

FINANCIAL INDUSTRY REGULATORY AUTHORITY¹
OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT,

Complainant,

v.

KEVIN GUZMAN
(CRD No. 4497415),

Respondent.

Disciplinary Proceeding
No. 20050000720-02

DEFAULT DECISION

Hearing Officer – SW

Date: April 9, 2008

Respondent Guzman was barred from associating with any FINRA member firm in any capacity for (i) excessive trading, churning, and making unsuitable recommendations in the joint account of two customers, (ii) intentionally or recklessly preparing false account applications for the customers, and (iii) making false representations to the customers regarding their account balances.

Appearances

Elissa M. Meth, Esq., Senior Regional Counsel, New York, NY, for the Department of Enforcement.

No appearance by or for Kevin Guzman.

DECISION

I. Procedural Background

On December 4, 2006, the Department of Enforcement (“Enforcement”) filed a four-count Complaint against two respondents, Kevin Guzman and [REDACTED]. Counts one, two, and three of the Complaint contain allegations against Respondent Guzman regarding the trading in the account of customers CSR and SG at Joseph Stevens & Co., Inc. (“Joseph

¹ As of July 30, 2007, NASD consolidated with the member firm regulation functions of NYSE and began operating under a new corporate name, the Financial Industry Regulatory Authority (FINRA). References in this decision to FINRA include, where appropriate, NASD.

Stevens"). At an August 2007 hearing, Respondent [REDACTED] responded to the allegations of count four of the Complaint that he failed to adequately supervise Respondent Guzman at Joseph Stevens.² Accordingly, this Default Decision only addresses the three counts of the Complaint that relate to Respondent Guzman.

Count one of the Complaint alleges that, during the period October 2003 to November 2004, Respondent Guzman engaged in excessive trading, churning, and making unsuitable recommendations in the Joseph Stevens account of customers CSR and SG, in violation of Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act"), SEC Rule 10b-5 thereunder, NASD Conduct Rules 2110, 2120 and 2310(a), and IM-2310-2(b)(2). Count two of the Complaint alleges that in 2003, Respondent Guzman prepared Joseph Stevens account applications for customers CSR and SG with false information, in violation of NASD Conduct Rules 3110(a) and 2110. Count three of the Complaint alleges that in 2004, Respondent Guzman made misrepresentations to customers CSR and SG regarding their account balances, in violation of NASD Conduct Rule 2110.³

On January 28, 2008, Enforcement filed a motion for entry of a default decision ("Motion") against Respondent Guzman with respect to counts one, two, and three of the Complaint. Enforcement supported its Motion with (i) an affidavit of Elissa M. Meth, Esq., Senior Regional Counsel in FINRA's New York, NY office, (ii) exhibits accepted at the August

² A Hearing Panel issued a decision as to count four of the Complaint with respect to Respondent [REDACTED] on December 11, 2007.

³ The NASD Conduct Rules on their face may apply only to member firms. However, NASD Conduct Rules regarding members are applicable to associated persons, such as Respondent Guzman, because NASD General Rule 0115(a) provides that associated persons "shall have the same duties and obligations as a member under these Rules."

2007 Hearing, and (iii) 38 additional attached exhibits.⁴ For the reasons set forth below, the Hearing Officer grants Enforcement's Motion.

II. Default of Respondent Guzman

On December 4, 2006, Enforcement served the Complaint and Notice of Complaint on Respondent Guzman by sending the Complaint and Notice of Complaint, via first class and certified mail, to his address of record in FINRA's Central Registration Depository ("CRD").⁵ (DECL at ¶¶ 7, 8; CX-100; HCX-2, p. 1). Respondent Guzman failed to file an answer to the Complaint. (DECL at ¶ 11).

On January 3, 2007, Enforcement served the Complaint and Second Notice of Complaint on Respondent Guzman at his CRD address. (CX-102, p. 2). The first class mailing and the certified mailing were returned with a sticker indicating a first alternate address.⁶ (DECL at ¶¶ 13, 14; CX-103; CX-104). Respondent Guzman did not file an answer to the Second Notice of Complaint. (DECL at ¶ 16).

On January 24, 2007, Enforcement served a Third Notice of Complaint and Complaint on Respondent Guzman at the CRD address and the first alternate address via Federal Express, first class mail, and certified mail. (DECL at ¶ 17; CX-105, p. 3). The U.S. Postal Service returned the certified mailing sent to the first alternate address with a sticker showing a second alternate

⁴ Hereinafter, the statements in the attached Complaint will be designated as "Complaint at ¶"; the statements in the Motion will be designated as "Motion, p."; the statements in the Meth Declaration will be designated as "DECL at ¶"; and Enforcement's exhibits attached to the Motion will be designated as "CX-," with the appropriate page or paragraph numbers. In addition, exhibits offered by Enforcement and accepted at the August 2007 Hearing will be designated as "HCX-," with the appropriate page or paragraph numbers.

⁵ Respondent Guzman's CRD address is [REDACTED] (DECL at ¶ 8; HCX-2, p. 1).

⁶ The first alternate address is [REDACTED] (CX-101; CX-103).

address.⁷ (DECL at ¶ 21; CX-108). Respondent Guzman did not answer the Third Notice of Complaint. (DECL at ¶ 25).

On February 26, 2007, the Hearing Officer served an order on Respondent Guzman at his CRD address, via Federal Express and first class mail, scheduling a pre-hearing conference on March 5, 2007. Respondent Guzman failed to appear at the March 5, 2007 pre-hearing conference. Subsequently, on April 3, 2007, the Hearing Officer issued an Order to Show Cause, instructing Respondent Guzman to demonstrate why he should not be held in default. The Order to Show Cause was served on Respondent Guzman, via Federal Express and first class mail, at his CRD address. Respondent Guzman did not respond to the Order to Show Cause. Accordingly, the Hearing Officer issued an order on April 25, 2007, holding Respondent Guzman in default pursuant to Code of Procedure Rules 9241(f) and 9269.

Following the August 2007 Hearing, on January 8, 2008, Enforcement served a Fourth Notice of Complaint and Complaint on Respondent Guzman at his CRD address, the first alternate address, the second alternate address, and three additional addresses that were listed on a December 6, 2006 Form U-6 filing for Respondent Guzman.⁸ (DECL at ¶ 26; CX-111, pp. 3-4; CX-112, p. 1). Enforcement served the Fourth Notice of Complaint and Complaint on all six addresses via Federal Express, first class mail, and certified mail. (DECL at ¶ 26; CX-111, pp. 3-4). The three additional addresses were prior residences that Respondent Guzman has not lived at since at least 2002. (DECL at ¶ 26; CX-123). To date, Respondent Guzman has not filed an answer to the Complaint. (DECL at ¶ 47).

⁷ The second alternate address is [REDACTED] (DECL at ¶ 21; CX-108).

⁸ The three additional addresses were (1) [REDACTED] (2) [REDACTED] and (3) [REDACTED] (DECL at ¶ 26; CX-112, p. 1).

The Hearing Officer finds that Enforcement complied with Rule 9134(b)(1) by sending the mailings to Respondent Guzman's CRD address and the alternative addresses.⁹ Finding that Respondent Guzman received effective constructive notice of this proceeding, and failed to file an Answer or otherwise respond, the Hearing Officer confirms her previous finding that Respondent Guzman defaulted.¹⁰

III. Findings of Fact and Conclusions of Law

A. Jurisdiction

Respondent Guzman first became associated with a FINRA member when he joined Ladenburg Capital Management, Inc. ("Ladenburg") on January 17, 2002. (HCX-2, p. 11). Respondent Guzman was registered at Ladenburg from February 6, 2002 to September 2, 2003.¹¹ (HCX-2, pp. 10-11).

From August 29, 2003 through December 17, 2004, Respondent Guzman was registered with Joseph Stevens as general securities representative. (HCX-2, p. 9).

