CX-17, at 154-61; CX-18; Tr. 111-15.

[119] CX-13, at 30-33; CX-15; Tr. 1018-20, 1030, 1036.

[120] Tr. 4794.

[121] Tr. 4730.

[122] Tr. 3898, 3901, 3906, 3913, 3923, 4154-55.

[123] Tr. 3999-4000.

[124] Tr. 4017-18. SW testified, correctly, that riskless principal trades are permissible under FINRA rules. He also acknowledged, however, that because of the way in which markups and markdowns for riskless principal trades are disclosed on confirmations, "[an] unsophisticated customer, not aware of the difference between [riskless principal trades and agency trades] would be paying more for that transaction and not knowing it." Tr. 4022. The Panel finds that is precisely what happened in this case. LaBarbera, Levy and Costanzo used riskless principal trading to conceal from their unsophisticated customers the amounts they were charging the customers for those trades.

receiving customer complaints about LaBarbera, Levy, and Costanzo, and that KM, the CEO, was also aware of the complaints. He testified that, in spite of the complaints, as CCO he could not limit their trading or terminate their association with the firm because they were big producers for the firm and KM, who "ruled with an iron fist," would not allow it. Similarly, SW testified he was aware that Leone, another large producer, was actively trading customers' accounts, that he had seen excessive trading in Leone's accounts, and that the firm had received customer complaints against Leone, but SW felt he could not limit Leone's trading or terminate him because KM would not allow it.[125]

Eventually, as a result of discussions with FINRA staff, Leone, LaBarbera, Levy, and Costanzo were placed on heightened supervision in May 2012.[126] SW testified that when that occurred the compliance department did not go back and review their customers' accounts because "there weren't any secrets about what was taking place with these RRs, … [KM] was fully cognizant of what was going on, and I don't know what it would have accomplished other than to paper some files, but I don't think it would have resulted in any changes."[127]

B. Conclusions Regarding Supervision

Enforcement alleged that "[t]hese red flags were not addressed by … Newport Coast. [Newport Coast] failed to take any meaningful measure to address the misconduct and to ensure that the Firm's representatives acted in a manner that was compliant with applicable laws, regulations and rules." Enforcement charged that "[b]y failing to adequately supervise Leone, Levy, Costanzo, LaBarbera, and Bartelt, Newport Coast violated NASD Rule 3010 and FINRA Rule 2010 (for transactions occurring on or after December 15, 2008), and NASD Rules 3010 and 2110 (for transactions occurring before December 15, 2008)."[128]

At all relevant times, Newport Coast's supervisory responsibilities were governed by NASD Rule 3010.[129] Rule 3010 required Newport Coast, as a member firm, to "establish and maintain a system to supervise the activities of each registered representative … that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable NASD Rules." The NAC has explained: "NASD Rule 3010 has been applied to require that supervisors exercise 'reasonable' supervision. … In addition to requiring an adequate supervisory system, '[t]he duty of supervision includes the responsibility to investigate

[125] Tr. 4057-61, 4164, 4169-72.

[126] CX-11; CX-248; CX-249; CX-250; Tr. 4173-79.

[127] Tr. 4179-80.

[128] Compl. ¶¶ 426, 429.

[129] NASD Rule 3010 was supplanted by FINRA Rule 3100 after the end of the relevant time period.

"red flags" that suggest that misconduct may be occurring and to act upon the results of such investigation.'"[130]

The facts set forth above substantiate Enforcement's allegations and establish that Newport Coast failed to reasonably respond to evidence of red flags indicating possible quantitatively unsuitable trading in, and churning of, customer accounts by Leone, LaBarbera, Levy, and Costanzo.[131] The Panel therefore concludes that Newport Coast violated NASD Rule 3010 and FINRA Rule 2010 (for transactions occurring on or after December 15, 2008), and NASD Rules 3010 and 2110 (for transactions occurring before December 14, 2008), as charged.

V. Qualitative Unsuitability

A. Facts

In addition to the quantitative unsuitability charge, which was the focus of the hearing in this matter, the Complaint charged that LaBarbera, and Newport Coast through LaBarbera, Levy, and Costanzo, recommended certain qualitatively unsuitable investments. Enforcement's qualitative unsuitability charge related to the purchases of various ETPs in the accounts of two customers of LaBarbera (DB and DR), one customer of Levy (NK), and two customers of Costanzo (AB and MZ). Some of the purchases were of leveraged and, in some cases, inverse Exchange Traded Funds ("ETFs"), while other purchases were of a different type of product, the iPath S&P 500 VIX Short Term Futures Exchange Traded Notes ("ETNs"), which traded under the symbol VXX.

