FINANCIAL INDUSTRY REGULATORY AUTHORITY
OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT, Complainant, v. JAMES LARKIN POWERS (CRD No. 2450818), Respondent.	Disciplinary Proceeding No. 2014041985401 Hearing Officer–MC **EXTENDED HEARING PANEL DECISION** **November 8, 2017**

Respondent engaged in a fraudulent scheme involving the use of sham trades for his own profit. For this misconduct, Respondent is barred from associating with any FINRA member firm in any capacity, and ordered to disgorge the profits. He also engaged in unauthorized transactions in customer accounts. For this misconduct, he is also barred. His misconduct caused his firm to maintain false books and records. Because of the bars, no additional sanctions are imposed for the recordkeeping violations.

The Extended Hearing Panel dismisses allegations that Respondent converted customer funds and engaged in fraudulent practices by making material misstatements and omissions of fact in customer trade confirmations.

Appearances

For the Complainant: Danielle I. Schanz, Esq., and Jason Mogel, Esq., Department of Enforcement, Financial Industry Regulatory Authority.

For Respondent: Roger G. Heim, Esq., Meyers & Heim, LLP.

I. Introduction

Respondent James Larkin Powers was an equity trader at FINRA member firm du Pasquier & Co. (the "Firm"), where he executed unsolicited trades for customers who were sophisticated investors.

The first and central charge of the Complaint is that from January 1 to July 25, 2014 (the "Relevant Period"), Powers engaged in a fraudulent scheme, by executing 18 fictitious trades, in Firm accounts he controlled, at prices he set, for his own benefit, with no corresponding market executions in the securities involved, in violation of Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act"), Rule 10b-5, and FINRA Rules 2020 and 2010.

The Complaint's second and third causes of action focus on transactions Powers executed for customers who placed sell orders in three initial public offerings ("IPOs"). The second cause of action charges conversion. It alleges that Powers gave customers lower sales prices for their shares in the IPOs than he obtained when he executed their orders, and kept the difference for himself, in violation of FINRA Rule 2010. The third cause of action charges Powers with fraud for providing his customers with account statements that contained material misrepresentations and omissions and did not inform them that they had not received the prices they should have received for the shares Powers sold on their behalf, in violation of Section 10(b) of the Exchange Act, Rule 10b-5, and FINRA Rules 2020 and 2010.

The fourth and fifth causes of action focus on unauthorized transactions Powers allegedly effected in customer accounts. The fourth cause of action alleges that Powers booked a large short sale position into customer accounts without authorization 12 times over seven weeks, canceling each trade before it settled, then booking it into another customer account, in violation of FINRA Rule 2010. The fifth and final cause of action alleges that by executing and booking these trades, Powers caused the Firm to create false trade confirmations and orders in its trade blotters and order entry system, and maintain false and inaccurate books and records, in violation of Section 17(a) of the Exchange Act, Exchange Act Rule 17a-3, and thereby in violation of FINRA Rules 4511 and 2010.

As explained below, the Extended Hearing Panel finds that the Department of Enforcement presented sufficient evidence to prove the allegations in the first, fourth and fifth causes of action, but failed to prove the allegations in the second and third causes of action by a preponderance of the evidence.

II. Background

A. Respondent and Jurisdiction

Powers started his career in the securities industry in 1992. He was subsequently employed by several FINRA member firms as a trader.[1] He registered with the Firm in 2005, as a General Securities Representative, Uniform Securities Agent, Equity Trader Limited Representative, and General Securities Principal.[2] While at the Firm, Powers had 20 accounts that he characterized as "very active."[3] As an agency equity trader, he executed orders placed by

[1] Hearing Transcript ("Tr.")144–49; Complainant's Exhibit ("CX")-1, at 5.

[2] Tr. 874–75; CX-1, at 7.

[3] Tr. 882–84.

customers, many of them sophisticated and with high net worth, who were involved in IPOs and secondary offerings.[4]

Powers is not currently associated with a FINRA member firm but is subject to FINRA's jurisdiction for the purposes of this disciplinary proceeding pursuant to Article V, Section 4 of FINRA's By-Laws, because the Complaint alleges the misconduct occurred while he was registered with a FINRA member firm, and Enforcement filed the Complaint less than two years after the termination of Powers' FINRA registration.[5]

B. Origins of the Investigation

FINRA member firm Pershing LLC performed trade clearing functions for the Firm.[6] In that capacity, Pershing prepared and transmitted trade confirmations, monthly account statements, and a variety of reports to the Firm. Pershing provided the Firm with credit for margin accounts, and calculated and assessed margin interest charges. Pershing also provided the Firm with an order entry system and the ability to set up principal trading accounts for its registered representatives.[7] These trading accounts included three that figure in this case: an average price account, a riskless principal account, and an error account. The purpose of the average price account was to facilitate trade executions with the market, to process multiple executions for a large order in a security, and calculate the average price of the multiple executions in an order.[8] The error account served as a repository for trades in which the trader had made a mistake.[9] The purpose of the riskless principal account was to process trades with markups or markdowns, including trades of bonds and preferred shares.[10] In addition, Powers maintained a personal brokerage account to conduct his own trading.[11]

Pershing's credit department monitored the Firm's trading and reviewed trades priced 10 percent or more away from the market.[12] In July 2014, the credit department noticed a series of trades involving 1500 shares of Netflix, Inc. stock in Powers' average price account and error account. It saw that one trade was 21 percent away from the market price and another was 28 percent away from the market.[13] Looking into the trades, Pershing discovered that in June and

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[4] Tr. 158, 882.

[5] Powers' registration was terminated on September 13, 2016. CX-1, at 2. The Complaint ("Compl.") alleges his misconduct extended from January 1 through July 25, 2014. Enforcement filed the Complaint November 15, 2016.

[6] Tr. 55.

[7] Tr. 69–70.

[8] Tr. 70, 161–62, 320–21.

[9] Tr. 77.

[10] Tr. 170.

[11] Tr. 170-71.

[12] Tr. 75.

[13] Tr. 100.

July there were multiple cancellations and rebillings of orders for the block of Netflix stock in Powers' average price account, and one cancellation and rebill to his error account.[14]

Pershing's credit department brought the Netflix trades to the attention of Craig Queripel, a Pershing compliance officer since 2006.[15] Because Queripel knew Emmanuel Scott at du Pasquier, and believed him to be a compliance officer at the Firm, the credit department asked Queripel to contact Scott to find out the reason for the unusual activity.[16] First Queripel checked both the average price account and the error account and compared the prices of the transactions with publicly available sources of market prices to confirm that the prices were away from the market.[17] On the afternoon of July 10, 2014, he sent an email to Scott asking for an explanation.[18]

The Firm's response to Queripel's inquiry came from Christopher Moran, Chief Financial Officer and owner of the Firm.[19] Moran's brief email explained: "the trader had a customer error and [it] will be resolved today."[20] This did not satisfy Queripel. Because there were multiple cancellations and rebillings, which he did not think could be explained as "a customer error," he pressed Moran for more information.[21]

With no further explanation forthcoming, on July 15, 2014, Queripel and Pershing's counsel called Scott. At the conclusion of the call, Scott informed Moran in an email that Pershing's counsel found Moran's reply to Queripel's initial query unacceptable. Pershing's attorney was "extremely displeased" that Moran had not responded to Queripel's request for a fuller explanation of what the lawyer termed as the "shenanigans" involving Powers' questionable trading activity. Scott told Moran that the lawyer had threatened that if Moran did not respond that day, Pershing would curtail its clearing of the Firm's trades, and would clear only liquidating trades for the Firm.[22]

Moran sent a second reply to Pershing's lawyer by email that day. He apologized for the delay and wrote that the Netflix order "should have been cancelled and when it was executed, the market was well against the trader." Moran assured the lawyer that Powers "accepts full responsibility," had "closed out the position," and no customer had been "affected."[23]

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[14] Tr. 75–77, 96.

[15] Tr. 75–76; CX-57, at 3.

[16] Tr. 62, 75–76.

[17] Tr. 76.

[18] Tr. 74–76.

[19] Tr. 758, 770.

[20] Tr. 79; CX-57, at 5.

[21] Tr. 79–80; CX-57, at 5.

[22] Tr. 79–81; CX-57, at 7.

[23] Tr. 82–83; CX-57, at 12.

Once again, Moran's email did not satisfy Queripel because it did not explain the cancellations and rebillings. Furthermore, he disagreed with the statement that the matter had not affected any customers. In Queripel's view, depositing an unauthorized order into a customer's account and canceling it does affect the account.[24]

In October 2014, at the request of FINRA staff, Pershing provided an extract of trade data, tracking Powers' Netflix trades from June 11 through July 10. The final transaction in his error account, after Powers covered the trade, showed a loss to the Firm of $110,854.[25] Subsequently, in 2015, FINRA staff referred the matter to Enforcement.[26]

C. Powers' Use of the Average Price Account

As noted above, the Firm provided three trading accounts for Powers to utilize: an average price account, an error account, and a riskless principal account. Whether or not Powers used his average price account as he should have was a contested issue at the hearing.