After his employment with Joseph Stevens ended, Respondent Guzman was registered as a general securities representative with two other FINRA member firms. (HCX-2, pp. 5, 7). Respondent Guzman's association with National Securities Corporation, the last FINRA member firm with which he was associated, ended on September 6, 2006, when National Securities Corporation terminated Respondent Guzman's registration, noting that "RR absent without notice or explanation to the Firm. RR failed to report receipt of a Wells Letter on [Form] U-4."

⁹ See *Dep't of Enforcement v. Verdiner*, No. CAF020004, 2003 NASD Discip. LEXIS 42, at * 5 n.1 (NAC Dec. 9, 2003) (finding that respondent received constructive notice when the complaint was mailed to respondent's CRD address).

¹⁰ The following Findings of Fact and Conclusions of Law incorporate the allegations in the attached Complaint, pursuant to NASD Rules 9215(f) and 9269, and *NASD Notice to Members* 99-77.

¹¹ In November 2002, there was a mass transfer from Ladenburg Capital Management to Ladenburg, Thalmann & Co., Inc. (HCX-2, p. 3).

(Complaint at ¶ 6; HCX-2, pp. 25-26). Respondent Guzman is not currently associated with any FINRA member firm. (Complaint at ¶ 7; HCX-2, p. 5; DECL at ¶ 8).

Nevertheless, Respondent Guzman remains subject to FINRA's jurisdiction for purposes of this proceeding, pursuant to Article V, Section 4 of the NASD By-Laws, because (1) the Complaint was filed within two years after his association with National Securities Corporation was terminated, and (2) the Complaint charges him with misconduct while he was associated with a FINRA member.

B. Background

FINRA began its investigation of Respondent Guzman as the result of an amended Form U-5 filed by Joseph Stevens in January 2006 reporting a verbal complaint by customer CSR. (HCX-3, p. 3; DECL at ¶ 49).

1. Respondent Guzman's Customers CSR and SG

In 2003, CSR was 61-years old and had retired as a production supervisor from Chesebrough-Ponds in Puerto Rico. (Complaint at ¶ 14; HCX-77). CSR had a high school education, but no training in finance. (*Id.*). CSR's wife, SG, was in her 50's and had worked as a machine operator; she stopped working approximately seven years ago. (Complaint at ¶¶ 13, 15). By 2003, CSR and SG had accumulated savings of over \$300,000. (Complaint at ¶ 16; HCX-77).

In January 2003, Respondent Guzman met with CSR and SG in Puerto Rico, and convinced them to invest with him. (Complaint at ¶ 17; HCX-77). CSR and SG are the uncle and aunt of Respondent Guzman. (Complaint at ¶¶ 13, 15; HCX-77).

At the time, CSR told Respondent Guzman that (i) the money they were investing with him represented their life savings; (ii) they needed the money for their retirement; and (iii) the money should be invested safely. (Complaint at ¶ 18; HCX-77). Respondent Guzman assured

CSR and SG that he understood their need to preserve their funds; and that he would make sure that they never suffered any sizeable losses in their account. (*Id.*)

In February 2003, CSR and SG opened a joint account at Ladenburg and deposited their entire savings of approximately \$300,000 in the account. (Complaint at ¶¶ 19, 21). At the time, CSR and SG's net worth was under \$500,000, and their joint income for the year 2002 was under \$60,000. (Complaint at ¶ 20). CSR and SG's only prior investment experience consisted of investments in a few mutual funds that they did not trade after purchasing. (Complaint at ¶ 36).

Although the Ladenburg account documents for the joint account indicated that CSR and SG's investment objective was speculation, Respondent Guzman invested the \$300,000 in Class A mutual funds. (Complaint at ¶ 22; HCX-44; HCX-49).

Respondent Guzman agreed to send CSR and SG approximately \$3,000 per month from their Ladenburg account as a supplement to CSR's social security benefits. (Complaint at ¶ 23). From May 2003 through August 2003, CSR and SG received approximately \$11,000 in disbursements from their Ladenburg account. (*Id.*).

2. CSR and SG's Joseph Stevens Account

When Respondent Guzman left Ladenburg to join Joseph Stevens, he asked CSR and SG to transfer their Ladenburg account to his new firm. (Complaint at ¶ 24). They agreed. (*Id.*).

In September 2003, CSR and SG signed a Joseph Stevens new account application. (Complaint at ¶ 25). At that time, their net worth remained approximately what it had been in February 2003, *i.e.*, under \$500,000, and their investment objective remained the same, *i.e.*, they wanted their money to be invested safely and conservatively. (*Id.*).

In October 2003, the mutual funds that CSR and SG had purchased at Ladenburg were transferred to Joseph Stevens and held in a Joseph Stevens account for CSR and SG ("Account").

(Complaint at ¶ 26). At the end of October 2003, the market value of the customers' Account was \$331,682.09. (Complaint at ¶ 26; CX-50).

In October 2003, Respondent Guzman sold all of CSR and SG's mutual funds transferred from their Ladenburg joint account. (Complaint at ¶ 27; CX-50). Respondent Guzman invested 100% of the proceeds in the common stock and options for a single technology company. (*Id.*). In November and December of 2003, Respondent Guzman made margin purchases and sales of a single pharmaceutical company. (*Id.*). By the end of January 2004, Respondent Guzman sold all of the Account's stock of the original technology company that it had held. (*Id.*).

For the rest of the life of the Account, until November 2004, Respondent Guzman invested the Account's assets on a rotating basis in a few technology and pharmaceutical companies, and most of the time, 100% of the Account's assets were held in one, two, or three stocks. (*Id.*).

From October 2003 through November 2004, Respondent Guzman directed over 100 transactions in the Account. (Complaint at ¶ 39.a). Purchases in the Account totaled \$2,534,198, using average monthly account equity of \$106,445.40. (*Id.*). The Account's cost-to-equity ratio was at least 176.05%. (Complaint at ¶ 39.c).

From October 2003 through November 2004, CSR and SG lost approximately \$280,000 of their initial investment with Joseph Stevens. (Complaint at ¶ 35). During the same period, the Account was charged \$182,996 in commissions, mark-ups, and mark-downs, which represented approximately 55% of CSR and SG's initial investment with Joseph Stevens. (Complaint at ¶¶ 35, 39.e).

Respondent Guzman executed frequent short-term, or “in and out,” buying and selling in the Account. (Complaint at ¶ 39.f). The turnover rate was at least 23.807, indicating that the securities in the Account were replaced by new securities at least 23 times. (Complaint at ¶ 39.d).

During the relevant period, Respondent Guzman directed all of the transactions in the Account, including from February 2004 to June 2004, when the Account was assigned to the partnership between Respondent Guzman and Respondent [REDACTED]¹² (Complaint at ¶¶ 37, 38). CSR and SG accepted all or virtually all of Respondent Guzman’s recommendations for the transactions. (Complaint at ¶ 37). The customers did not understand the information in the account statements that they received, and they could not discern whether the Account was generating a profit or loss. (Complaint at ¶ 36). When the Account was closed in November 2004, its value was approximately \$2,200. (Complaint at ¶ 29).

C. Respondent Guzman Engaged in Excessive Trading, Churning, and Made Unsuitable Recommendations

Count one of the Complaint alleges that Respondent Guzman recommended and effected unsuitable and excessive transactions in customer CSR and SG’s Account, in violation of NASD Conduct Rules 2110 and 2310, and IM-2310-2, and churned that same Account, in violation of Section 10(b) of the Securities Exchange Act, SEC Rule 10b-5 promulgated thereunder, and NASD Conduct Rules 2120 and 2110.

NASD Conduct Rule 2310(a) requires that, in recommending to a customer the purchase, sale, or exchange of any security, an associated person must have reasonable grounds for believing that the recommendation is suitable for the customer based on facts disclosed by the customer as to his other securities holdings and his financial situation and needs.