LaBarbera recommended approximately 25 purchases of ETFs in DR's account during the period March 2009 through August 2010. The ETFs LaBarbera recommended included: (1) Direxion Daily Financial Bull 3X Shares (FAS); (2) Direxion Daily Clean Energy Bull 3X Shares (ERX); (3) Direxion Daily Small Cap Bear 3X Shares (TZA); (4) ProShares UltraShort Financials (SKF); (5) ProShares UltraShort Real Estate (SRS); and (6) ProShares Ultra DJ-UBS Crude Oil (UCO). Costanzo recommended three ETF purchases in MZ's account between March 2010 and September 2010. The ETFs Costanzo recommended were ERX, TZA, and UCO.[132]

The ETFs both LaBarbera and Costanzo recommended were designed to generate daily leveraged and, in some cases, inverse returns on a defined benchmark. Specifically, FAS, ERX, and UCO were designed to generate daily returns that were 300%, or for UCO 200%, of the daily performance of their benchmark, while TZA, SKF, and SRS were designed to generate

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[130] *Dep't of Enforcement v. Rooney*, No. 2009019042402, 2015 FINRA Discip. LEXIS 19, at *60-61 (July 23, 2015), quoting *Ronald Pellegrino*, Exchange Act Release No. 59125, 2008 SEC LEXIS 2843, at *33 (Dec. 19, 2008).

[131] Enforcement offered very little evidence regarding Newport Coast's supervision of Bartelt. Accordingly, the Panel rested its conclusion that the firm violated its supervisory obligations on the evidence regarding the deficiencies in Newport Coast's supervision of Leone, LaBarbera, Levy, and Costanzo.

[132] CX-592.

daily returns that were inverse, or opposite, to the daily performance of their benchmark by 300% for TZA or 200% for SKF and SRS. All these ETFs were high-risk investments designed to be traded over a single day and were intended to be used by highly sophisticated investors. For example, the prospectus for TZA explained:

> The Fund seeks daily investment results, before fees and expenses, of 300% of the inverse (or opposite) of the price performance of the Russell 2000® Index ("Index"). ***The Fund seeks*** **daily** ***leveraged investment results and does not seek to achieve its stated investment objective over a period of time greater than one day.*** The Fund is different and much riskier than most exchange-traded funds.
>
> **The Fund is designed to be utilized only by knowledgeable investors who understand the potential consequences of seeking daily leveraged investment results, understand the risks associated with shorting and the use of leverage, and are willing to monitor their portfolios frequently. The Fund is not intended to be used by, and is not appropriate for, investors who do not intend to actively monitor and manage their portfolios.**[133]

The prospectuses for the other ETFs LaBarbera and Costanzo recommended contained similar warnings regarding the risks of investing.[134]

LaBarbera was questioned about the suitability of the ETFs he purchased for DR's account during his testimony, but could offer no coherent explanation for recommending those products. For example, he was asked to describe his strategy in recommending ETFs and responded: "It was an overall volatile market, coming off one of the largest volatile markets in all of time. So these products were being used and being traded during this period of time." When asked in a follow-up question why he was recommending them to his customers, he responded: "[O]bviously it was to see some sort of appreciation at the time based on the specific indices that these were related to and events going on in those indices." When asked why they were suitable for DR, a farmer from Iowa, he responded: "[T]he products were discussed with [DR], approved the products [sic] and we purchased the products and we sold the products."[135] When questioned about the suitability of the specific ETFs he had recommended and sold to DR, LaBarbera could offer no explanation other than "it was heavily recommended, not only by myself but throughout the industry" and "it met his … objectives … for short-term trading, speculation, and aggressive growth."[136]

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[133] CX-333, at 139-40 (emphasis in original).

[134] *See* CX-333, at 139-51, 254-65, 301-14 (FAS, ERX, TZA); CX-342, at 104-05, 112-13 (SKF and SRS); CX-344 (UCO).

[135] Tr. 3706-07.

[136] Tr. 3713-14.

Costanzo did not testify at the hearing, but in his investigative testimony introduced at the hearing, he was asked why the ETFs he recommended and sold to MZ, the retired school teacher, were suitable. In response, Costanzo claimed that he had previously believed that they were suitable for MZ, but acknowledged that, based on his understanding at the time he testified, the type of ETFs he recommended "are not geared or suited for retail clients."[137]

LaBarbera recommended three purchases of VXX in DB's account between December 2011 and February 2012. Levy recommended one purchase of VXX in NK's account in February 2012, while Costanzo recommended one purchase of VXX in MZ's account in June 2010, as well as one purchase of VXX in AB's account in February 2012.[138]

The prospectus for VXX, which also covered a related ETN, explained:

> Each series of ETNs are medium-term notes that are uncollateralized debt securities and are linked to the performance of an underlying Index that is designed to provide investors with exposure to one or more maturities of futures contracts on the VIX Index, which reflect implied volatility of the S&P 500® Index at various points along the volatility forward curve. The VIX Index is calculated based on the prices of put and call options on the S&P 500® Index.[139]