Enforcement's witnesses established clearly that the Firm expected Powers to use his average price account to facilitate trading on behalf of customers, not to hold and buy securities for himself. This meant he should strive to ensure that the average price account was flat, with trades allocated to customer accounts at the end of the day, and with minimal or no margin interest charges assessed.[27] However, Powers testified inconsistently about his use of the average price account.

At the outset of his hearing testimony, Powers agreed that his average price account was a "passthrough" account to facilitate trade executions on behalf of his customers[28] where all of the trades he made in the course of a day were to be deposited, until allocated to customers.[29] This was consistent with an on-the-record interview ("OTR") conducted on October 29, 2015, when he testified that all trades he executed through the Firm's order management system went through his average price account[30] and that at the end of a trading day, his average price account should be flat, with no funds or securities from the executed transactions remaining.[31] Powers

[24] Tr. 83–85.

[25] Tr. 102–103, 823; CX-58.

[26] Tr. 329–30.

[27] Tr. 70–71 (Queripel); 365–67 (Segarra); 722–24 (Gallagher); 772–74 (Moran). Pershing charged margin interest when securities purchased into the account were held after settlement date. Pershing would extend credit to the Firm to pay for the transaction, and charge the Firm interest until the securities were allocated. Tr. 365.

[28] Tr. 161–62.

[29] Tr. 164–65.

[30] Tr. 162-63; CX-64, at 5.

[31] CX-64, at 5–6.

insisted he allocated every trade in the average price account to the appropriate customer account.[32]

As the hearing progressed, however, Powers hedged on this point, suggesting the average price account would only be flat at the end of a trading day "[i]n a perfect world … a perfect scenario."[33] As he was questioned further about his use of the average price account, Powers became evasive. When asked if he used the average price account for its intended purpose, he responded, "Define intended purpose." When asked if he was allowed to buy and sell securities in his average price account without allocating the trades daily to customers, he responded: "Define what you mean by allocated."[34] When asked a series of questions about whether he was supposed to use his average price account as a trading account to buy and hold securities, he first said, "It's an account that was used to facilitate orders," then testified that every trade in the average price account "would eventually get allocated." Then he stated: "Define buy and hold securities. I mean, are you talking buying, holding a security for what period of time? I don't know what you're talking about."[35]

In the investigation he conducted, Enforcement Principal Investigator Raymond Segarra found that Powers used the account to buy and hold securities for trading purposes, at times for more than a week,[36] contrary to his OTR testimony denying that he ever used his average price account as a trading account.[37]

Segarra testified that at the end of December 2013, Powers' average price account had a credit of $22,000, and showed more than $60,000 in charges for margin interest. By the end of January 2014, it had a deficit of $95,000 and $3,200 in margin interest charges for the month.[38] The deficit meant that securities held in the account had been sold and proceeds held. The account incurred margin interest because it held securities positions for days, without allocations to customers, which should not have been the case, evidence that Powers used the average price account to buy and hold securities for trading purposes.[39] According to Segarra, even when there is a problem with a trade—such as a customer not paying for it promptly—it should not take a trader more than a day or two to resolve the problem, allocate the trade, and flatten the account with regard to that transaction,[40] with minimal or no margin interest charges.

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[32] CX-64, at 17.

[33] Tr. 165.

[34] Tr. 178.

[35] Tr. 171–72.

[36] Tr. 367–68.

[37] CX-64, at 9.

[38] Tr. 363–64; CX-32, at 1, 2, 88–89.

[39] Tr. 364–67.

[40] Tr. 366.

Segarra's review of the average price account portfolio-holding page for January 2014 revealed that the account held approximately $1.8 million in stocks purchased and settled without being allocated to a customer.[41] Trade blotters also attest to Powers' use of the average price account to buy and hold securities. They show numerous occasions when Powers bought and held securities for days or weeks, before allocating shares to customer accounts.[42] For example, Powers used the average price account to purchase 3,500 shares of Herbalife Ltd. stock on January 24, 2014. He did not allocate the shares. Then he purchased an additional 1,500 shares on February 4. He held the stock in the average price account until selling both lots on February 12.[43] In another instance, Powers used the average price account to purchase a total of 5,500 shares of Netflix stock on April 25, May 1, and May 2, 2014. He sold 4,500 shares on May 2, purchased some additional shares on May 6, and sold the position on May 12.[44]

The Firm's operations manager, Thomas Gallagher, provided additional evidence of Powers' use of the average price account. Gallagher handled back-office operations.[45] When Pershing called with a question about a trader's accounts, Gallagher would notify the trader.[46] He also reviewed the firm's average price, error, and riskless principal accounts[47] for securities held on the day after a trade. He wanted to see that traders' average price accounts were flat, in keeping with Moran's insistence that traders not hold positions in any firm accounts overnight. When he saw that an average price account held securities overnight, he would direct the trader to flatten it.[48] He testified that usually the trader would accomplish this in no more than two or three days.[49]

Gallagher testified that he sent messages to Powers on a number of occasions during the Relevant Period telling him to flatten his Firm accounts. For example, on February 28, 2014, Gallagher sent an email to Powers about a million dollar position in his average price account, directing him to "flatten out position today" because "Pershing is all over me on this current position" because of its dollar value.[50] On April 28, 2014, Gallagher sent another email to Powers titled "Positions in Firm Account Close of April 28, 2014," asking Powers to flatten the

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[41] Tr. 369–70.

[42] CX-32, at 350 and 562.

[43] CX-16D.

[44] CX-69, at 1–2.

[45] Tr. 715.

[46] Tr. 716–17.

[47] Tr. 722–23.

[48] Tr. 719–24, 737. Moran confirmed that he expected the equity positions and dollar balance in the average price account to be flat at the end of each trading day, with allocations to customers occurring on the day of the execution. Tr. 773–74.

[49] Tr. 728.

[50] Tr. 734. Gallagher identified the account number as 897748, Tr. 735, which was Powers' average price account. Tr. 75–76, 90-91.

account.[51] On April 30, Gallagher sent an email to Powers again telling him he needed to flatten his error account.[52] And on May 4, Gallagher notified Powers that Pershing was questioning a position in Netflix stock in Powers' average price account, "which is still there," consisting of 1,000 shares priced at more than $340,000, and asked "Can you flatten position soonest?"[53]

III. The Fraudulent Transactions (First Cause of Action)

The first cause of action alleges that Powers engaged in a fraudulent scheme, executing 18 fictitious trades, buying and selling securities to and from Firm accounts he controlled, at prices he set, for his own benefit, with no corresponding market executions in the securities involved. To understand the fraudulent scheme, we begin with an example of a legitimate trade. We then discuss the 18 sham transactions.

A. Example of a Legitimate Trade

When Powers executed a legitimate transaction, trading records provide evidence of executions for each leg of the transaction. For example, Pershing's aggregate trade execution and allocation blotter for February 2014 shows that on February 19 Powers used the average price account to purchase 2,500 shares of Tesla, Inc. stock from the market. Then his personal trading account purchased the shares from the average price account at the same price. Several hours later, he used the average price account to purchase the shares from his personal account, and sold them at that price to the street. The blotter records each leg of the transaction, two of them with the market, two of them internal. This was an appropriate use of the average price account to facilitate Powers' trades, in a legitimate "round trip" transaction.[54]

B. The 18 Sham Transactions

The 18 allegedly sham trades between Powers' average price account and his personal account occurred from January 2 through May 14, 2014.[55] They involved more than 53,000 shares in eight stocks, and generated profits exceeding $388,000.[56] To review the trades, Enforcement used Bloomberg trade data supplemented by FINRA proprietary data showing the high and low market prices from 6:00 a.m. to 8:00 p.m. for the relevant trade dates for the eight securities.[57] Segarra testified that Powers booked some of the trades at prices inside the market's

[51] Tr. 736–38.

[52] Tr. 738–39; CX-53.

[53] Tr. 739–40; CX-54.

[54] Tr. 403–08; CX-17B, at 1. Powers happened to lose money in this transaction.

[55] Tr. 386–87, CX-8.

[56] Tr. 398; CX-8.

[57] Tr. 390–394, CX-8.

trading range, and others outside, but that there were no street executions correlating to the 18 trades at the prices at which he booked them.[58]

C. Analysis of Sham Trades

Segarra testified that Powers' fraudulent transactions were markedly different, lacking at least one of the two market executions present in all of the legitimate market transactions executed through the average price account.