¹² CSR and SG’s Account was listed as being serviced by the joint partnership of Respondent Guzman and Respondent [REDACTED] from February 2004 to July 2004. (Complaint at ¶ 31).

Recommendations may violate Rule 2310 when they are either qualitatively unsuitable, *i.e.*, the quality of the recommended transactions, or quantitatively unsuitable, *i.e.*, the frequency of the recommended transactions.¹³ Respondent Guzman's recommendations were both qualitatively and quantitatively unsuitable.

1. Unsuitable Trading in the Account

The SEC has repeatedly found that a high concentration of investments in one or a limited number of speculative securities is not suitable for investors seeking limited risk.¹⁴ CSR and SG wanted their money invested conservatively so that their Account would provide them with income to supplement their social security.¹⁵ Instead, Respondent Guzman invested the Account's assets on a rotating basis in a few technology and pharmaceutical companies, and most of the time, 100% of the Account's assets were held in one, two, or three stocks, some of which were speculative. The lack of sufficient diversity in the investments recommended by Respondent Guzman was inconsistent with CSR and SG's articulated investment objective of safety and income. (HCX-77).

2. Excessive Trading in the Account

A representative's recommendations are quantitatively unsuitable when they generate excessive trading.¹⁶ Excessive trading occurs when (i) a broker has control over trading in an

¹³ *Daniel Richard Howard*, Exch. Act Rel. No. 46,269, 2002 SEC LEXIS 1909 (July 26, 2002).

¹⁴ *Stephen Rangen*, Exch. Act Rel. No. 38,486, 1997 SEC LEXIS 762, at *10 (Apr. 8, 1997) ("by concentrating so much of their equity in particular securities, Rangen increased the risk of loss for these individuals beyond what is consistent with the objective of safe, nonspeculative investing").

¹⁵ From October 2003 to November 2004, CSR and SG received monthly disbursements of approximately \$3,000 from their Account. (HCX-82).

¹⁶ *Dep't of Enforcement v. Stein*, Complaint No. C07000003, 2001 NASD Discip. LEXIS 38, at *9 (NAC Dec. 3, 2001).

account, and (ii) the level of activity in that account is inconsistent with the customer's objectives and financial situation.¹⁷

Control is established if the broker exercises de facto control of the account.¹⁸ De facto control "may be shown when the client does not understand the trading activity in his or her account or routinely follows the broker's advice."¹⁹ Respondent Guzman exercised de facto control over the Account for the entire period of October 2003 through November 2004 because customers CSR and SG did not understand the trading activity in their Account, and they relied on Respondent Guzman's advice.

While there is no single test to determine whether trading is excessive, a high turnover rate, a high cost-to-equity ratio, and evidence of "in-and-out" trading in a customer's account may all provide a basis for a finding of excessive trading.²⁰ Where a broker has de facto control over a customer's account, a high turnover rate by itself may be sufficient to establish excessive trading.²¹ The Securities and Exchange Commission has held that "a turnover rate of 6 or a cost-to-equity ratio in excess of 20% generally indicates that excessive trading has occurred."²² Both the turnover rate and the cost-to-equity ratio for CSR and SG's Account far exceeded those parameters. The turnover rate for CSR and SG's Account was at least 23.807, and the cost-to-equity ratio was at least 176%. (Complaint at ¶¶ 39.d, 39.c). On an annualized basis, the

¹⁷ *Id.*

¹⁸ *Rafael Pinchas*, Exch. Act Rel. No. 41, 816, 1999 SEC LEXIS 1754, at *18 (Sept. 1, 1999).

¹⁹ *Id.*

²⁰ "The term 'in and out' trading denotes the sale of all or part of a customer's portfolio, with the money reinvested in other securities, followed by the sale of the newly acquired securities. In and out trading is a practice extremely difficult for a broker to justify." *DBBC v. Gliksman*, Complaint No. C02960039, 1999 SEC LEXIS 12, at *27-28 (NAC Mar 31, 1999).

²¹ *Pinchas*, 1999 SEC LEXIS 1754, at *18.

²² *Howard*, 2002 SEC LEXIS 1909, at *8. See also *David Wong*, Exch. Act Rel. No. 45,426, 2002 SEC LEXIS 339, at *14, n.18 (Feb. 8, 2002); *Peter C. Bucchieri*, 1996 SEC LEXIS 1331, at *11, n.11, citing *Mihara v. Dean Witter & Co., Inc.*, 619 F.2d 814, 821 (9th Cir. 1980); *Pinchas*, 1999 SEC LEXIS 1754, at *18.

turnover rate for CSR and SG's Account was at least 20.41, and the cost-to-equity ratio was at least 150.90%. (*Id.*).

In addition, Respondent Guzman directed frequent short-term, or "in and out" buying and selling of securities. (Complaint at ¶ 39.f). For example, on January 26, 2004, Respondent Guzman bought 5,000 shares of American Pharm. (*Id.*). He sold all of those shares four days later for a realized loss of \$32,024. (*Id.*). On March 3, 2004, Respondent Guzman bought 10,000 shares of Comtech. (*Id.*) Respondent Guzman sold all of the shares approximately eleven days later for a realized loss of \$22,473. (*Id.*).

There is no evidence that would justify that quantity of trading given CSR and SG's age, financial situation, and investment objectives. Based on the allegations deemed admitted in the Complaint, the Hearing Officer finds that Respondent Guzman engaged in a level of trading activity in CSR and SG's Account that was excessive and at odds with the customers' financial needs and authentic investment objectives.

Moreover, NASD Conduct Rule 2310 encompasses a "fundamental responsibility for fair dealing" that a registered representative has to his or her customers.²³ A violation of Conduct Rule 2310 is also a violation of Rule 2110, in contravention of "just and equitable principles of trade."²⁴

3. Churning in the Account

"Churning occurs when a securities broker buys and sells securities for a customer's account, without regard to the customer's investment interests, for the purpose of generating

²³ See IM-2310-2(b)(2). See also *Larry Ira Klein*, Exch. Act Rel. No. 37,835, 1996 SEC LEXIS 2922, at **16-17 (Oct. 17, 1996) (citing *John M. Reynolds*, Exch. Act Rel. No. 30,036, 1991 SEC LEXIS 2725, at *10, n.13 (Dec. 4, 1991)).

²⁴ *Howard*, *supra*, 2002 SEC LEXIS 1909, at *8.

commissions.”²⁵ Churning violates the antifraud provisions of Section 10(b) of the Exchange Act, SEC Rule 10b-5, and NASD Conduct Rules 2120 and 2110.²⁶ Churning may be found where the broker exercised control over an account, trading was excessive in light of the investment objectives, and the broker acted with intent to defraud or with reckless disregard for the interests of the customer.²⁷

As noted above, Respondent Guzman exercised control over CSR and SG’s account, and his trading in the account was excessive in light of their investment objectives. The question is whether the volume of transactions, in light of the nature and objectives of the Account, was so excessive as to indicate that Respondent Guzman intended to profit at his customers’ expense.²⁸ For the reasons that follow, the Hearing Officer concludes that the volume was so excessive as to compel a finding of scienter.

At the time of the excessive trading, CSR was retired and SG had not worked for a number of years. They were living on Social Security payments and disbursements from their Account. They told Respondent Guzman that the money they invested with him constituted their entire life savings and they needed it for retirement. Accordingly, the customers had a low tolerance for risk.

Nevertheless, from October 2003 through November 2004, Respondent Guzman directed over 100 transactions in the Account. (Complaint at ¶ 39.a). Purchases totaled \$2,534,198, using average monthly account equity of \$106,445.40. (*Id.*).

²⁵ *Sandra K. Simpson*, Exch. Act Rel. No. 45,923, 2002 SEC LEXIS 1278, at *52 (May 14, 2002), quoting *Olson v. E.F. Hutton & Co.*, 957 F.2d 622, 628 (8th Cir. 1992).