The prospectus further explained that the VXX ETN was "linked to the performance of the S&P 500 VIX Short-Term Futures™ Index TR that is calculated based on the strategy of continuously owning a rolling portfolio of one-month and two-month VIX futures to target a constant weighted average futures maturity of 1 month …."[140] The prospectus listed numerous risks associated with an investment in VXX and suggested VXX might be an appropriate investment for an investor who, *inter alia*, was "willing to accept the risk of fluctuations in volatility in general and in the prices of futures contracts on the VIX Index in particular."[141]

At the hearing, LaBarbera was asked to explain why VXX was a suitable investment for DB, particularly considering that it represented more than 70% of his account equity at the time of purchase. LaBarbera responded: "Based on the speculative nature the way the account was set up, his objectives in the account for short-term trading, this was a suitable recommendation for [DB] …."[142] In the portions of his investigative testimony offered in evidence by the parties, Levy did not address the suitability of VXX for NK, but in Costanzo's investigative testimony,

[137] CX-626, at 51-58, 60-68. MZ testified that Costanzo did not explain the ETFs to him. Tr. 2599, 2615.

[138] CX-593.

[139] CX-347, at 4.

[140] CX-347, at 4.

[141] CX-347, at 6-7.

[142] Tr. 3673.

he acknowledged that his comment that the ETFs he sold were "not geared or suited for retail clients" also applied to VXX.[143]

B. Discussion

NASD Rule 2310, which was the governing standard during the relevant time period, required that in recommending an investment to a customer, FINRA member firms and their RRs have "reasonable grounds for believing that the recommendation is suitable for such customer upon the basis of the facts, if any, disclosed by such customer as to his other security holdings and as to his financial situation and needs."

As their prospectuses make plain, the leveraged and inverse ETFs LaBarbera and Costanzo recommended were complex investment products suitable only for certain sophisticated investors. Indeed, in June 2009, prior to many of LaBarbera's recommended purchases in DR's account and prior to Costanzo's recommended purchases in MZ's account, FINRA issued a Regulatory Notice addressing the sale of leveraged and inverse ETFs. The Notice stated that, "[w]hile such products may be useful in some sophisticated trading strategies," they "typically are unsuitable for retail investors who plan to hold them for longer than one trading session, particularly in volatile markets." The Notice further explained that to perform the suitability assessment required by NASD Rule 2310 in connection with the recommendation of leveraged or inverse ETFs, the first step would be to determine that the particular ETF was suitable for at least some customers, "an analysis that requires firms and associated persons to fully understand the products and transactions they recommend." Assuming the firm and the RR concluded that the particular ETF was suitable for at least some customers, the Notice advised that the firm and the RR would also need to determine that the ETF was suitable for the particular customers to whom it was being recommended.[144]

There is no evidence that Newport Coast performed any general suitability analysis of the ETFs recommended by LaBarbera or Costanzo that led it to conclude they were suitable for any of the firm's customers; neither LaBarbara nor SW, the firm's CCO during much of the relevant time period, nor KK, the firm's COO during the entire relevant time period, claimed that the firm undertook any such analysis. On the contrary, SW testified that after he became the firm's CCO in January 2011, he sought to preclude the firm's RRs from recommending any leveraged and inverse ETFs to the firm's customers, and ultimately did so. He testified that prior to his action, the firm placed no limits on recommendations of ETFs to the firm's customers.[145] Further, there is no indication that LaBarbera or Costanzo performed or was capable of performing either a general analysis of the suitability of the ETFs they sold or a specific assessment of the suitability of those ETFs for the customers to whom they recommended those investments. On the contrary,

[143] CX-626, at 67-68.

[144] FINRA Regulatory Notice 09-31 (June 2009), http://www.finra.org/industry/notices/09-31; CX-253, at 1, 3.

[145] Tr. 4135-38; CX-256.

LaBarbera evinced no understanding of the ETFs and Costanzo conceded they were not suitable for the customer to whom he recommended them.

If anything, VXX was an even more sophisticated and complex product than leveraged and inverse ETFs, as the descriptions from the prospectus quoted above make clear. Once again, there is no evidence that Newport Coast ever concluded that it was suitable for at least some of its customers. Indeed, SW, a highly experienced securities professional who was Newport Coast's CCO at the time of all but one of the VXX recommendations, testified that the VXX product was so complex he had difficulty even determining what it was.[146] LaBarbera could not offer any coherent explanation for believing that VXX was suitable for DB, and Costanzo acknowledged it was not suitable for any retail investor. Even assuming that VXX might have been a suitable investment for some highly sophisticated customers, the Panel heard testimony from NK, MZ, and AB, and none was a sophisticated investor. No member firm or RR could have reasonably concluded that VXX was a suitable investment for those customers.

Accordingly, the Panel conclude that LaBarbera and Newport Coast, acting through LaBarbera, Levy, and Costanzo, made qualitatively unsuitable recommendations of ETPs and thereby violated NASD Rule 2310 for conduct over the entire relevant time period, and violated NASD Rule 2110 (for conduct through December 14, 2008) and FINRA Rule 2010 (for conduct after December 14, 2008).