Below is a chart of the 18 trades Enforcement alleges were "fictitious," with no corresponding market transactions:[59]

No.	Date	Security	Power's Trade	Powers' Profit	One leg outside of trading range	Mkt high/low
1.	Jan. 2, 2014	Twitter Inc. (TWTR)	Bought/Sold 6,000 shares at 64.55/67.422	$17,232	No	n/a
2.	Jan. 3, 2014	TWTR	Bought/Sold 7,000 shares at $67.38/$70.20	$19,740	Yes	$70.43/$68.432 bought below range
3.	Jan. 6, 2014	Tesla, Inc. (TSLA)	Bought/Sold 4,500 shares at $145.446/$150.22	$21,483	No	n/a
4.	Jan. 8, 2014	Medbox, Inc. (MDBX)	Sold/Bought 1,000 shares at $71.478/$44.10 (purchase booked on Jan 9, 2014 "as of" Jan. 8, 2014)	$27,378	Yes	$93.50/$46.90 bought below range
5.	Jan. 8, 2014	Netflix, Inc. (NFLX)	Bought/Sold 500 shares at $338.58/$343.66	$2,540	No	n/a
6.	Jan. 9, 2014	TSLA	Bought/Sold 1,500 shares at $146.28/$151.90	$8,430	Yes	$153.43/$146.85 bought below range
7.	Jan. 13, 2014	NFLX	Bought/Sold 1,200 shares at $332.15/$346.00	$16,620	No	n/a
8.	Jan. 24, 2014	NFLX	Bought/Sold 2,000 shares at $380.38/$390.15	$19,540	No	n/a

[58] Tr. 394.

[59] Enforcement prepared and included the chart in the Complaint. Compl. ¶ 27. The information contained in the chart is identical to the information contained in CX-8, a summary exhibit admitted into evidence at the hearing.

No.	Date	Security	Power's Trade	Powers' Profit	One leg outside of trading range	Mkt high/low
9.	Jan. 31, 2014	MDBX	Bought/Sold 2,000 shares at $38.35/$39.15 (sale booked on Feb. 3, 2014 "as-of" Jan. 31, 2014)	$1,600	Yes	$37.15/$34.26 bought and sold above trading range
10.	Feb. 3, 2014	Herbalife Ltd. (HLF)	Bought/Sold 4,000 shares at $62.38/$67.88	$22,000	No	n/a
11.	Feb. 24, 2014	TSLA	Bought/Sold 2,500 shares at 209.86/$217.65 (sale booked on Feb. 25, 2014 "as-of" Feb. 24, 2014)	$19,475	No	n/a
12.	Feb. 25, 2014	TSLA	Bought/Sold 2,500 shares at $218.38/$252.65 (sale booked on Feb. 27, 2014 "as-of" Feb. 25, 2014)	$85,675	Yes	$259.20/$228.45 bought below range
13.	Feb. 26, 2014	NFLX	Bought/Sold 600 shares at $446.223/$455.19	$5,380	No	n/a
14.	Mar. 4, 2014	InterMune (ITMN)	Bought/Sold 3,000 shares at $31.00/32.02	$3,060	No	n/a
15.	Apr. 25, 2014	Weibo Corp. (WB)	Bought/Sold 10,000 shares at $16.06/$21.00	$49,400	Yes	$20.33/$19.08 bought below and sold above trading range
16.	Apr. 30, 2014	Yelp Inc. (YELP)	Bought/Sold 3,000 shares at 56.50/$62.22 (sale booked on May 1, 2014 "as-of" Apr. 30, 2014)	$17,160	Yes	$58.88/$54.68 sold above range
17.	May 12, 2014	NFLX	Bought/Sold 1,000 shares at $326.28/$344.85	$18,570	Yes	$345.53/$330.52 bought below range
18.	May 14, 2014	NFLX	Bought/Sold 1,500 shares at $331.95/$353.85	$32,850	Yes	$354.40/$346.06 bought below range
			Total	**$388,133**		

For example, on February 10, 2014, Powers used his average price account to purchase 2,500 shares of Tesla stock from the street at $210.32 per share. This acquisition gave the Firm a long position in Tesla.[60] On February 24, with the Firm still holding the position, as shown in trade 11 in the table, Powers booked a purchase of 2,500 shares of Tesla, at $209.86 per share, from the average price account into his personal account.[61] The following day, he booked a sale of the shares from his personal account to the average price account at $217.65, "as of" February 24, 2014.[62] Powers' profit from the round trip totaled more than $19,000.[63] There were no corresponding market executions for these trades. When the transactions were completed, the Firm still held 2,500 shares of Tesla from the February 20 purchase. In sum, Powers had transferred funds from the average price account into his personal account by first purchasing the shares from the market into the average price account, selling them from the average price account to his personal account, which then sold them back to the average price account at a higher price, with the profit going to his personal account.

The following day, Powers purchased 2,200 shares of Tesla into the average price account from the street at $245.4478 per share, and then allocated 700 of the shares to a customer. This made the average price account long by an additional 1,500 shares of Tesla stock, for a total of 4,000 shares.[64] That day, as shown in trade 12 above, Powers sold 2,500 shares from the average price account to his personal account at a price of $218.38, for a total of $545,950. Powers sold 2,500 shares of Tesla, booked on February 27, "as of" February 25, for $252.65, for a total price of $631,625. The trade data for February 25 showed the market's lowest price for Tesla stock was $228.45, well above the price Powers booked for the purchase by his personal brokerage account. By "buying low and selling high," the transaction yielded Powers a profit of $85,675 in his personal account.[65]

There were no corresponding street side executions for these trades.[66] Although they were not real trades, these paper trades yielded real dollar profits to Powers' personal brokerage account.[67] Segarra testified that the gains came at the expense of the average price account holding the shares.[68] Segarra concluded that Powers created the sham trades to take paper gains in the average price account and actualize them in his personal account without actually selling or buying stock on the market.

[60] CX-17B, at 1.

[61] CX-17C, at 1.

[62] Tr. 431; CX-17C, at 2.

[63] CX-17C, at 2.

[64] Tr. 428–430; CX-18B.

[65] Tr. 431–35.

[66] Tr. 419–20; CX-17C; CX-17D.

[67] Tr. 424–25.

[68] Tr. 448.

On some occasions, Segarra testified, Powers executed a legitimate profitable trade with the market, and then he moved the profit from the average price account to his personal account by means of a sham trade involving fewer shares, but priced to generate "profits" roughly equivalent to the legitimate trade.[69] For example, on January 10, 2014, in a legitimate trade, Powers purchased 3,000 shares of Netflix stock from the market into the average price account. He paid $331.997 per share, for a total cost of almost one million dollars. The same day, the average price account sold 3,000 shares of Netflix to the market at $337.547. The transaction yielded a gain of $16,650.[70]

Three days later, in trade 7 depicted in the table above, Powers "purchased" 1,200 shares of Netflix from the average price account into his personal account at $332.15. He then sold the shares from his personal account back to the average price account at $346 per share.[71] The result was a profit of $16,620 to his personal account. Enforcement argues that this was a sham transaction that not only earned him almost the same gain realized by the legitimate transaction, but did so by using fewer shares, requiring less capital in his personal account, compared to the nearly one million dollars of capital the average price account used to make the initial purchase.[72]

Enforcement argues that on other occasions, Powers moved money from the average price account to his personal account by means of sham trades after losing money from trading in the average price account. According to Enforcement, an example of this occurred in December 2013 and January 2014 when Powers bought and sold 16,000 shares of Herbalife, Ltd. stock on the market through the average price account, losing more than $7,000.[73] Then, as shown in trade 10 in the table, on February 3, 2014, he booked a trade of 4,000 shares between the average price account and his personal account, for a profit of $22,000, from a transaction with no corresponding market executions.[74]

Powers acknowledged in his November 23, 2015 OTR that he booked trades between his personal account and the average price account, with no corresponding trades to the market.[75] When Enforcement focused on specific trades in Tesla stock, Powers described the trades as cross-transactions, with "no risk" and "no execution to the Street." He testified that when he had a long position in Tesla, he would "book a sell to flatten out" his personal trading account, and

[69] Tr. 496–97.

[70] CX-14D, at 3.

[71] CX-14D, at 4.

[72] Tr. 469–71; CX-14D, at 4.

[73] Enforcement's Pre-Hr'g Br., at 10; CX-16D.

[74] Enforcement's Pre-Hr'g Br., at 10; CX-16B.

[75] Enforcement argues that this testimony amounts to an admission by Powers that he engaged in sham trades. Enforcement's Pre-Hr'g Br., at 10.

"[i]nstead of actually going out to the Street and actually selling it" he "would just take that long position again."[76]

When Powers sold stock from his personal account to his average price account, he sold at a higher price than the price at which he bought the shares back into his personal account. When asked about the prices, he testified that the market set them. But, as Enforcement notes, in nine of the 18 allegedly sham trades, Powers set prices that were outside that day's market range of prices; for example, the price at which he purchased the stock from the average price account into his personal account on February 25, 2014, was below the lowest price Tesla stock traded for on the market that day.[77] This is evidence, Enforcement maintains, that Powers, not the market, set the prices in these transactions.

In the same OTR, Powers at one point claimed that there *were* corresponding market transactions for these trades. He asserted, "There are offset transactions." But he could not identify any, and when pressed he conceded, "I don't know when . . . I can't recall when the offset transactions were actually done. There are offset transactions . . . [but] I don't know what dates I actually sold shares of Tesla to the Street."[78] The blotters provide no evidence that he sold the shares to the street.

From early January through May 14, 2014, Powers' internal trading in the eight stocks shown above, of more than 53,000 shares of stock, at prices Powers chose, all without corresponding street executions, generated profits of more than $388,000 for him.

D. Discussion

The Complaint charges that this activity constitutes a fraudulent, manipulative trading scheme in violation of Section 10(b) of the Exchange Act, Rule 10b-5, and FINRA Rules 2020 and 2010.