²⁶ *Donald A. Roche*, Exch. Act Rel. No. 38,742, 1997 SEC LEXIS 1283 (June 17, 1997); *Dep’t of Enforcement v. U.S. Rica Financial, Inc.*, No. C0100003, 2003 NASD Discip. LEXIS 24, at *14, n.5 (NAC Sept. 9, 2003).

²⁷ See *Dep’t of Enforcement v. Castle Securities*, No. C3A010036, 2004 NASD Discip. LEXIS 1, at *14 (NAC Feb. 19, 2004); *Roche*, 1997 SEC LEXIS 1283, at **12-13.

²⁸ *Id.*

Respondent Guzman's pattern and level of trading activity in the Account during this period, considered in light of CSR and SG's financial situation and needs, demonstrated that his purpose was to derive a profit for himself at the expense of CSR and SG. (Complaint at ¶ 39.h). Indeed, the high cost-to-equity ratio is compelling evidence that Respondent Guzman recommended and effected the trades for his own benefit without regard for CSR and SG's resources or best interests.

The allegations in the first cause of the Complaint, which are deemed admitted, are sufficient to establish for purposes of this Default Decision that Respondent Guzman acted with scienter and churned CSR and SG's Account, in violation of Section 10(b) of the Exchange Act and SEC Rule 10b-5 thereunder, as well as NASD Conduct Rules 2120 and 2110.

D. Respondent Guzman Created Inaccurate Account Documents

Count two of the Complaint alleges that Respondent Guzman included false financial information and investment experience on CSR and SG's Joseph Stevens account application documents, in violation of NASD Conduct Rules 3110(a) and 2110.

In 2003, when Respondent Guzman initially solicited CSR and SG to open an account with him at Ladenburg, he prepared or caused to be prepared new account applications for CSR and SG's account at Ladenburg. (Complaint at ¶ 44). The Ladenburg applications indicated that CSR and SG's income was \$100,000, their liquid net worth was \$500,000, and their net worth was \$1,000,000. (Complaint at ¶ 44; HCX-44). The Ladenburg applications also indicated that CSR had 10 years of investment experience. (*Id.*).

When Respondent Guzman joined Joseph Stevens and solicited CSR and SG to transfer their assets from Ladenburg to Joseph Stevens, Respondent Guzman prepared or caused to be prepared and completed portions of the following documents for the Account:

- (1) a new account application dated September 2, 2003 (the Initial Application);
- (2) an account update application dated October 20, 2003 (the Update Application); and
- (3) an application for the opening of an option account dated October 20, 2003 (the Option Application). (Complaint at ¶ 45; HCX-45; HCX-46; HCX-47).

Respondent Guzman sent the completed documents to CSR and SG and instructed them to sign the documents. (Complaint at ¶ 45). After CSR and SG returned the signed copies of the documents, Respondent Guzman signed the documents as the Joseph Stevens account executive. (*Id.*).

The Initial Application contained income, net worth, and investment experience information substantially different from and inconsistent with the information contained in (1) the prior Ladenburg applications,²⁹ (2) the subsequent Update Application, and the (3) the Option Application. (Complaint at ¶ 46).

The information differed as follows:

Document	Date	Income	Liquid Net Worth/Net Worth	Investment Experience
Ladenburg Applications	January and March 2003	\$100K	\$500K/ \$1 million	10 Years
Initial Application	September 2, 2003	\$60K	\$1.5 million/ \$600K ³⁰	6 Years
Update Application	October 20, 2003	\$200K	\$600K/ \$1.5 million	20 Years
Option Application	October 20, 2003	\$200K	\$600K/ \$1.5 million	20 Years in Options/Stocks/Bonds

Except for the \$60,000 income recorded on the Initial Application, the financial information and investment experience recorded on the Initial Application, the Update

²⁹ CSR and SG actually opened six accounts at Ladenburg with Respondent Guzman as the investment representative, but only two of the accounts were funded. (HCX-17; HCX-49). None of the Ladenburg accounts is at issue in this case.

³⁰ Clearly, the liquid net worth and net worth were inadvertently switched when written on the Initial Application.

Application, and the Option Application were inaccurate and overstated. (Complaint at ¶ 47).

Respondent Guzman knew or should have known that the Account documents contained inaccurate and misleading information about CSR and SG's financial profile and needs.³¹ (Complaint at ¶ 43).

NASD Conduct Rule 3110(a) provides, in part, that each member shall make and preserve books, accounts, records, memoranda, and correspondence as prescribed by SEC Rule 17a-3. SEC Rule 17a-3(a) provides that every broker or dealer shall make and keep current certain books and records including, among other things, an account record showing the "customer's name, . . . annual income, net worth (excluding value of primary residence), and the account's investment objectives." Accordingly, it is a violation of NASD Conduct Rule 3110(a) to enter false information on account records.³²

The allegations in the second cause of the Complaint, which are deemed admitted, are sufficient to establish for purposes of this Default Decision that Respondent Guzman created inaccurate Account documents for customers CSR and SG, in violation NASD Conduct Rules 3110 and 2110.

E. Respondent Guzman Made Several Misrepresentations to Customer CSR

Count three of the Complaint alleges that in connection with queries by customer CSR regarding his Account, Respondent Guzman made several false statements to CSR, in violation of NASD Conduct Rule 2110. (Complaint at ¶ 51).

³¹ The Joseph Stevens' Option Procedure Memorandum required a minimum income of \$100,000 for customers to be eligible to engage in option trading. (Complaint at ¶ 48).

³² *In re Charles E. Kautz*, Exch. Act Rel. No. 37,072, 1996 SEC LEXIS 994 (Apr. 5, 1996) (affirming a FINRA decision that respondent violated the predecessor provision to Rule 2110 by entering false information on official firm records).

Specifically, the Complaint alleges that in mid-2004, Respondent Guzman misrepresented to CSR and SG, at a dinner in New York City, that because the market was not doing well, he had stopped placing trades for the Account. (Complaint at ¶ 51.a). During that time period, Respondent Guzman continued to actively trade the Account. (*Id.*). At the same dinner, Respondent Guzman misrepresented to customers CSR and SG that the value of the Account was in the high \$200,000 range. (Complaint at ¶ 51.b). At all times during the mid-2004 time period, the Account's value was significantly less than \$200,000. (*Id.*).

On or about October 20, 2004, Respondent Guzman, at CSR's request, falsely promised to send CSR \$10,000 from the Account. (Complaint at ¶ 51.c). Respondent Guzman repeatedly assured CSR that he would receive \$10,000, but CSR never received a \$10,000 check. (*Id.*). In fact, Respondent Guzman could not have fulfilled his promise because the Account was worth less than \$10,000. (Complaint at ¶ 51.d).

On or about November 2004, CSR inquired about the value of the Account. (*Id.*). Respondent Guzman misrepresented to CSR that the Account was worth \$270,000. (*Id.*). The Account was worth less than \$7,500 at the end of September 2004, and its value only decreased thereafter. (*Id.*).

On or about November 2004, Banco Bilboa, a bank located in Puerto Rico, at CSR's direction, requested the transfer of the Account's balance to Banco Bilboa. (Complaint at ¶ 51.e). After a Banco Bilboa representative reported to CSR that the bank had received the Account's balance of approximately \$2,200, customer CSR contacted Respondent Guzman. (*Id.*). Respondent Guzman told CSR that the \$2,200 was a small account that held the cash for CSR's monthly disbursements, and that the \$270,000 was held in a separate account, which Respondent Guzman had opened to avoid risking loss in an unstable market. (*Id.*).

Respondent Guzman suggested that Banco Bilboa resubmit the transfer forms. (*Id.*). After Banco Bilboa made a second request to Joseph Stevens, and confirmed that the Account's balance was \$2,200, Respondent Guzman informed CSR that the bank was not handling the transfer properly and that he would send the money to CSR. (*Id.*).