VI. Providing Inaccurate Account Values to One Customer

In the Complaint, Enforcement alleged that Leone provided false and exaggerated account values to a customer, in violation of FINRA Rule 2010. The evidence established that on several occasions, customer JB asked Leone to provide the current value of his account. In response to these requests, Leone sent five emails to JB that overstated the value of the account. On May 13, 2010, Leone's email overstated the value of JB's account by more than $5,200; on June 1, 2010, Leone's email overstated the value of the account by more than $1,200; on November 16, 2010, Leone's email overstated the value of the account by more than $1,500; on February 4, 2011, Leone's email overstated the value of JB's account by more than $5,500; and on April 6, 2011, Leone's email overstated the value of JB's account by more than $3,000.[147]

The SEC has stated: "Material misstatements and misleading statements to a customer are inconsistent with just and equitable principles of trade. In particular, we have found that inaccurate and misleading account summaries and/or reports fail to satisfy these principles."[148] During his testimony at the hearing, Leone made no effort to explain or justify his emails to JB misrepresenting the value of JB's account. Nevertheless, if there had been only a single instance in which Leone provided an inaccurate account value to JB, the Panel might have found it to

[146] Tr. 4151-52, 4337-38.

[147] Tr. 205-14, 4995-5010; CX-21; CX-22; CX-23; CX-507; CX-508; CX-536; CX-537; CX-538; CX-539; CX-540.

[148] *Cody*, 2011 SEC LEXIS 1862, at *56 (footnotes and internal quotations omitted).

have reflected a good-faith error by Leone. Instead, the evidence established that Leone provided exaggerated account values to JB on five occasions, which, when combined with Leone's failure to offer any explanation, effectively precludes such a finding. Instead, the Panel finds that Leone's actions in repeatedly providing exaggerated account values were at least negligent, if not intentional.

Accordingly, the Panel concludes that Enforcement proved, by a preponderance of the evidence, that Leone violated FINRA Rule 2010 by sending JB emails that provided inaccurate account values.[149]

VII. Mismarking Solicited Trades as Unsolicited

The Complaint alleged that "on at least 22 occasions" LaBarbera deliberately mismarked solicited trades in DR's account as "unsolicited," causing Newport Coast's books and records to be inaccurate. The evidence Enforcement offered on this charge was very limited. Enforcement provided an analysis of the trades in DR's account, identifying those that were marked unsolicited.[150] DR did not testify and there was no other direct evidence that the trades were, in fact, solicited. LaBarbera claimed not to recall the trades, but asserted that it was possible that they had been initiated by DR, or that they were incorrectly entered as unsolicited by Newport's trading desk.

In spite of the lack of direct evidence, Enforcement argued that the Panel should infer that the trades were solicited, and that LaBarbera was responsible for mischaracterizing them, based on the sequence, pattern, and timing of the trades. For example, Enforcement cited a 2,500 share purchase of UCO, an ETF, at 9:43 a.m. on August 2, 2010, followed by the sale of 5,000 shares of UCO at 9:48 a.m., with both transactions marked as unsolicited. Enforcement pointed out that when asked about these trades during the hearing, LaBarbera could not explain why DR would have initiated them. By the same token, however, Enforcement could not explain why LaBarbera, who demonstrated no reluctance to mark the other trades in the account as solicited, would have mismarked these trades.

The Panel concludes that while Enforcement's argument is not unreasonable, in the absence of any testimony from DR or other direct evidence that the trades were, in fact, solicited, Enforcement failed to prove by a preponderance of the evidence that LaBarbera mismarked the trades. Therefore, this charge will be dismissed.

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[149] The Complaint also cites NASD IM-2310-2 as a basis for this charge. IM-2310-2, which was in effect during the relevant time period but has been superseded, set forth a number of sales practices that had been held to be inconsistent with the obligation of "fair dealing with customers." It is not apparent how IM-2310-2 would apply to Leone's emails conveying inaccurate account values and in its post-hearing brief Enforcement offered no analysis or argument to support the application of IM-2310-2 to Leone's actions. Accordingly, the Panel does not find a violation of IM-2310-2.

[150] CX-560A, at 21-23.

VIII. Newport Coast's Supervision of the Sale of ETFs and Structured Products

The Complaint also alleged that Newport "offered and sold structured products and inverse/leveraged ETPs" through its RRs without offering or providing any training regarding those products.[151] It further alleged that Newport Coast lacked adequate procedures and policies for the supervision of the sales of those products, and in particular lacked any system or procedure for flagging customer accounts that were unsuitably concentrated in structured products or inverse or leveraged ETFs. The Complaint charged that, as a result, Newport Coast violated NASD Rules 3010(a) and (b) and FINRA Rule 2010.