Exchange Act Section 10(b) makes it unlawful for a person, employing any means or instrumentality of interstate commerce or of the mails, to employ any manipulative or deceptive device or scheme in connection with the purchase or sale of securities. SEC Rule 10b-5 further makes it unlawful for a person through any instrumentality of interstate commerce or the mails to employ a scheme or artifice to defraud, and engage in any course of business that operates as a fraud or deceit on any person in connection with the purchase or sale of a security.[79] To prove Powers culpable for fraud, Enforcement must also establish that he acted with scienter, consciously engaging in prohibited conduct, or acted recklessly. The provisions of Section 10(b)

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[76] CX-64, at 32.

[77] Enforcement's Pre-Hr'g Br., at 11; CX-64, at 32–33; CX-70.

[78] CX-64, at 32.

[79] *SEC v. Wolfson*, 539 F.3d 1249, 1256 (10th Cir. 2008).

and Rule 10b-5 are to be read broadly and inclusively, as their purpose is "to achieve a high standard of business ethics in the securities industry."[80]

At the hearing, Enforcement established, first, that Powers used his average price account improperly, in contravention of the expectations of the Firm, and contrary to industry practice, to hold and trade securities.

Enforcement also established that Powers fabricated the 18 transactions with no corresponding executions with market counterparties to transfer more than $388,000 from the average price account to his personal account at the Firm, and then to his personal bank account at JP Morgan Chase.[81]

The evidence shows that Powers acted deceptively and in his own interest in making use of the Firm's capital, and incurring costs charged against the Firm, to create sham trades to siphon funds from the Firm's average price account to his personal account. By the end of the seven-month Relevant Period, Powers' average price account had generated margin interest charges of more than $27,000, which the Firm, not Powers, paid to Pershing. [82]

Based on this evidence, it is clear that Powers executed the 18 fictitious or sham trades in a scheme trading securities between his personal brokerage account and the Firm's average price account that he controlled. Even though he did not use the facilities of a national securities exchange, Powers effected his trades by means of interstate commerce because he traded from the Firm's New York office, and Pershing, located in New Jersey, cleared the transactions.[83] Powers devised the scheme to enable him to profit at the Firm's expense. He did so knowingly, therefore with scienter, because he set the prices and engineered the trades with no market counterparty, with no actual nexus to the market, and often outside the market's range of prices for the securities on the dates he traded them between the two accounts.

E. Conclusion

The Panel finds that Powers willfully violated Exchange Act Section 10(b), SEC Rule 10b-5, and FINRA Rules 2020 and 2010, as charged in the Complaint's first cause of action.

IV. Conversion Charge – The Three IPOs (Second Cause of Action)

The second cause of action focuses on customer orders Powers executed to sell shares of stock in the initial public offerings of three companies, Cypress Energy Partners L.P. (CELP), Rice Energy, Inc. (RICE), and Cara Therapeutics, Inc. (CARA). The Complaint alleges that

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[80] *SEC v. First Jersey Securities, Inc.*, 101 F.3d 1450, 1466 (2d Cir. 1996).

[81] CX-71.

[82] Tr. 205–06; CX-32, at 659.

[83] During the Relevant Period, Pershing was the Firm's clearing firm, and all trades executed by Powers at the Firm were transmitted to Pershing for execution, and Pershing prepared and transmitted confirmations. Tr. 64–65. Powers worked at the Firm's New York City office. CX-1, at 7. Pershing is located in New Jersey. CX-6, at 1.

when Powers executed the orders he obtained a higher price than the price he reported to customers. The Complaint alleges that Powers converted approximately $25,000 in customer funds when he moved the surplus funds this price difference created in his average price account to his personal trading account, or his error account, with internal trades.[84]

Powers denies converting customer funds. Powers testified that for all three of these initial public offerings, he initially made errors, but he communicated with his customers, usually several times in the course of the day, and he filled their orders according to their instructions, at the prices he was obligated to provide them with.[85]

At the hearing, Powers described filling these orders in some detail. He testified that prior to the hearing, he made notes as he reviewed the trade blotters and account statements from his personal, average price, and error accounts to reconstruct the trading.[86]

A. CELP

On January 15, 2014, the first day of the initial public offering of CELP, a customer directed Powers to sell 7,600 shares.[87] Powers sold the shares for a total of $156,640, but he reported and provided to the customer a total of $151,099 from the proceeds, which was $5,541 less than he had obtained from selling on the market.[88]

That day, Powers engaged in a series of internal trades, buying 3,600 shares of CELP into his average price account at $19.77 per share, and selling them back to the average price account at $21.30 per share, yielding a profit for his error account of approximately $5,506. Enforcement charges that Powers used these transactions to siphon funds into his error account that should have gone to his customer, noting that there were no related market trades that explain the transactions.[89]

When questioned during an OTR, Powers denied that his customer received less than was due from the executions. Powers testified that because the trade was in his error account, it had to have derived from an error.[90] The original order was a stop order to sell at $19.50.[91] Powers informed FINRA that the customer then ordered him to raise the stop limit, and instead of

[84] Compl. ¶ 34.

[85] Tr. 964–65.

[86] Tr. 969–73.

[87] CX-25E, at 7 (CELP order and trade blotter for January 15, 2014); NASDAQ Company IPO Overview, http://www.nasdaq.com/markets/ipos/company/cypress-energy-partners-lp-920309-73967.

[88] CX-25A (Summary of CELP trading and allocation activity for 2014) and CX 25E at 7 (CELP order and execution blotter for January 15, 2014).

[89] Enforcement's Pre-Hr'g Br., at 15.

[90] Tr. 588–89; CX-64, at 28–29. However, Powers testified, "I don't recall that particular day in this particular stock, you know, how that error was."

[91] Tr. 595; CX-25E, at 6.

replacing the original order with a "go-around order," he canceled the original order to sell 3,800 shares at $19.50. When asked to explain why he decided to do it this way, Powers testified that he thought it would be faster to cancel than to replace the order. Powers filled the order at a price of $19.77.[92] Enforcement's data showed that the last time the stock was bid at $19.77 or below was at 9:39.48, before Powers canceled the order at 9:42:36.[93] When Powers canceled, the stock traded above $19.77, and Powers should have seen this and provided a higher price to his customer.[94]

At the hearing, Powers testified that on the first day of the CELP initial public offering, one customer received a price of $20.74 per share, another received $19.64. There are two other trades with the same customer, one for 4,000 shares and the other for 3,600 shares. The error occurred in connection with the order to sell 3,600 shares. He reported to the customer the sale of the 3,600 shares at $19.77 per share, and taking into consideration the 4,000-share order at $19.99 per share, he provided the customer with the average price of $19.88 per share. Often, his customers instructed him to sell the stock at market price at the opening of trading, but in this instance, he erroneously neglected to enter the orders then. He speculated his error may have occurred because he was occupied with other business, he was dealing with different orders, he may have made a keypunch error, or other reasons.[95]

When Segarra testified about his analysis of the CELP transactions, he conceded that if the customer gave Powers an order to sell, and Powers erroneously failed to execute it on time, and the price increased before Powers filled it, the customer would be entitled to receive the price at the time of the order, not the later, higher market price.[96]

B. RICE

January 24, 2014, was the first day of the RICE initial public offering. Two customers directed Powers to sell a total of 42,675 shares of RICE for eight accounts.[97] Powers sold the shares on the market for $917,969.12, but reported and allocated to the customers a total of $906,442.61, which was $11,526.51 less than he had obtained when he sold the shares.[98]

The same day, Powers undertook a series of internal transactions, using his error account to buy 11,000 shares of RICE from the average price account at $20.90, and then to sell them back to the average price account at $21.95, leaving the error account with a profit of

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[92] Tr. 595–98.

[93] Tr. 601–02; CX-25G; CX-25E, at 6.

[94] Tr. 602–06.

[95] Tr. 976–79.

[96] Tr. 671–72.

[97] NASDAQ Company IPO Overview, http://www.nasdaq.com/markets/ipos/company/rice-energy-inc-922398-74212.

[98] CX-26D, at 11 (RICE trade blotter for January 24, 2014).

approximately $11,545.[99] Enforcement contends these were sham trades because no corresponding market trades occurred that could explain the 11,000 shares traded between the average price account and the error account, and because Powers, when asked at an OTR, was unable to remember any details of the transactions.[100]

Powers contends that he made an initial order entry error when he received customer orders to sell shares of RICE on January 24, 2014. Reconstructing the trades, Powers stated that he must have owed a customer an execution at $20.90 per share. On January 24, the share price for RICE dropped as low as $20.78. There were numerous executions at $21 per share. Powers posits that when he discovered his error, the price had moved higher. This enabled him to sell the shares for more than the limit order price the customers had given, to which they were entitled and which they received, and to retain the difference for himself.