When CSR did not receive the check, he contacted Respondent Guzman again, who told him that the check had been returned because it was delivered to the wrong address, but that the check would be re-sent by Federal Express, and that CSR should have the check by Thanksgiving Day. (*Id.*). CSR never received a check from Respondent Guzman. (*Id.*).

In December 2004, CSR contacted Joseph Stevens and was told that Respondent Guzman no longer worked at Joseph Stevens. (Complaint at ¶ 51.f). A Joseph Stevens' representative provided CSR with the name of Respondent Guzman's new employer. (*Id.*). When CSR spoke with Respondent Guzman at his new firm, Respondent Guzman falsely assured CSR that his money was safe, but that CSR should contact Joseph Stevens to find out what happened to his money. (*Id.*).

NASD Conduct Rule 2110 requires registered representatives to observe "high standards of commercial honor" and "just and equitable principles of trade." Misrepresentations and omissions that mislead customers violate Conduct Rule 2110.³³ Proof of scienter is not required to prove a misrepresentation violation under Conduct Rule 2110.³⁴ Respondent Guzman's false representations concerning the customers' Account were made to conceal from the customers the losses that had occurred in the Account.

³³ Rule 2110 applies to all business related misconduct, regardless of whether the misconduct involved securities. See *Dept. of Enforcement v. James S. Davenport*, Complaint No. C05010017, NASD Discip. LEXIS 4, at *8-9 (NAC May 7, 2003); See also *DBCC No. 10 v. Lucadamo*, Complaint No. C109300053, 1997 NASD Discip. LEXIS 35 at *35 (NBCC May 20, 1997) (respondent violated predecessor of NASD Conduct Rule 2110 by negligently omitting material facts and/or negligently making misrepresentations in discussions with customers).

³⁴ *DBCC v. Euripides*, Complaint No. C9B950014, 1997 NASD Discip. LEXIS 45, at *18 (NBCC July 28, 1997).

The allegations in the third cause of the Complaint, which are deemed admitted, are sufficient to establish for purposes of this Default Decision that Respondent Guzman made misrepresentations, in violation of NASD Conduct Rule 2110.

IV. Sanctions

A. Respondent Guzman Barred for His Excessive Trading, Churning and Unsuitable Recommendations

Enforcement seeks a bar for count one of the Complaint. (Motion, p. 18). Enforcement does not request restitution because the customers received restitution via settlement of their arbitration claims against Joseph Stevens. (Motion, p. 21).

FINRA Sanction Guidelines for churning and excessive trading recommend a fine of \$5,000 to \$75,000 and a suspension in any or all capacities for a period of 10 business days to one year.³⁵ In egregious cases, the Guidelines recommend a longer suspension of up to two years or a bar.³⁶ The Guidelines for unsuitable recommendations recommend a fine of \$2,500 to \$75,000 and a suspension in any or all capacities for a period of 10 business days to one year.³⁷ In egregious cases, the Guidelines recommend a longer suspension (of up to two years) or a bar.³⁸

Respondent Guzman's misconduct was egregious. As noted above, Respondent Guzman:

- (1) engaged in the misconduct over an extended period of time, in excess of one year;
- (2) attempted to conceal his misconduct and to lull his customers into inactivity by misrepresenting the Account's value as more than \$200,000; (3) caused severe injury to his

³⁵ *FINRA Sanction Guidelines*, p. 82 (2007), available at <http://www.finra.org/web/groups/enforcement/documents/enforcement/p011038.pdf>.

³⁶ *Id.*

³⁷ *Id.* at 99.

³⁸ *Id.*

customers, a loss of \$280,000 of the customers' \$300,000 investment; (4) acted intentionally or at least recklessly; (5) acted to achieve significant financial gain for himself; (6) engaged in numerous trades, in excess of 100; and (7) took advantage of unsophisticated customers by taking their life savings, which he knew they could ill afford to lose.

Motivated solely by the opportunity to enrich himself through commissions, Respondent Guzman gave no consideration to his uncle and aunt's needs, financial situation, or investment objectives. Accordingly, the Hearing Officer agrees that Respondent Guzman's misconduct was egregious and warrants a bar.

B. Respondent Guzman is Barred for Creating Inaccurate New Account Documents for the Account

The Guidelines for recordkeeping violations recommend a fine of \$1,000 to \$10,000 and a suspension in any or all capacities for 30 business days.³⁹ In egregious cases, the Guidelines recommend that the adjudicator impose fines of \$10,000 to \$100,000 and a lengthier suspension (of up to two years) or a bar.⁴⁰ A principal consideration in determining sanctions for this violation is the nature and materiality of the inaccurate or missing information.⁴¹

Enforcement argued that Respondent Guzman's misconduct was egregious and warranted a six-month suspension. (Motion, p. 19).

The account documents that Respondent Guzman falsified were done intentionally to thwart Joseph Stevens' customer safeguards. Pursuant to Joseph Stevens' Option Procedure Memorandum, customers CSR and SG were not eligible to trade options at Joseph Stevens based on the \$60,000 income figure shown on their Initial Application because Joseph Stevens required

³⁹ *Id.* at 30.

⁴⁰ *Id.*

⁴¹ *Id.*

a minimum income of \$100,000 to trade options. (Complaint at ¶ 48). By falsely increasing the income figure to \$200,000 on the Update Application and the Option Application, Respondent Guzman was able to execute a covered option writing program, which generated commissions of approximately \$53,000 and caused the Account to realize a net loss of approximately \$50,000. (Complaint at ¶¶ 39.f, 49). Respondent Guzman's intentional decision to falsify the Account documents permitted Respondent Guzman to obtain significant financial gain and to inflict severe injury on his customers. Accordingly, the Hearing Officer finds that Respondent Guzman's misconduct was so egregious as to warrant a bar rather than the six-month suspension recommended by Enforcement.

**C. Respondent Guzman Barred for Making Misrepresentations to Customers
CSR and SG**

The Guidelines for intentional or reckless misrepresentations or material omissions of fact recommend a fine of \$10,000 to \$100,000 and a suspension in any or all capacities for a period of 10 business days to two years.⁴² In egregious cases, a bar is recommended.⁴³

For this misconduct, Enforcement recommended a bar, arguing that Respondent Guzman's conduct was egregious. (Motion, p. 20). Respondent Guzman intentionally and repeatedly lied to his customers about the value of their account and the location of their assets. He did so in an attempt to conceal his misconduct, mislead his customers, and retain his commissions from the misconduct. Finding that Respondent Guzman's misconduct was egregious, the Hearing Officer agrees that his misconduct warrants a bar.

⁴² *Id.* at 93.

⁴³ *Id.*

V. Order

Respondent Guzman is barred from associating with any FINRA member firm in any capacity for: (i) excessive trading, churning, and making unsuitable recommendations in the Joseph Stevens account of customers CSR and SG, in violation of Section 10(b) of the Exchange Act, SEC Rule 10b-5 thereunder, NASD Conduct Rules 2110, 2120 and 2310(a), and IM-2310-2(b)(2); (ii) preparing Joseph Stevens account applications for customers CSR and SG with false information, in violation of NASD Conduct Rules 3110(a) and 2110; and (iii) making false representations to customers CSR and SG regarding their account balances, in violation of NASD Conduct Rule 2110. The bars will become effective immediately if this Default Decision becomes FINRA's final disciplinary action in this proceeding.


Sharon Witherspoon
Hearing Officer

Dated: Washington, DC
April 9, 2008

Copies to:
Kevin Guzman (via FedEx and first-class mail)
Elissa M. Meth, Esq. (via electronic and first-class mail)
William St. Louis, Esq. (via electronic and first-class mail)
Mark P. Dauer, Esq. (via electronic and first-class mail)
David R. Sonnenberg, Esq. (via electronic and first-class mail)

**NASD
OFFICE OF HEARING OFFICERS**

DEPARTMENT OF ENFORCEMENT,

COMPLAINANT,

v.