To support the allegations regarding structured products, Enforcement offered the testimony of a former Newport Coast branch office manager in Florida who stated that Newport Coast did not initially offer its own training to RRs regarding structured products, but also testified that the firm directed him to a knowledgeable wholesaler of structured products who taught him about the products.[152] Enforcement also cited Newport Coast's February 5, 2013 response to a staff request for information during the investigation in which the firm stated that the firm "has now implemented a requirement that [Newport Coast] RRs obtain training from an approved vendor before selling a structured product," as well as SW's testimony that, to the best of his knowledge, the firm did not provide any training to its RRs regarding structured products prior to January 2011, when he became CCO.[153]

With regard to training on leveraged or inverse ETFs, Enforcement relied principally on the same Newport Coast response to a staff request for information, in which the firm stated: "During the relevant time period, [Newport Coast] did not provide any training to firm RRs regarding leveraged and inverse ETFs. RRs were encouraged to educate themselves using resources available from the issuer and independent research available on the internet, including FINRA and SEC's websites."[154] In his testimony, SW confirmed that initially the firm did not offer training on leveraged or inverse ETFs, but encouraged RRs who intended to sell the products to obtain training from issuers and other sources. He further testified, without contradiction, that most firms similar to Newport Coast do not provide training internally but rather refer their RRs to outside sources. He testified that fewer than 10 of the firm's RRs sold leveraged or inverse ETFs. He also testified that he prohibited RRs from selling leveraged or inverse ETFs after April 2011.[155]

[151] Compl. ¶ 444.

[152] Tr. 4038-40, 4048-51.

[153] Tr. 4135; CX-398, at 3.

[154] CX-398, at 3. The former Newport Coast branch manager who testified about training for structured products did not address leveraged or inverse ETFs, testifying that neither he nor any of the RRs he supervised ever solicited any customer to purchase those products. Tr. 4056.

[155] Tr. 4115-17, 4130, 4318-19; CX-233; CX-256.

The Panel did not find the evidence sufficient to sustain the charge. Although Enforcement asserted in its post-hearing brief that the firm's failure to provide in-house training regarding structured products and leveraged or inverse ETFs violated the firm's supervisory obligations under NASD Rule 3010, it did not cite any prior cases finding that the rule imposed such an obligation on member firms. Instead, Enforcement cited a sentence in the June 2009 FINRA Regulatory Notice on ETFs stating: "Firms must train registered persons about the terms, features and risks of all ETFs that they sell, as well as the factors that would make such products either suitable or unsuitable for certain investors. In the case of leveraged and inverse ETFs, that training should emphasize the need to understand and consider the risks associated with such products …." Notably, this section of the Notice, unlike the prior sections, did not cite any NASD or FINRA rules.[156] Further, Enforcement did not establish that the firm failed to satisfy its supervisory obligations, under the circumstances, by encouraging its RRs to obtain information from outside sources, rather than providing training in-house.

To support its allegation that Newport Coast lacked any system or procedure for flagging customer accounts that were unsuitably concentrated in structured products or inverse or leveraged ETFs, Enforcement asserted that, while Newport Coast "did have certain exception reports that would flag concentrated positions, … none of these exception reports specifically flagged accounts that had high concentrations of structured products or leveraged or inverse ETFs."[157] As explained above, the exception reports to which Newport Coast had access were provided by its clearing firms. Enforcement did not cite any evidence that the clearing firms made available to Newport Coast, or any of the other member firms for which they cleared, any reports that specifically flagged accounts with high concentrations of structured products or leveraged or inverse ETFs. Similarly, Enforcement did not cite any evidence that any other clearing firms, or indeed any other FINRA member firms of any sort, generated or used any such exception reports. And Enforcement cited no rule, notice, interpretation or prior case holding that member firms have an obligation to generate such reports.

Accordingly, the Panel finds that Enforcement failed to prove this charge by a preponderance of the evidence.

IX. Sanctions

Enforcement requested that the Panel expel Newport Coast from FINRA membership; bar Leone and LaBarbera from association with any FINRA member firm; order Newport Coast to pay restitution to the customers (except three customers who settled arbitrations with Newport Coast) in the amount of more than $750,000; order Leone and LaBarbera to pay restitution to their customers; fine Newport Coast at least $600,000; and fine Leone and LaBarbera at least $100,000 each.

[156] CX-253, at 5.

[157] Enf. Post-Hearing Br. at 74.