C. CARA

On January 31, 2014, the first day of the CARA initial public offering,[101] Powers received customer orders to sell shares of CARA.[102] Enforcement alleges that Powers sold the shares on the market for a total of $83,831 but when he allocated the shares to the customer accounts, he gave them a total of $75,930, approximately $7,900 less than the amount he obtained from executing the customer orders.[103]

On the same day, Powers purchased 4,000 shares of CARA into his personal account at $11.35 per share, then sold the shares back to the average price account at $13.43, to net himself a profit of approximately $8,000, roughly the amount of the cash surplus generated by his executions of the customer orders.[104] Enforcement characterizes these as sham trades, with no corresponding street execution, fabricated to transfer the cash surplus, the difference between the price obtained from the sale of the shares to the market and the price Powers provided to the customers, from the average price account to his personal account.[105]

Powers testified that he received the two customer orders to sell CARA, one for 1,000 shares and another for 3,000.[106] He testified that initially he did not realize the orders were

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[99] CX-26 (summarizing trading and allocations in the error account and customer purchases for RICE).

[100] Enforcement's Pre-Hr'g Br., at 14.

[101] NASDAQ Company IPO Overview, http://www.nasdaq.com/markets/ipos/company/cara-therapeutics-inc-693401-73918.

[102] Tr. 277–78; CX-27 (summary exhibit showing CARA trades for January 31, 2014; CX-27E, at 5 (CARA trade execution blotter); CX-27I (CARA trade confirmations).

[103] Enforcement's Pre-Hr'g Br., at 13; CX-27B (summarizing trading and allocations in the average price account for CARA in 2014).

[104] Comp. ¶ 36.

[105] Enforcement's Pre-Hr'g Br., at 13.

[106] Tr. 284–86.

placed, did not execute them promptly, and the stock price dropped.[107] The customer orders left his average price account long by 4,000 shares, and he decided to purchase the shares for his personal account, flattening the average price account.[108] He purchased the shares for himself because he liked the stock and wanted to trade in it for himself. He testified that the Firm had told him he could purchase stock into his personal account so long as doing so did not conflict with his customers' interests. He perceived no conflict in this instance: his customers were selling, and the average price account was long.[109] He filled his customer orders at $11.50 and $11.60,[110] prices, he testified, "that they deserved based upon their order[s]."[111]

Powers testified that he did not report the transactions between his personal account and the average price account to the market because they were internal cross trades between the two accounts, essentially a transfer of the shares.[112] Powers testified "[m]y customers were still getting the price they were entitled to . . . the trades were reported to them. If I made my average price account long and I had [sic] took the position in my personal account these are internal transactions, there's nothing—no need to report anything."[113] He then sold the shares for $13.55.[114]

D. Discussion

Enforcement contends that Powers converted customers' funds by not giving them the prices he obtained on the market for the shares they instructed him to sell. The Panel notes, however, that there is no evidence any customer was dissatisfied with the executions of their orders. No customers or representatives of customers testified. The only evidence of the prices the customers were entitled to receive came from Powers, and his testimony was unrebutted. To the extent that Enforcement relies on Powers' lack of recollection of the details of these trades in his OTRs as evidence of his culpability, the Panel notes that the trades occurred years before the OTR, and Powers had no advance notice that he would be questioned about these particular trades. We do not find it unreasonable that he would, after the OTRs and in preparing for the hearing, be able to reconstruct the trades from the records he consulted and refresh his recollection of these transactions.

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[107] Tr. 282–83.

[108] Tr. 284–86, 289.

[109] Tr. 283.

[110] Tr. 282–86.

[111] Tr. 292.

[112] Tr. 286–88.

[113] Tr. 290.

[114] Powers testified that he booked the sale at $13.43. Tr. 296. Powers explained that this was the average price. Tr. 297. The Pershing trade execution blotter for CARA for January 31 reflects a trade for 4,000 shares at $13.55. Tr. 296–97; CX-27E, at 1.

There was no evidence to rebut Powers' claim that he filled the orders as the customers directed via their limit orders. It is undisputed that Powers had no discretionary authority, and he traded on behalf of customers only when he received orders from them. As Powers testified, there is no evidence any customers complained that he failed to provide the price the customer felt entitled to receive, and no evidence that the Firm expressed any concern about this activity.[115]

E. Conclusion

Based on this record, the Panel finds there is insufficient evidence that Powers failed to fill these customer orders at the prices the customers should have received. Therefore, the evidence does not establish that the surpluses, or profits, Powers obtained in the course of selling to the market were funds to which the customers were entitled. For these reasons, we find that Enforcement failed to meet its burden of proving that Powers converted customer funds as alleged in the Complaint's second cause of action, and we therefore dismiss it.[116]

V. Fraudulent Misrepresentations and Omissions (Third Cause of Action)

In connection with the trades underlying the conversion charge, the third cause of action alleges that Powers caused the trade confirmations to misrepresent material facts—by understating the prices his customers were entitled to receive from selling their shares of CELP, RICE, and CARA on the market—to facilitate and conceal his conversion of customer funds. It alleges that by doing so, he engaged in a fraudulent scheme, with scienter, utilizing the means or instrumentalities of interstate commerce, in violation of Section 10(b) of the Exchange Act, Rule 10b-5, and FINRA Rules 2020 and 2010.[117]

As noted above, Enforcement failed to prove that Powers did not provide his customers the prices they were entitled to receive for selling their shares. Finding the evidence insufficient to establish that the customers were not provided the prices they were due, the Panel concludes that the evidence is also insufficient to prove the confirmations Powers sent to his customers for the sales of CELP, RICE, and CARA materially misrepresented or omitted to accurately inform them of the prices he should have provided to them. For these reasons, we dismiss the Complaint's third cause of action.

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[115] Tr. 973, 986.

[116] When describing the CARA trades, Powers did not explain why he booked the 4,000 shares from his average price account to his personal account instead of to his error account when he claims he made an error. Tr. 970–73. Furthermore, the Panel does not agree with Powers' assertion that, just as he was responsible for losses sustained in error trades, he was entitled to retain profits from errors, as he did here. In the Panel's view, those profits should have remained with the Firm. However, the Complaint charges Powers with converting customer funds, and we find that Enforcement did not prove that the surpluses, or profits, Powers obtained in the course of these transactions were funds to which the customers were entitled.

[117] Compl. ¶¶ 44–48; Enforcement's Pre-Hr'g Br., at 18–21.

VI. Unauthorized Trading – The Netflix Transactions (Fourth Cause of Action)

The fourth cause of action focuses on the transactions that first brought Powers' activity to FINRA's attention. It charges Powers with executing 12 unauthorized trades in Netflix stock, that he booked to 9 different customer accounts from May 19 through July 10, 2014.[118]

A. The Trades

The table below, taken from the Complaint, provides an overview of the 12 trades at issue, identifying them by the date of each trade, the customer account into which Powers booked the trade, the price at which he booked it, and the date on which Powers canceled it:[119]

No.	Trade Date	Customer	Transaction	Price per Share	Date Trade Canceled
1.	May 19, 2014	BFT	Sell 1,500 shares NFLX	$364.54	May 22, 2014
2.	May 23, 2014	ICP	Sell 1,500 shares NFLX	$365.47	May 28, 2014
3.	May 30, 2014	ICBC	Sell 1,500 shares NFLX	$364.10	June 3, 2014
4.	June 4, 2014	LAI	Sell 1,500 shares NFLX	$365.00	June 6, 2014
5.	June 9, 2014	PSP	Sell 1,500 shares NFLX	$364.63	June 11, 2014
6.	June 12, 2014	LAI	Sell 1,500 shares NFLX	$364.78	June 16, 2014
7.	June 16, 2014	FIA	Sell 1,500 shares NFLX	$364.67	June 18, 2014
8.	June 19, 2014	MFT	Sell 1,500 shares NFLX	$364.38	June 23, 2014
9.	June 24, 2014	PA	Sell 1,500 shares NFLX	$364.56	June 26, 2014
10.	June 27, 2014	PSP	Sell 1,500 shares NFLX	$363.76	July 1, 2014

[118] Compl. ¶¶ 53–54.

[119] Compl. ¶ 53.

No.	Trade Date	Customer	Transaction	Price per Share	Date Trade Canceled
11.	July 2, 2014	CSTT	Sell 1,500 shares NFLX	$364.59	July 7, 2014
12.	July 7, 2014	ICBC	Sell 1,500 shares NFLX	$363.48	July 9, 2014

The series of unauthorized trades began on May 19, 2014, when Powers acquired a short position in Netflix stock by short selling 1,500 shares at $364.54 per share,[120] without a customer order.[121] He did this with trades in several blocks of stock: one 1,100-share and two 200-share executions. Powers entered them as market orders, and they were filled quickly, leaving his average price account short 1,500 shares. At the hearing, Powers testified that the orders came from a customer but he lost track of who placed the order.[122]

Shortly after the initial transaction, Powers entered a limit order to purchase 1,500 shares of Netflix stock at $353 per share; 20 minutes later, he replaced it with another buy limit order at $365.85. These orders were not filled; had they been, his average price account would have bought 1,500 shares of Netflix, and it would have canceled out the 1,500-share short sale position, leaving his average price account flat, and he would have made a small profit.[123]

After taking this short position in his average price account on May 19, that same day, Powers booked a trade for a customer to sell 1,500 shares at $364.54, the price Powers had paid.[124] In the two days following the short sale, the market price of the stock began to rise, closing at $390.60 per share on May 21.[125]

In a pattern he repeated during the next seven weeks, moving the position from one account to another, Powers canceled the trade on May 22, the day it was supposed to settle. The result was that his average price account was again short 1,500 shares of Netflix stock.[126] On the following day, Powers booked a sale of 1,500 shares of Netflix stock for another customer, this time at $365.476 per share, which eliminated the short position in his average price account. This price was not the price of the original short sale, and was well below the rising market range of prices for Netflix stock on May 23, when the lowest per share price was $389.66.[127]

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[120] CX-23G.