KEVIN GUZMAN (CRD No. 4497415),

RESPONDENT,

AND

RESPONDENT.

**DISCIPLINARY PROCEEDING
No. 20050000720-02**

HEARING OFFICER --

COMPLAINT

The Department of Enforcement alleges:

JURISDICTION

Kevin Guzman

1. On or around February 6, 2002, Kevin Guzman first became registered with NASD as a General Securities Representative through an association with a member firm.
2. Guzman's registration through that firm ended on or around November 20, 2002 when that firm mass transferred its brokers to Ladenburg, Thalmann & Co., Inc. (BD No. 505).
3. Subsequently, Guzman was registered through an association with member firm Joseph Stevens & Co. Inc. (BD No. 35459) as a GSR (from or around August 29, 2003 through or around December 17, 2004) and as a General Securities Principal (from or around June 18, 2004 through or around December 17, 2004).

4. On or around December 17, 2004, Joseph Stevens filed a Uniform Termination Notice for Securities Industry Registration (Form U-5). The Form U-5 indicated that Guzman's termination was voluntary.
5. The Form U-5 also stated that Joseph Stevens had received a verbal complaint against Guzman from customer CSR.
6. After his employment with Joseph Stevens ended, Guzman was registered as a GSR (beginning on or around August 8, 2005) and GSP (beginning on or around November 17, 2005) through an association with another member firm. That association ended on or around September 6, 2006. The member firm included a termination comment on a Form U-5 regarding Guzman that stated: "RR absent without notice or explanation to the Firm. RR failed to report receipt of a Wells Letter on Form U-4."
7. Guzman is not currently registered with NASD. Pursuant to Article V, Sec. 4 of the NASD By-laws, Guzman remains subject to the jurisdiction of NASD.

- [REDACTED]
8. Since in or around November 1992, [REDACTED] has been registered with NASD through consecutive associations with several different member firms.
 9. On or around November 18, 1992, [REDACTED] first became registered with NASD as a GSR through an association with a member firm.
 10. On or around July 1, 1997, he first became registered with NASD as a GSP through an association with a different member firm.
 11. From on or around September 26, 2002 through the present, [REDACTED] has been registered as, *inter alia*, a GSR and GSP through an association with member firm Joseph Stevens.

██████ therefore remains subject to the jurisdiction of NASD pursuant to Article V, Section 4 of NASD's By-Laws.

BACKGROUND

12. Paragraphs 1 through 11 of the Complaint are re-alleged and incorporated herein by reference.

Customers CSR and SG .

13. CSR and SG are married to each other and live in Puerto Rico.
14. CSR is retired and is approximately 63 years old. He worked as a production supervisor for Chesebrough Ponds, a manufacturer of household beauty and health products, for over 23 years. He retired from that job in or around 1999. He has a high school education. He has no training in finance. He had not made any investments prior to investing with Guzman, except for mutual funds that he held for three years and that he did not trade after purchasing.
15. SG is in her 50s. She is Guzman's aunt. In the past, she worked as a machine operator. She left work approximately seven years ago to care for her elderly mother.
16. By in or around 2003, CSR and SG had accumulated savings of over \$300,000.

The Ladenburg Joint Account

17. In or around January 2003, Guzman met with CSR and SG in Puerto Rico, and Guzman convinced CSR and SG to invest with him.
18. At that time, CSR told Guzman that the money they were investing with him represented their life savings; that they needed the money for their retirement; and that it should be invested safely and conservatively. Guzman assured them that he would not invest in

anything risky; that he understood CSR and SG's needs to preserve the funds; and that he would watch over their account and make sure they never suffer any sizeable losses.

19. In or around February 2003, Guzman opened a joint account for CSR and SG at Ladenburg.
20. CSR and SG's net worth at that time was under \$500,000, and consisted of their savings (approximately \$300,000), their home (approximately \$150,000), home furnishings (approximately \$8,000) and an automobile (approximately \$7,000). Their joint income for the year 2002 was under \$60,000 and was generated from the job that CSR then held.
21. CSR and SG deposited their entire savings of approximately \$300,000 into the Ladenburg joint account that Guzman opened for them.
22. Although the new account documents for the Ladenburg joint account indicated that the investment objective was speculation, Guzman invested the entire \$300,000 in Class A mutual funds.
23. Guzman agreed to send CSR and SG approximately \$3,000 per month from the Ladenburg joint account as a supplement for CSR's social security benefits, which were due to begin shortly thereafter. From May through August 2003, approximately \$11,000 in disbursements were paid to CSR and SG from the Ladenburg joint account.
24. When Guzman left Ladenburg to join Joseph Stevens, he asked CSR and SG to transfer their Ladenburg joint account to his new firm. They agreed.

The Joseph Stevens Joint Account (the "Account")

25. In or around September 2003, CSR and SG signed a new account application for the Account. Their net worth at that time remained approximately what it had been in February 2003 – it remained under \$500,000, and consisted of their savings

(approximately \$300,000), their home (approximately \$150,000), home furnishings (approximately \$8,000) and an automobile (approximately \$7,000). Their investment objectives also remained the same – the money they invested at Joseph Stevens represented their life savings, they needed the money for their retirement, and they wanted it to be invested safely and conservatively.

26. In or around October 2003, the mutual funds CSR and SG had purchased at Ladenburg were transferred to the Account. At the end of October 2003, the market value of the Account was approximately \$331,682.09.
27. In or around October 2003, Guzman sold all of the mutual funds transferred from Ladenburg. He invested 100% of the proceeds in common stock of and options for a single technology company. In November and December of 2003, Guzman added to the Account's activity margin purchases and sales of a single pharmaceutical company. By the end of January 2004, Guzman sold all of the Account's stock of the original technology company it had held. For the rest of the life of the Account, Guzman invested the Account's assets on a rotating basis in a few technology and pharmaceutical companies, and most of the time, 100% of the Account's assets were held in one, two or three stocks.
28. CSR and SG continued to receive approximately \$3,000 a month from the Account through October 2004, except in October and December 2003 when they received a disbursement of approximately \$10,000.
29. When the Account was closed in November 2004, its value was approximately \$2,200.

Supervision of Guzman

30. During part of Guzman's association with Joseph Stevens, [REDACTED] supervised Guzman. Specifically, from at least September 2003 through January 2004, [REDACTED] supervised Guzman. During that time, [REDACTED] ignored red flags warning of Guzman's misconduct.
31. In or around February 2004 through July 2004, [REDACTED] joined Guzman in a partnership (the Partnership). The Partnership serviced Guzman's accounts, including the Account. Guzman and [REDACTED] split 50/50 their share of commissions on accounts serviced by the Partnership.
32. After [REDACTED] entered the Partnership with Guzman, he ceased acting as Guzman's supervisor and a new supervisor was assigned to supervise Guzman.

FIRST CAUSE OF ACTION

Against Guzman

(Churning, Excessive Trading and Unsuitability)

Violation of Section 10(b) of the Securities Exchange Act of 1934, Rule 10b-5 thereunder, and NASD Conduct Rules 2120, 2310 and 2110 and IM-2310-2(b)(2)

33. Paragraphs 1 through 32 of the Complaint are re-alleged and incorporated herein by reference.
34. From October 2003 through November 2004, trading activity in the Account was unsuitable and excessive in size and frequency in view of CSR and SG's financial situation and needs, i.e., CSR was about to retire, SG had not worked in 7 years, the money represented their life savings, and they wanted the money invested safely and conservatively.
35. During that timeframe, CSR and SG lost approximately \$280,000 of their initial investment with Joseph Stevens of approximately \$330,000. During that same

timeframe, CSR and SG received disbursements of \$55,109 and the Account was charged commissions, mark-ups and mark-downs of \$182,996.