The violations found in this case were closely interrelated. The churning violation arose from the same excessive trading as the quantitative suitability violation; the qualitatively unsuitable recommendations were made as part of the quantitatively unsuitable trading; Newport Coast's failure to supervise violation related to its failure to address the quantitatively unsuitable trades; and Leone misrepresented the value of his customer's account in the context of excessively trading the account. Accordingly, the Panel agrees that a single set of sanctions should be applied to each Respondent to address that Respondent's misconduct.[158]

The Panel first considered Enforcement's request that Leone and LaBarbera be barred and that Newport Coast be expelled. The primary violation in this case was the excessive trading of the customers' accounts. For excessive trading or churning, the Sanction Guidelines recommend a suspension in any or all capacities for a period of 10 business days to one year, or in egregious cases, a longer suspension of up to two years or a bar. Similarly, for unsuitable recommendations, the Guidelines provide: "Where aggravating factors predominate, strongly consider a bar for an individual respondent."[159] Leone's excessive trading and churning of eight customer accounts was plainly egregious. Several of the applicable relevant factors listed in the Guidelines apply to Leone: (1) Leone has accepted no responsibility for or acknowledged his misconduct; (2) Leone did not, prior to detection, attempt to remedy his misconduct or to pay restitution to the injured customers; (3) Leone engaged in numerous acts and a pattern of misconduct; (4) Leone engaged in the misconduct over an extended period of time; and (5) the misconduct caused substantial injury to the affected customers.[160] The Panel discerns no mitigating factors relating to Leone's excessive trading and churning violations. Accordingly, the Panel concludes that a bar is the appropriate sanction for those violations.

In comparison to Leone's misconduct, LaBarbera's appears less egregious. Enforcement offered evidence relating to only four of his customers, three of whom testified, and both the turnover rates and cost-to-equity percentages for LaBarbera's customers were somewhat lower than those for Leone's. Nevertheless, all of the aggravating factors applicable to Leone also applied to LaBarbera, and while LaBarbera's customers had somewhat lower turnover rates and cost-to-equity percentages than Leone's, the figures for LaBarbera's customers were

[158] *See Dep't of Enforcement v. Fox & Co. Invs., Inc.*, No. C3A030017, 2005 NASD Discip. LEXIS 5, at *37 (NAC Feb. 24, 2005) ("[W]here multiple, related violations arise as a result of a single underlying problem, a single set of sanctions may be more appropriate to achieve [FINRA's] remedial goals.") (citation omitted), *aff'd*, 58 S.E.C. 873, 894 (2005).

[159] FINRA Sanction Guidelines ("Guidelines") at 77, 94 (2015), http://www.finra.org /industry/sanction-guidelines. The Panel concludes that the Guidelines for Fraud, Misrepresentations or Material Omissions of Fact would be applicable to Leone's provision of inaccurate account values to a customer. For negligent misconduct, those Guidelines recommend a suspension in any or all capacities for 31 calendar days to two years, and because the evidence does not support a finding that Leone's actions were reckless or intentional, the Panel finds those Guidelines would be applicable, and concludes that a suspension in all capacities at the lower end of the range would be appropriate if the violation were considered in isolation. *Id.* at 88. However, when considered along with Leone's excessive trading and churning violations, it provides an additional aggravating circumstance supporting a bar.

[160] Guidelines at 6.

substantially higher than the turnover rates and cost-to-equity figures identified by the NAC and the SEC as excessive. In addition, LaBarbera recommended qualitatively unsuitable purchases of ETPs, and the Panel finds that violation to also be egregious, with the same aggravating factors. Accordingly, the Panel concludes that LaBarbera, too, should be barred.

Enforcement's request that Newport Coast be expelled presents a more difficult issue. The expulsion of a member firm is a harsh remedy, with serious ramifications for the firm's employees, RRs, customers, and owners, and therefore is appropriate only when necessary to protect the investing public.[161] The Panel's determination that Newport Coast recommended quantitatively and qualitatively unsuitable trading and churned customer accounts is based on the imputed conduct of just five of more than 100 Newport Coast RRs during the relevant time period, and those five RRs are no longer associated with the firm. By themselves, therefore, those violations might not support expulsion as the appropriate sanction.

But the Panel's determination of the appropriate sanctions here does not rest solely on the five RRs' violations. The firm, through its management, utterly failed to properly supervise at least four of the five RRs. The Sanction Guidelines for failure to supervise state: "In a case against a member firm involving systemic supervision failures, consider a longer suspension of the firm with respect to any or all activities or functions (of up to two years) or expulsion of the firm." The principal considerations specifically relevant to sanctions for failure to supervise include "[w]hether respondent ignored 'red flag' warnings that should have resulted in additional supervisory scrutiny [and the n]ature, extent, size and character of the underlying misconduct."[162]

As explained above, Newport Coast, through its COO, its CCO, and other supervisory personnel, ignored glaring red flags indicating that customer accounts were being excessively traded, causing serious injury to numerous, vulnerable firm customers. The failure to supervise Guidelines also direct the Panel to "[c]onsider whether [the] individuals responsible for [the] underlying misconduct attempted to conceal [their] misconduct from respondent."[163] In this case, the five RRs did not conceal their misconduct; on the contrary, their excessive trading in customer accounts was carried out through the firm, was fully reflected in the firm's records, and, indeed, was at least to some degree recognized by the firm's senior management and supervisory personnel. In terms of the Sanction Guidelines' general considerations, Newport has not accepted responsibility for the conduct of its RRs and has not attempted to pay restitution or otherwise remedy the effects of the RRs' misconduct; the violations involved several RRs and numerous customers, and it took place over a lengthy period; and the violations caused

[161] *See Mission Sec. Corp.*, Exchange Act Release No. 63453, 2010 SEC LEXIS 4053, at *53-54 (Dec. 7, 2010) ("A bar and expulsion are severe sanctions. Applicants' demonstrated lack of fitness to be in the securities industry, however, supports the remedial purpose to be served by such sanctions. Applicants represent a clear danger to the investing public if they remain in the securities industry ….").