[121] CX-24D, at 28.

[122] Tr. 227–30.

[123] Tr. 231. Powers testified that he does not know why he entered these orders. Tr. 232–33.

[124] CX-24A, at 1.

[125] CX-24B, at 2.

[126] Tr. 518; CX-24A, at 2.

[127] Tr. 518–19; CX-24, at 1.

On May 28, the day before the transaction was to settle, Powers canceled it, once again creating a short position in the average price account. Two days later, he booked a sale of 1,500 shares of Netflix in a third customer's account, now at $364.10 per share, again outside the price at which the stock traded that day, which was from $411.61 to $421.74 per share. The settlement date was June 4; on June 3, Powers canceled and rebilled the trade, this time to his riskless principal account. Because it was a rebill, the transaction retained the same price, trade, and settlement dates.[128]

On the June 4 settlement date, Powers booked a trade for another customer, for a short sale of 1,500 shares at $365 per share, with a new settlement date of June 9. At this point, both Powers' average price and riskless principal accounts were flat, and the customer account held the short position. The price, once again, was below the market range for Netflix on June 4, which traded from $413.30 to $425.60.[129]

Powers canceled this trade before it settled, on June 6, creating once again a short position in his riskless principal account. On the same day, Powers booked another customer short sale of 1,500 shares of Netflix stock from the riskless principal account at a price of $364.63 per share, well below $420.09, the lowest price at which the stock traded on the market on June 6. The new settlement date was June 11.[130]

Powers' next step on June 11 was to cancel the trade with the fifth customer, booking a short sale that moved the position back into the average price account at $364.68 per share, when the lowest market price for Netflix stock that day was $425.[131] On June 12, Powers booked a short sale of 1,500 shares of Netflix from a customer account that had previously held the position, to the average price account, at a price of $364.776, moving the short position from the average price account to the same customer account that held it on June 4, but at a new price, with a new settlement date of June 17.[132]

On June 16, Powers canceled that trade, and booked a short sale of 1,500 shares of Netflix to another customer account at $364.673 per share, again well outside the lowest market price that day, with a settlement date of June 19.[133] The day before settlement, on June 18, Powers canceled the trade, and moved the short position from the average price account to the riskless principal account by having the average price account buy from the riskless principal account, again at a new price, $364.563, well outside the market range.[134]

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[128] Tr. 520–22; CX-24, at 1; CX-24A, at 5–6.

[129] Tr. 522; CX-24, at 1; CX-24A, at 7.

[130] Tr. 523–24; CX-24, at 1-2.

[131] Tr. 525–26; CX-24, at 2.

[132] Tr. 527; CX-24, at 2.

[133] Tr. 527–28; CX-24, at 2.

[134] Tr. 528–29; CX-24, at 2.

On the following day, June 19, Powers booked a trade for 1,500 shares of Netflix to a new customer account, with a new settlement date of June 24, at a new price of $364.38 per share; the lowest market price per share that day was $438.06.[135]

Consistent with this pattern, Powers canceled the trade on June 23, which returned the short position to his riskless principal account. The following day, June 24, Powers booked a short sale of 1,500 shares of Netflix to a new customer account at a new price of $364.563 per share, and a new settlement date of June 27; the lowest price for Netflix stock on the market was $435.50.[136]

On June 26, the day prior to settlement, Powers canceled the trade, returning the short position to the riskless principal account. Powers then moved the position once more into the average price account, and on the next day, June 27, he booked a short sale of 1,500 shares of Netflix for the second time to a customer account that had previously held the position, with a new settlement date, this time at $363.76 per share, on a day when the lowest per share price for Netflix on the market was $443.19.[137]

Powers canceled this trade, too, on July 1, the day prior to settlement, once more making the average price account short the 1,500 Netflix shares. On July 2, Powers booked a trade to a new customer account, with a new settlement date of July 8, at $364.59 per share, when the lowest per-share market price was $466.04, more than $100 per share greater than the price at which Powers booked.[138] The same day, Powers effected two transactions, moving the short position to his error account. Then on July 7, the day before settlement, Powers canceled and booked a new trade with a customer account he had booked a trade with in June, with a new settlement date of July 10, at a new per share price of $363.48, when the lowest market price per share was $460. The net effect of these transactions was that Powers left the average price account long and his error account short 1,500 shares of Netflix.[139]

On July 9, the day prior to settlement, Powers canceled this trade. His average price account was flat, and his error account held the short position. On July 10, as described above, Pershing contacted the Firm questioning the series of cancellations and rebillings. When the Firm directed Powers to cover the trade on July 10, 2014, his average price account bought 1,500 shares of Netflix stock from the market at the market price of $438.478, and allocated the trade to his error account.[140]

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[135] Tr. 529–30; CX-24, at 2.

[136] Tr. 531–32; CX-24, at 2.

[137] Tr. 532–34; CX-24, at 3.

[138] Tr. 534–35; CX-24, at 3.

[139] Tr. 535–36; CX-24, at 3.

[140] Tr. 537–38; CX-24, at 3.

Because of the steady rise in price of Netflix, Powers' error account lost $110,000 when Powers covered the position with his purchase from the market.[141]

B. Powers' Explanations of the Netflix Trades

Over time, Powers has given inconsistent explanations of the 12 unauthorized customer trades in Netflix stock.

When Moran, the Firm's owner, Chief Financial Officer, and FINOP,[142] prompted by Pershing's inquiry, initially questioned Powers about the Netflix trades by email, Powers responded that the cancellations and rebillings resulted from a customer order that he ought to have canceled, but did not, and that when he saw it had been executed, the price of Netflix shares had increased.[143]

When Moran asked for more details, Powers wrote that the initial trade was on May 19, 2014 and that "[i]t was entered as a sell and should have been a buy order. When I realized the mistake, the stock was well away from the price and I believed incorrectly that it would come back."[144] Under pressure from Pershing, Moran insisted Powers provide more information, specifically telling him to identify the account and system into which the order was incorrectly entered. Powers responded: "Was entered on [the Firm's order management system]. No other positions in the error account."[145]

At the hearing, Moran testified that if Powers made an error on May 19, he should have rectified it that day in the error account.[146] But Moran did not pursue the matter further with Powers. And Powers never told Moran or anyone at the Firm what he later told FINRA, that the original trade was ordered by a customer of whom he lost track. Powers also never told Moran that he successively booked and canceled the trade in 12 customer accounts just before settlement dates, and he never explained why the problem remained unresolved for seven weeks.[147]

During Enforcement's investigation, Powers provided a written response to a request for information pursuant to FINRA Rule 8210 in which he stated "unequivocally" that a customer

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[141] Tr. 564–65. Powers paid the Firm approximately $55,000 towards the loss. CX-44, at 4.

[142] Tr. 758, 767–68, 770.

[143] Tr. 808–09; CX-57, at 14.

[144] Tr. 811; CX-57, at 13.

[145] Tr. 814–15; CX-57, at 13.

[146] Tr. 817–18.

[147] Tr. 818–19.

gave him the order to sell the Netflix stock and he tried "to the best of his ability to book the trade into the account that he thought gave the original order."[148]

At an OTR, however, Powers did not claim he had received a customer order and lost track of it. Powers could not explain what had happened. When asked about the cancellation of the first sell order he booked in a customer account, Powers testified that he had "no recollection" of the reason for the cancellation. Later in the interview, Powers stated that he thought he may have "oversold" Netflix, and that he should have canceled the initial order, but did not.[149] When Enforcement suggested that it appeared as if he booked the trades in the various customer accounts to hide the position, Powers acknowledged this by replying, "you are not wrong."[150] When Enforcement pressed further by saying "you were trying to hide . . . this particular error by booking trades versus customer accounts that did not take place," Powers did not answer directly, but said "I was under the impression that the stock would eventually come back to the price that I had sold it," but "[i]t never did."[151]

In another OTR, Powers testified that he booked the Netflix position into accounts of customers who may have traded in the stock prior to the May 19, 2014 short sale.[152] But when Segarra examined the execution blotters, he found that Powers had filled no customer orders for Netflix from December 2013 to May 19, 2014.[153] In the months prior to May 19, 2014, Powers engaged in several Netflix trades; none, however, was for a customer, and the trades involved only his personal brokerage account or his average price account, through which he acknowledged he bought and sold securities for himself.[154]

At the hearing, Powers was unable to give a plausible explanation. When asked why he initially booked the Netflix stock into a customer account, Powers testified he believed it was the account that had originated the order, but the customer did not accept the trade, so he tried booking it into other customer accounts, choosing customer accounts he thought might have given the order in the first place.[155] He persisted for seven weeks, he testified, because he assumed that eventually "a customer was going to own up to the trade."[156] Yet he also testified that because the price of Netflix stock increased, the customer who gave him the order would refuse to accept the trade.[157] When asked why, when he realized he did not know which customer

[148] Tr. 242–44; CX-42, at 2–3.