36. From October 2003 through November 2004, CSR and SG received in the mail monthly account statements describing the Account's activity. They did not understand the information in the statements and could not discern whether the Account was generating a profit or a loss. Neither CSR nor SG had a financial background, and prior to investing with Guzman, their only investment experience consisted of investments in a few mutual funds that they did not trade after purchasing.
37. From October 2003 through November 2004, Guzman directed all of the transactions in the Account. During that time period, Guzman telephoned CSR and SG at their home in Puerto Rico from his office in New York. CSR and SG accepted all or virtually all of Guzman's recommendations for transactions. Guzman therefore exercised *de facto* control over the Account.
38. Although the Account was assigned to the Partnership between Guzman and [REDACTED] for the period February through July 2004, Guzman directed all of the transactions in the Account during the time of the Partnership.
39. From October 2003 through November 2004:
 - a. Guzman directed over 100 transactions in the Account. Purchases totaled approximately \$2,534,198.00, using average monthly account equity of approximately \$106,445.40.
 - b. The costs of trading incurred by the Account were at least \$187,394.00.

- c. The Account's cost-to-equity ratio was at least 176.05%. On an annualized basis, the cost-to-equity ratio was at least 150.90%. Accordingly, it would have been necessary for CSR and SG to earn a rate of return of at least 176% to break even on the investments, and, on an annualized basis, CSR and SG would have needed a rate of return of at least 150% to break even.
- d. The turnover ratio was at least 23.807, indicating that the securities in the Account were replaced by new securities at least 23 times. On an annualized basis, the turnover ratio was at least 20.41, with the securities in the Account having been replaced by new securities at least 20 times annually.
- e. The Account was charged \$182,996 in commissions, mark-ups and mark-downs, which represented approximately 55% of CSR and SG's initial investment with Joseph Stevens. The commissions-to-equity ratio was at least 171.92%. The annualized commissions-to-equity ratio was at least 147.36%. Accordingly, it would have been necessary for CSR and SG to earn a rate of return of at least 171% to recover for commission costs alone, and, on an annualized basis, CSR and SG would have needed a rate of return of at least 147% to recover for commission costs alone.
- f. Guzman executed frequent short-term, or "in and out," buying and selling of the same securities in the Account, the commissions and markups for which generally exceeded the profits generated. For example:
 - i. During October 2003, Guzman initiated an options covered writing program on Intel. During the next three months (Oct. 2003 to Dec. 2003), Guzman generated commissions of approximately \$53,000 on the

- purchases and sales of Intel common shares and approximately \$10,000 on the purchases and sales of Intel options. The Account realized a net loss of approximately \$50,000 on the activity due to those transactions.
- ii. On November 14 and 26, 2003, Guzman bought approximately 25,000 shares of Antigenics. He sold all of those shares between November 28, 2003 and February 13, 2004 for a loss of approximately \$20,833. The markups and markdowns generated on those Antigenics purchases and sales totaled approximately \$43,700.
 - iii. On January 26, 2004, Guzman bought approximately 5,000 shares of American Pharm. He sold all of those shares approximately four days later. The Account realized a loss from those transactions of approximately \$32,024 of which approximately \$12,500 was markups and markdowns.
 - iv. On March 3, 2004, Guzman bought approximately 10,000 shares of Comtech. He sold all of those shares approximately eleven days later. The Account realized a loss from those transactions of approximately \$22,473, of which approximately \$20,000 was markups and markdowns.
- g. Guzman directed the transactions without reasonable grounds for believing that the level of activity represented by such transactions was suitable based on CSR and SG's financial situation and needs.
- h. Guzman's pattern and level of trading activity in the Account during this period, considered in light of CSR and SG's financial situation and needs, demonstrated Guzman's purpose to derive a profit for himself at the expense of CSR and SG.

40. Even before the Partnership, i.e., between October 2003 and the end of January 2004, Guzman churned and excessively traded the Account.
41. By virtue of this conduct, Guzman, by the use of any means or instrumentality of interstate commerce or of the mails, intentionally or recklessly engaged in manipulative or deceptive devices or contrivances in connection with the purchase or sale of securities, and intentionally or recklessly effected transactions in, or induced the purchase or sale of, securities by means of manipulative, deceptive or other fraudulent devices or contrivances.

By reason of the foregoing, Guzman violated Section 10(b) of the Securities Exchange Act of 1934, Rule 10b-5 thereunder, NASD Conduct Rules 2110, 2120 and 2310(a), and IM-2310-2(b)(2).

SECOND CAUSE OF ACTION
Against Guzman
(Inaccurate New Account Documents)
Violation of NASD Conduct Rules 3110(a) and 2110.

42. Paragraphs 1 through 41 of the Complaint are re-alleged and incorporated herein by reference.
43. Guzman oversaw the creation of and signed the new account and other applications for the Account. Guzman knew or should have known that those documents contained inaccurate and misleading information about CSR and SG's financial profile and needs.
44. On or about January and March 2003, Guzman prepared or caused to be prepared new account applications for CSR and SG's joint account at Ladenburg. He oversaw the creation of such applications for six Ladenburg accounts. Only two of those accounts actually were opened and held assets, and one was closed after transferring a few assets

to the other account. Those applications indicated that CSR and SG's income was \$100k, their liquid net worth was \$500k, and their net worth was \$1 million. Those applications also indicated that CSR had 10 years of investment experience.

45. Guzman also prepared or caused to be prepared, completed portions of the following documents for the Account:
 - a. A new account application dated September 2, 2003 (the Initial Application).
 - b. An account update application dated October 20, 2003 (the Update Application).
 - c. An application for the opening of an option account dated October 20, 2003 (the Option Application).

He then sent the completed documents to CSR and SG and instructed them to sign the documents. After CSR and SG returned signed copies, Guzman signed the documents as account executive.

46. The Initial Application contained income, net worth and investment experience information substantially different from and inconsistent with the same kind of information contained in the Ladenburg applications, the Update Application and the

Option Application. The information differed as follows:

<u>Document</u>	<u>Dated</u>	<u>Income</u>	<u>Liquid Net Worth</u>	<u>Net Worth</u>	<u>Investment Experience.</u>
Ladenburg Application	January and March 2003	\$100k	\$500k	\$1 million	10 Years
Initial Application	September 2, 2003	\$60k	\$1.5 million	\$600k	6 Years
Update Application	October 20, 2003	\$200k	\$600k	\$1.5 million	20 Years
Option Application	October 20, 2003	\$200k	\$600k	\$1.5 million	20 Years in Options/Stocks/Bonds

47. Except for the \$60k income recorded on the Initial Application, the financial information and investment experience recorded on the Initial Application, the Update Application and the Option Application were inaccurate and extremely overstated.
48. The inaccurate level of income inappropriately qualified the Account under Joseph Stevens's Option Procedure Memo to trade options. That Memo required an investor to earn \$100,000 a year in income to trade options.
49. Guzman included that false financial information and investment experience, or caused that information to be included, on the Initial Application, the Update Application and the Option Application.

By reason of the foregoing, Guzman violated NASD Conduct Rules 3110(a) and 2110.