[162] Guidelines at 103.

[163] *Id*.

substantial customer injury.[164] All of these seriously aggravating factors led the Panel to conclude that expelling Newport Coast from FINRA membership is necessary to protect the investing public.

The Panel also agrees with Enforcement that restitution is an appropriate sanction in this case. The Sanction Guidelines provide: "Adjudicators may order restitution where necessary to remediate misconduct. Adjudicators may order restitution when an identifiable person … has suffered a quantifiable loss proximately caused by a respondent's misconduct." Further, "Adjudicators should calculate orders of restitution based on the actual amount of the loss sustained by a person … as demonstrated by the evidence. Orders of restitution may exceed the amount of the respondent's ill-gotten gain. Restitution orders must include a description of the Adjudicator's method of calculation."[165]

In this case, the customers suffered quantifiable losses as a result of the excessive trading of their accounts. Enforcement contended that the proper amount of restitution to the customers would be the total amount of losses in their accounts, but the Panel disagrees. Those losses reflect the market results of the trades placed by the five RRs, as well as the costs imposed by the excessive trading. All of the customers understood, however, that they might realize market gains or losses in their accounts and they agreed to accept that risk. And apart from LaBarbera, Levy, and Costanzo's recommendations of ETPs in a few customer accounts, Enforcement did not allege that any market losses in the customers' accounts were attributable to qualitatively unsuitable recommendations.

The Panel finds that the loss proximately caused by the misconduct of Newport Coast and the five RRs is the costs imposed on the customers as a result of the excessive trading in their accounts. Accordingly, the Panel will order Newport Coast to pay restitution to all of the customers, except those who have already pursued and settled claims against the firm, in the full amount of the costs paid by the customers. The Panel recognizes that Newport Coast did not retain the full amount of the commissions, markups and markdowns, and other charges paid by the customers, but the costs were imposed by Newport Coast and the Panel concludes that the firm was properly charged with making restitution of the full amount. Leone and LaBarbera also will be ordered to pay restitution to their customers in the full amount of the costs incurred by those customers. Although they received only a partial payout of the commissions, markups and markdowns and other costs, they initiated the excessive trading and determined the amount of commissions, markups, and markdowns that were charged. The responsibility for restitution will be joint and several. Finally, the Panel will order Respondents to pay interest on the restitution amounts. Because the costs were imposed and collected over an extended period that varied from

[164] Guidelines at 6.

[165] Guidelines at 4.

customer to customer, interest will run from the end of the relevant time period, *i.e.*, May 31, 2013.[166]

The Panel will also order Newport Coast, Leone, and LaBarbera to pay fines for their misconduct. Under the particular circumstances of this case, the Panel finds it appropriate to impose substantial fines against each Respondent, but to give each Respondent a credit against the fine for any amounts that the Respondent pays to customers to satisfy the Panel's order of restitution.

X. Order

The Extended Hearing Panel concludes that:

(1) Respondents Leone and LaBarbera, and Newport Coast through Leone, LaBarbera, Levy, Costanzo, and Bartelt, engaged in quantitatively unsuitable trading in the accounts of customers, in violation of NASD Rules 2310 and 2110, FINRA Rules 2111 and 2010, and NASD IM-2310-2;

(2) Respondents Leone and LaBarbera, and Newport Coast through Leone, LaBarbera, Levy, Costanzo, and Bartelt, churned the accounts of customers, in violation of Section 10(b) of the Securities Exchange Act of 1934, Exchange Act Rule 10b-5, FINRA Rules 2020 and 2010, and NASD Rules 2120 and 2110;

(3) Respondents LaBarbera, and Newport Coast through LaBarbera, Levy, and Costanzo, made qualitatively unsuitable recommendations of transactions involving leveraged or inverse ETPs to customers, in violation of NASD Rules 2310 and 2110 and FINRA Rule 2010;

(4) Respondent Newport Coast failed to properly supervise Leone, LaBarbera, Levy, Costanzo, and Bartelt, in violation of NASD Rules 3010 and 2110 and FINRA Rule 2010; and

(5) Leone gave one customer inaccurate information overstating the value of the customer's account on five occasions, in violation of FINRA Rule 2010.

For these violations, Respondent Newport Coast is expelled from FINRA membership, Respondent Leone is barred from association with any FINRA member firm in any capacity, and Respondent LaBarbera is barred from association with any FINRA member firm in any capacity.