[149] Tr. 246–47.

[150] Tr. 247–48; CX-64, at 15.

[151] Tr. 248; CX-64, at 15.

[152] Tr. 459–60; CX-64, at 18–20.

[153] Tr. 459–60; CX-69.

[154] Tr. 199–201; CX-24D.

[155] Tr. 993–94.

[156] Tr. 996.

[157] Tr. 997.

gave him the order he did not simply put the trade in his error account, he stated he feared that if he did so, and the stock's price increased, the customer would demand execution.[158] When asked why he canceled and rebilled some of the trades to his riskless principal account, when there was no markup or markdown involved, Powers had no answer; he testified: "I don't know why."[159]

C. Discussion

It is well established that a broker with a non-discretionary account must obtain a customer's consent before engaging in securities transactions in the customer's account.[160] The evidence shows that Powers initially sought to trade 1,500 shares of Netflix stock, with a value of more than half a million dollars, not for a customer but for himself, and in doing so created a short position in his average price account. When the price of Netflix stock rose, it became a losing position. The evidence supports Enforcement's argument that Powers then attempted to conceal his losing position by booking it to a customer account, making it appear that the customer had given him the order, then canceled it before settlement, and repeated the process again and again.

The evidence does not support Powers' claim that he received a customer order and then forgot who the customer was. The Panel gives no credit to Powers' claim that he engaged in a futile effort to prompt the customer who gave him the order to accept the trade when, on 12 occasions spanning seven weeks, he booked the 1,500 share block of Netflix into nine different customer accounts, booking the position in the same three accounts two times. No documentary evidence corroborates Powers' claim. Instead, the evidence supports the conclusion that Powers, having previously engaged in a profitable trade in Netflix stock, attempted to repeat that success. He was unable to do so as the market price of the stock rapidly increased, leaving him in a progressively worse position. This led him to book the trades as he did in order to hide the position, in the hope that over time the market would become more favorable and allow him to recoup his loss. Pershing noticed the pattern of cancellations and rebillings of the block of Netflix stock, and took the actions that compelled the Firm to make Powers place the stock in his error account and cover the trade.

D. Conclusion

The Panel finds that by this conduct, Powers engaged in 12 unauthorized securities transactions in nine customer accounts, in violation of FINRA Rule 2010, as charged in the Complaint's fourth cause of action.

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[158] Tr. 1060–61.

[159] Tr. 1062.

[160] *Dep't of Enforcement v. Griffith*, No. 2010025350001, 2015 FINRA Discip. LEXIS 55, at *15 (NAC Dec. 22, 2015); *Wanda Sears*, Exchange Act Release No. 58075, 2008 SEC LEXIS 1521, at *6 (July 1, 2008).

VII. Causing Firm to Maintain False Books and Records (Fifth Cause of Action)

The fifth cause of action charges that when Powers booked the Netflix position into customer accounts without authorization, he caused the Firm to create and maintain false and inaccurate records.

FINRA Rule 4511 requires all FINRA members to create and maintain books and records as required by FINRA rules, the Exchange Act, and Exchange Act Rules 17a-3 and 17a-4. Exchange Act Rule 17a-3(a) requires firms to keep daily records of securities purchases, sales, and trade confirmations. These records must be accurate.[161] Keeping inaccurate or false books and records violates Rule 4511, and a violation of Rule 4511 is inconsistent with the obligation of all members to observe high standards of commercial honor and just and equitable principles of trade, and thereby violates FINRA Rule 2010.[162]

The Firm's trading blotters and confirmations recorded Powers' transactions making it appear that his customers were placing sell orders for Netflix stock that they then canceled on or before trade settlement dates, when there were actually no customer orders. By booking these unauthorized trades, Powers caused the Firm to create and maintain false records of orders and false confirmations, in violation of FINRA Rules 4511 and 2010.

VIII. SANCTIONS

A. Fraud: First Cause of Action

For an individual who engages in intentional fraudulent misconduct, the Sanction Guidelines strongly recommend considering imposing a bar and a fine of $10,000 to $146,000 unless mitigating factors predominate.

1. The Arguments of the Parties

For the fraudulent scheme charged in the first cause of action, which Enforcement characterizes as egregious, Enforcement urges the Panel to impose a bar, a fine of $146,000, and to order Powers to disgorge $388,000 in profits that he made from the 18 trades.[163] Enforcement stresses these aggravating factors: Powers has not accepted responsibility for his misconduct and his misconduct included numerous fraudulent acts in connection with the 18 improper trades.[164]

Powers insists he did nothing wrong, that FINRA "cherry-picked" the 18 trades at issue, focusing only on profitable trades, and failed to establish that he violated any Firm supervisory

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[161] *Dep't of Market Regulation v. Ko Securities Inc.*, 2002 NASD Discip. LEXIS 18, at *23 (NAC Nov. 13, 2002); *Voss & Co., Inc.*, Exchange Act Release No. 18028, 1981 SEC LEXIS 915, at *14, n.16 (Aug. 11, 1981).

[162] *Dist. Bus. Conduct Comm. v. Sickels,* No. C9A950036, 1997 NASD Discip. LEXIS 23, at *10–11 (Jan. 22, 1997).

[163] Tr. 1138; Enforcement's Pre-Hr'g Br., at 25.

[164] Enforcement's Pre-Hr'g Br., at 25.

procedure by placing orders for his personal account in his average account, and by using internal cross-trading to transfer profits to his personal account.[165] Furthermore, Powers points out that the Firm reviewed his trading and never found fault with his conduct, and has made no claim that Powers owes it money as a result of his trading.[166] Powers contends that FINRA does not understand that since the 18 trades were internal cross transactions, subject to Firm review, there was no need for him to engage in market transactions to make them genuine.[167] He argues that since none of the orders was publicly reported or seen by investors, there was no possibility of manipulation.[168] And, Powers contends, he had no intent to defraud anyone.[169]

With regard to sanctions, Powers argues that a bar is not warranted. He insists the funds he transferred from the average price account to himself were his profits. Powers also claims that if Enforcement included, as it should have, his unprofitable internal trades in its calculations, the estimate of profits would be considerably reduced.[170] Powers also contends the Firm lost no money, because it held substantial funds from Powers' accounts that offset any margin interest charges or other costs associated with his activity. A bar would be excessive not only because there was no loss, but also, Powers argues, because nobody was defrauded.[171] Finally, Powers argues that the Panel should not consider the 18 allegedly sham trades to be separate violations, but, citing the Sanction Guidelines, should apply the principle of "batching" them because they are similar transactions and part of the same course of conduct.[172]

2. Discussion

The Panel does not share Powers' view that Enforcement "cherry-picked" only profitable trades in its analysis of the 18 trades at issue. We find persuasive Segarra's explanation that Enforcement focused on trades between Powers' average price account and personal brokerage account that did not have corresponding market executions supporting the prices Powers set for the transactions, and that Enforcement did not exclude from its consideration trades on which Powers failed to profit. Furthermore, we do not conclude, as Powers does, that the absence of specific Firm supervisory procedures forbidding trading between his two accounts, or forbidding him from incurring margin interest charges in his average price account, supports the propriety of his conduct, or mitigates it.

We find, for the reasons we set forth above, that Powers' conduct was fraudulent, and accompanied by seriously aggravating circumstances, as Enforcement argued.

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[165] Tr. 1150–51, 1156–58.

[166] Tr. 1168.

[167] Tr. 1177.

[168] Tr. 1179–80.

[169] Tr. 1215.

[170] Tr. 1215–17

[171] Tr. 1220–21.

[172] Tr. 1222. Powers referred to Guidelines at 4, General Principal No. 4.

We find aggravating that Powers engaged in numerous acts in a pattern of misconduct for a prolonged period, from January through May 14, 2014.[173] He acted intentionally, deliberately devising the 18 sham trades, at times setting the prices outside the market high or low.[174] The Panel declines Powers' invitation to "batch" the trades, noting that the Guidelines provide for batching similar violations only if the conduct is unintentional, without fraudulent or deceptive intent. The Guidelines also state, with regard to batching, that it may not be appropriate when, as here, multiple violations are treated as an aggravating factor.[175]

We find aggravating that Powers has not accepted responsibility for the fraudulent trades.[176] He did not cooperate with FINRA's investigation; instead, he gave testimony that was misleading when he denied that he used the average price account for personal trading, and denied that he engaged in trades with no corresponding market executions.[177]

We also find aggravating that the 18 trades resulted in significant financial gain for Powers,[178] and financial loss for the Firm because it paid margin interest charges incurred when Powers held positions in the average price account for days and sometimes weeks.[179]

3. Conclusion

Taking into consideration these aggravating circumstances, and the mandate of the Sanction Guidelines to fashion a sanction that upholds the high standards of business conduct required by FINRA Rules, prevents Powers from engaging in similar future misconduct, and deters others from engaging in similar misconduct,[180] we conclude that a bar is appropriate in this case.