THIRD CAUSE OF ACTION
Against Guzman
(Misrepresentations to Customer)
Violation of NASD Conduct Rule 2110

50. Paragraphs 1 through 49 of the Complaint are re-alleged and incorporated herein by reference.

51. In connection with queries by CSR regarding the Account, Guzman made the following false statements to CSR:
- a. In or about mid-2004, Guzman misrepresented to CSR and SG, during a dinner in New York City, that because the market was not doing well, he had stopped placing trades for the Account. However, during that time period, Guzman continued to actively trade the Account.
 - b. At the same dinner in New York City in or about mid-2004, Guzman also misrepresented that the Account was then worth in the high \$200,000 range. At all times during mid-2004, the Account's value was far lower than \$200,000.
 - c. On or about October 20, 2004, Guzman, at CSR's request, agreed to send CSR \$10,000 from the Account. CSR wanted the money to fund a trip to Mexico. Guzman repeatedly assured CSR that CSR would receive a check for \$10,000, but CSR never received it.
 - d. On or about November 2004 (on the day before CSR's trip to Mexico), CSR inquired about the value of the Account. Guzman misrepresented to CSR that the Account was worth \$270,000. The Account was worth less than \$7,500 at month end September 2004, and its value only decreased thereafter.
 - e. On or about November 2004, Banco Bilboa in Puerto Rico, at CSR's direction, requested the transfer of the Account's balance to Banco Bilboa. After a Banco Bilboa representative informed CSR that the bank had received the Account's balance of approximately \$2,200, CSR immediately contacted Guzman. Guzman informed CSR that the \$2,200 was from a small account that held the cash for the

monthly payments and that \$270,000 was held in another account Guzman had opened to avoid risking loss in an unstable market. Guzman told CSR to have Banco Bilbao resubmit the transfer forms. After Banco Bilbao made a second request and confirmed the balance of approximately \$2,200, Guzman informed CSR that the bank was not handling the transfer properly and that Guzman would send the money to CSR. When CSR did not receive the check, he contacted Guzman who told CSR that the check was returned because it was delivered to the wrong address; that the check would be sent by Federal Express; and that CSR would have the check by Thanksgiving Day. CSR never received the check.

- f. In or about December 2004, CSR contacted Joseph Stevens. Joseph Stevens informed CSR that Guzman no longer worked there. It provided CSR with the name of Guzman's new employer. When CSR contacted Guzman at his new firm, Guzman told CSR that CSR's money was safe when Guzman knew that was false and that CSR had to contact Joseph Stevens to find out what happened to his money because the firm "screwed-up."

By reason of the foregoing, Guzman violated NASD Conduct Rule 2110.

FOURTH CAUSE OF ACTION

Against [REDACTED]

(Failure to Supervise)

Violation of NASD Conduct Rule 3010 and 2110

52. Paragraphs 1 through 51 are re-alleged and incorporated herein by reference.

Failure to Supervise Guzman's Churning, and Excessive and Unsuitable Trading

53. From October 2003 through January 2004, Guzman was the sole broker responsible for the Account, and [REDACTED] was his supervisor.

54. During that timeframe, Guzman directed all of the transactions in the Account, and CSR and SG accepted all or virtually all of Guzman's recommendations for transactions.
55. During that timeframe, Guzman's trading activity in the Account was unsuitable and excessive in size and frequency in view of CSR and SG's financial situation and needs.

During that period:

- a. Guzman directed over 70 transactions in the Account. Purchases totaled approximately \$1,855,992.00, using average monthly account equity of approximately \$292,780.00.
- b. The costs of trading incurred by the Account were at least \$119,827.00.
- c. The Account's cost-to-equity ratio was at least 40.93%. On an annualized basis, the cost-to-equity ratio was at least 122.78%. Accordingly, it would have been necessary for CSR and SG to earn a rate of return of at least 40% to break even on the investments, and, on an annualized basis, CSR and SG would have needed a rate of return of at least 122% to break even.
- d. The turnover ratio was at least 6.339, indicating that the securities in the Account were replaced by new securities at least 6 times. On an annualized basis, the turnover ratio was at least 19.02, with the securities in the Account having been replaced by new securities at least 19 times annually.
- e. The Account was charged approximately \$118,329 in commissions, mark-ups and mark-downs, which represented approximately 36% of CSR and SG's initial investment with Joseph Stevens. The commissions-to-equity ratio was at least 40.42%. The annualized commission-to-equity ratio was at least 121.25%.

Accordingly, it would have been necessary for CSR and SG to earn a rate of return of at least 40% to recover for commission costs alone, and, on an annualized basis, CSR and SG would have needed a rate of return of at least 121% to recover for commission costs alone.

- f. Guzman executed frequent short-term, or "in and out," buying and selling of the same securities, the commissions and markups for which generally exceeded the profits generated, as described in paragraph 39(f) above.
 - g. Guzman executed the transactions, or caused the transactions to be executed, without reasonable grounds for believing that the level of activity represented by such transactions was suitable based on CSR and SG's financial situation and needs.
 - h. Guzman's pattern and level of trading activity in the Account during this period, considered in light of CSR and SG's financial situation and needs, demonstrated Guzman's purpose to derive a profit for himself at the expense of CSR and SG.
56. From October 2003 through January 2004, [REDACTED] reviewed Daily Transaction Reports, New Account Documents and Suitability Supplements for the group of salespeople assigned to him, which included Guzman.
57. [REDACTED] signed GSP reports, which were monthly documents whereon Joseph Stevens GSPs confirmed that they had reviewed Daily Transaction Reports, New Account Documents and Suitability Supplements for the group of salespeople assigned to them. [REDACTED] signed such reports stating that he had conducted such reviews for the months of at least October through December 2003.

58. The Daily Transaction Reports contained "red flags" that should have alerted [REDACTED] that Guzman was churning and unsuitably trading in the Account. From those reports, [REDACTED] should have noticed an unsuitable level of trading and commission and mark-up/mark-down charges. For example, in the first two months of the Account's existence, Guzman made approximately 53 trades. Over the first three months of the Account's existence, Guzman made approximately 66 trades. In the first four months of trading, the Account was charged approximately \$118,329 in commissions, mark-ups and mark-downs, which was equal to approximately 35% of the Account's initial value.
59. That level of activity and commissions should have caused [REDACTED] to take affirmative steps to investigate the activity in the Account. [REDACTED] supervisory response to the level of activity and commissions was inadequate. He did not call the customer to discuss the activity in the Account. He did not discuss the Account's trading strategy with Guzman or question Guzman about the Account's activity. Although the Joseph Stevens compliance department sent CSR and SG a letter in December 2004 inviting them to contact Joseph Stevens for assistance, information on other investment opportunities or if they encountered any problems with Joseph Stevens's servicing of their account, that letter did not satisfy [REDACTED] supervisory responsibilities.

*Failure to Supervise Guzman's Creation of
New Account Documents and Updates for the Account*

60. During September and October 2003, [REDACTED] signed the Update Application and the Option Application as a Joseph Stevens principal and Guzman's supervisor. He lacked reasonable grounds to approve either document.

61. Those documents contained significantly different financial and investment experience information than the Initial Application, which [REDACTED] also signed just six weeks before signing the Update Application and the Option Application.
62. [REDACTED] made no attempt to question or verify the differences among the documents in income from \$60k to \$200k or the differences in the investment experience from 6 years to 20 years. Despite the inconsistencies among the documents, [REDACTED] verification of the information contained therein consisted solely of questioning Guzman.
63. The differing information among the documents constituted a "red flag." In response to that "red flag," [REDACTED] should have taken affirmative steps to investigate and verify the information in the Update Application and Options Application through a source other than Guzman. He did not do so.
64. [REDACTED] lack of supervision likely had serious consequences for the Account. The financial picture of CSR and SG and the investment objective of "Speculation" indicated by the Account Update and the Option Application likely reduced oversight over the Account by those who supervised Guzman from February 2004 through November 2004, which was the period after [REDACTED] supervisory responsibilities over Guzman ended. Further, the inaccurate information qualified the Account to trade options when CSR and SG's truthful financial profile likely would not have.

By reason of the foregoing, [REDACTED] violated NASD Conduct Rules 3010 and 2110.

PRAYER FOR RELIEF

WHEREFORE, Complainant respectfully requests that the Panel:

- A. order that one or more of the sanctions provided under NASD Rule 8310(a) be imposed, including that Guzman be required to disgorge fully any and all ill-gotten gains and/or make full and complete restitution, together with interest;
- B. order that Guzman and [REDACTED] bear such costs of proceeding as are deemed fair and appropriate under the circumstances in accordance with NASD Rule 8330.

NASD DEPARTMENT OF ENFORCEMENT

Date: December 4, 2006



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