[166] As noted above, Levy, Costanzo, and Bartelt's violations and sanctions will be addressed in a separate default decision.

In addition:

(1) Newport Coast shall pay restitution to all of the customer accounts listed on Addendum A to this Decision in the amounts listed for each customer, plus interest at the rate established for the underpayment of income taxes in Section 6621(a) of the Internal Revenue Code, 26 U.S.C. § 6621(a), from May 31, 2013 until paid.[167] Newport Coast shall also pay a fine in the amount of $1 million, less any amounts that Newport Coast can demonstrate it has paid in restitution to the listed customers.

(2) Leone, jointly and severally with Newport Coast, shall pay restitution to customers CP, DG, JB, LC, MJ, PH, and RER in the amounts listed for those customers on Addendum A, plus interest at the rate established for the underpayment of income taxes in Section 6621(a) of the Internal Revenue Code, 26 U.S.C. § 6621(a), from May 31, 2013, until paid. Leone shall also pay a fine in the amount of $400,000, less any amounts that Leone can demonstrate he has paid in restitution to customers CP, DG, JB, LC, MJ, PH, and RER.

(3) LaBarbera, jointly and severally with Newport Coast, shall pay restitution to customers DB, CA, and RG in the amounts listed for those customers on Addendum A, plus interest at the rate established for the underpayment of income taxes in Section 6621(a) of the Internal Revenue Code, 26 U.S.C. § 6621(a), from May 31, 2013, until paid. LaBarbera shall also pay a fine in the amount of $125,000, less any amounts that LaBarbera can demonstrate he has paid in restitution to customers DB, CA and RG.

Finally, Respondents Newport Coast, Leone, and LaBarbera are ordered, jointly and severally, to pay costs in the amount of $40,353.38, which includes a $750 administrative fee and the cost of the hearing transcript.

The restitution, fines, and costs shall be payable on a date set by FINRA, but not less than 30 days after this Decision becomes FINRA's final disciplinary action in this matter. If this Decision becomes FINRA's final disciplinary action, the bars and expulsion shall be effective upon service of this Decision.

The charges that (1) LaBarbera mismarked trades as unsolicited, causing Newport Coast's books and records to be inaccurate, in violation of NASD Rules 3110 and 2110 and FINRA Rule 2010; and (2) Newport Coast failed to offer or provide any training regarding ETFs

[167] The customer accounts listed on Addendum A are more specifically identified in Addendum B to this Decision, which is served only on the parties and in the exhibits cited in Addendum A.

and lacked adequate procedures and policies for the supervision of the sales of those products, in violation of NASD Rules 3010(a) and (b) and FINRA Rule 2010, are dismissed.[168]

David M. FitzGerald
Hearing Officer
For the Extended Hearing Panel

[168] The Hearing Panel has considered and rejects without discussion all other arguments of the parties.

ADDENDUM A
Costs Restitution Schedule

Customer	Costs
Leone Customers	
CP	$4,757.09[169]
DG	$76,309.07[170]
JB	$49,113.46[171]
LJC	$67,149.01[172]
MJ	$16,159.76[173]
PH	$14,340.25[174]
RER	$98,024.36[175]
Leone Customer Total	**$325,853.00**
LaBarbera Customers	
DB	$49,712.13[176]
CA	$29,268.90[177]
RG	$7,959.32[178]
LaBarbera Customer Total	**$86,940.35**

[169] CX-551A, at 1.

[170] CX-547A, at 1

[171] CX-548A, at 1.

[172] CX-549A, at 1.

[173] CX-550A, at 1

[174] CX-552, at 1.

[175] CX-553, at 1.

[176] CX-561, at 1.

[177] CX-559A, at 1.

[178] CX-562A, at 1.

Levy Customers

NK	$36,854.48[179]
BNS	$30,969.99[180]
JS	$57,827.04[181]
Levy Customer Total	**$125,651.51**

Costanzo Customers

RS	$10,078.23[182]
DS	$60,591.81[183]
AB	$24,542.39[184]
MZ	$19,629.09[185]
Costanzo Customer Total	**$114,841.52**

[179] CX-565A, at 1.

[180] CX-563A, at 1.

[181] CX-564A, at 1.

[182] CX-555A, at 1.

[183] CX-556A, at 1.

[184] CX-557A, at 1.

[185] CX-558A, at 1.

Bartelt Customers

MG Individual Account	$10,314.51[186]
MG IRA Account	$63,116.13[187]
MG Trust Account	$63,568.98[188]
LW	$11,696.21[189]
LAC Individual Account	$ 5,719.96[190]
LAC IRA Account	$45,914.87[191]
Bartelt Customer Total	**$200,330.66**
Newport Combined Total	**$853,617.04**

[186] CX-567B, at 1.

[187] CX-568A, at 1

[188] CX-569A, at 1.

[189] CX-572A, at 1.

[190] CX-570A, at 1.

[191] CX-571A, at 1.