We concur with Enforcement that it is also appropriate to require Powers to disgorge the ill-gotten profits he garnered, in the amount of $388,133.[181] We exercise our discretion under the

[173] FINRA Sanction Guidelines, at 7 (Principal Consideration Nos. 8, 9) (2017), http://www.finra.org/industry/sanction-guidelines.pdf.

[174] *Id.*, at 8 (Principal Consideration No. 13).

[175] *Id.*, at 4 (General Principle No. 4).

[176] *Id.*, at 7 (Principal Consideration No. 2).

[177] *Id.*, at 8 (Principal Consideration No. 12).

[178] *Id.*, at 8 (Principal Consideration No. 16).

[179] *Id.*, at 7 (Principal Consideration No. 11). Powers' average price account had accumulated $27,644.77 in margin interest charges during the Relevant Period. Tr. 89–90; CX-58, at 185. Powers' error account had in the same period accumulated margin interest charges of $8,994.13. Tr. 88–89; CX-58, at 26.

[180] *Id.*, at 2 (General Principles No. 1).

[181] *See* Guidelines, at 5 (General Principles No. 6) (adjudicators may require disgorgement of ill-gotten gain when determining sanctions) and Guidelines, at 10 (disgorgement is appropriate even if an individual is barred in a sales practice case if it involves widespread, significant and identifiable customer harm or the respondent has retained substantial ill-gotten gains); *see also Dep't of Enforcement v. Akindemowo*, No. 2011029619301, 2015 FINRA Discip. LEXIS 58, at *50–51 (NAC Dec. 29, 2015) (ordering respondent to disgorge ill-gotten gains from converting investor funds), *aff'd*, Exchange Act Release No. 79007, 2016 SEC LEXIS 3769 (Sept. 30, 2016).

Guidelines and impose prejudgment interest on the disgorgement.[182] Powers shall pay prejudgment interest beginning from May 14, 2014, the date of the last of the sham trades, until disgorgement is paid. However, we decline to impose a fine, consistent with the statement in the Guidelines that a fine ought not to be imposed when a respondent is barred and there is no showing of customer harm.[183]

B. Unauthorized Trading: Fourth Cause of Action

The Guidelines recommend a fine of $5,000 to $110,000, and, when aggravating factors predominate, consideration of a bar for engaging in unauthorized transactions.

1. Arguments of the Parties

Enforcement, characterizing Powers' unauthorized trading of Netflix stock as egregious, recommends a bar and a fine of $110,000.[184] Enforcement argues that all six Principal Considerations in Determining Sanctions for unauthorized trading are present: Powers did not make the trades because he reasonably misunderstood the terms of customer orders; he acted in bad faith; he made the trades in and out of 12 customer accounts; the value of the Netflix stock shares was high, approximately $550,000; he tried to conceal his misconduct by the manner in which he booked the trades and by the conflicting and misleading explanations he gave when discovered; and the purpose of the unauthorized trades was to advance his manipulative trading scheme.[185]

Powers argues that he had a legitimate customer sell order, lost track of the customer, and did his best to find the customer by booking the position in the various accounts.[186]

2. Discussion

The Panel concurs with Enforcement's assessment that all six of the aggravating factors identified by the Guidelines in its Principal Considerations for unauthorized trading sanctions are present in this case. Powers engaged in the series of 12 unauthorized bookings of a half-million dollar Netflix short position in nine customer accounts to hide his losing position in the hope that the market would change in his favor and permit him to make the profitable Netflix trade he originally sought to accomplish. We reject as untruthful Powers' claim that he engaged in the

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[182] *See Department of Enforcement v. Davidofsky*, No. 2008015934801, 2013 FINRA Discip. LEXIS 7, at *43 (NAC Apr. 26, 2013) ("When assessing disgorgement, FINRA adjudicators should require payment of prejudgment interest on the amount to be disgorged, or explain in their decision why the payment of prejudgment interest is not appropriate to effectuate the purposes of equitable disgorgement. The rate of prejudgment interest is the rate established for the underpayment of income taxes in the Internal Revenue Code, which is the same rate we use when ordering interest on a restitution award.").

[183] Guidelines, at 10.

[184] Enforcement's Pre-Hr'g Br., at 27–28.

[185] Guidelines, at 99.

[186] Tr. 1199–1200.

trades to find the correct customer he said had given him the order. We find that Powers not only fails to take responsibility for his misconduct, but persists in adhering to a fabrication. We also consider as additional aggravating factors that there were 12 discrete, willful, and wrongful unauthorized trades, booked over a seven-week period.

3. Conclusion

Considering the number of unauthorized trades, the evidence that Powers engaged in them solely out of pecuniary self-interest, and that he acted without regard to the ethical implications of making unauthorized bookings to unwitting customer accounts, the Panel does not believe a suspension would suffice to decrease the likelihood Powers would engage in such misconduct in the future, or would deter others from engaging in similar misconduct. For these reasons, the Panel concludes a bar is the appropriate sanction, necessary to protect the investing public and to uphold the high standards of business conduct required of securities professionals.

As we noted above, however, in light of the bar, and consistent with Guideline recommendations,[187] absent evidence of customer loss and because Powers did not succeed in profiting from this course of misconduct, we decline to impose a fine.

C. Causing False Books and Records: Fifth Cause of Action

The Guidelines recommend a suspension of 10 business days to three months, and a fine of $1,000 to $15,000, for an individual's recordkeeping violations, absent aggravating factors. When aggravating factors predominate, the Guidelines recommend considering a suspension of up to two years, or a bar, and a fine of $10,000 to $146,000. The relevant Principal Considerations in Determining Sanctions for recordkeeping violations include whether the violation occurred over an extended period, and whether the violations served to conceal other misconduct.

1. Arguments of the Parties

Enforcement argues that Powers' recordkeeping violations merit a bar and a fine of $146,000 because of their egregiousness. Enforcement contends that the false and unauthorized trade executions Powers booked through the Firm's trading systems caused it to maintain misleading trading blotters and issue incorrect trade confirmations, thereby misrepresenting the business of the Firm. A consequence of Powers' sham trades is that several of the Firm's blotters were misleading and incorrect for several months. Enforcement argues that Powers engaged in this misconduct to conceal his fraudulent activity and for his personal advantage, and it reflects his disregard for the importance of maintaining accurate Firm books and records. Finally, Enforcement argues that Powers did this in part to avoid the consequences of holding a large, losing position in Netflix stock.[188]

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[187] Guidelines, at 10.

[188] Enforcement's Pre-Hr'g Br., at 29–30.

Powers counters Enforcement's recommendations with his argument that the recordkeeping violations merit at worst a suspension from ten business days to six months, characterizing them as reflecting merely "a problem . . . with how the orders were marked and how . . . they were reflected on the firm's system."[189]

2. Discussion

We conclude, after carefully considering the evidence and arguments of the parties, that the recordkeeping violations Powers caused are not egregious. In our view, although they caused the Firm to maintain inaccurate books and records, the misconduct did not rise to the level of seriousness Enforcement attributes to it, in terms of the number of inaccurate records and the degree to which they may have misled investors or regulators. However, we agree with Enforcement that Powers' misconduct reflected a cavalier disregard of the Firm's need to maintain accurate records, and that he caused the recordkeeping violations out of self-interest, to conceal his losing Netflix short position.

3. Conclusion

For these reasons, the Panel concludes that an appropriate sanction is a three-month suspension in all capacities and a fine of $15,000. In light of the two bars, however, we do not believe it necessary to impose these sanctions.

IX. ORDER

For engaging in a fraudulent scheme involving the execution of sham trades for his own profit, in violation of Exchange Act Section 10(b), SEC Rule 10b-5, and FINRA Rules 2020 and 2010, Respondent James Larkin Powers is barred from associating with any FINRA member firm in any capacity. Powers is also ordered to disgorge $388,133 in ill-gotten profits derived from his sham trading, plus prejudgment interest. For making unauthorized trades in customer accounts, failing to "observe the high standards of commercial honor and just and equitable principles of trade" in violation of FINRA Rule 2010, Powers is barred from associating with any FINRA member firm in any capacity. In light of the bars imposed, we decline to impose additional penalties for Powers' recordkeeping misconduct, in violation of FINRA Rules 4511 and 2010.

Because the evidence did not establish that Powers converted customer funds or made material misrepresentations or omissions to customers in trade confirmations, we dismiss the Complaint's second and third causes of action.

In addition, we assess Powers the cost of hearing transcripts and an administrative fee of $750, for a total of $8,921.48.[190]

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[189] Tr. 1221–22

[190] The Panel has considered and rejects without discussion any other arguments made by the Parties that are inconsistent with this decision.

The bar shall become effective immediately if this decision becomes the final disciplinary action of FINRA. The disgorgement (plus prejudgment interest) and assessed costs shall be due on a date set by FINRA, but not less than 30 days after this decision becomes FINRA's final disciplinary action in this proceeding.

Matthew Campbell
Hearing Officer
For the Extended Hearing Panel

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