FINANCIAL INDUSTRY REGULATORY AUTHORITY
OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT, Complainant, v. THE DRATEL GROUP, INC. (BD No. 8049) and WILLIAM M. DRATEL (CRD No. 843025), Respondents.	Disciplinary Proceeding No. 2008012925001 Hearing Officer – MAD **EXTENDED HEARING PANEL DECISION** September 28, 2012

Respondent The Dratel Group, Inc. (DGI):[1]

DGI is fined a total of $185,000 and barred from engaging in the activity of day trading for the violations in the First, Second, Third, Fifth, Sixth, and Seventh Causes of Action.

DGI is fined $100,000 and barred from engaging in day trading for:

- **engaging in a fraudulent trade allocation scheme in willful violation of Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act"), and Rule 10b-5 thereunder, and in violation of NASD Conduct Rules 2120 and 2110, as described in the First Cause of Action;**

- **failing to ensure that order tickets accurately reflected account designations and times of entry in willful violation of Section 17(a) of the Exchange Act and Rules 17a-3(a)(6) and (7) thereunder, and in violation of NASD Conduct Rules 3110(a) and 2110, as described in the Second Cause of Action; and**

- **failing to ensure that account names or designations were placed on order tickets prior to execution of orders in violation of NASD Conduct Rules 3110(j) and 2110, as described in the Third Cause of Action.**

[1] The Department of Enforcement dismissed the Fourth Cause of Action at the hearing.

DGI is fined $50,000 for failing to establish and maintain reasonable supervisory systems and procedures to achieve compliance with applicable securities laws and regulations in violation of NASD Conduct Rules 3010(a) and (b) and 2110, as described in the Fifth Cause of Action.

DGI is fined $10,000 for failing to timely update customer account information in willful violation of Section 17(a) of the Exchange Act and Rule 17a-3(a)(17) thereunder, and in violation of NASD Conduct Rules 3110(a) and 2110, as described in the Sixth Cause of Action.

DGI is fined $25,000 for failing to obtain photo identification for new customer accounts and for failing to conduct independent testing of its Anti-Money Laundering program in 2006 and 2007 in violation of NASD Conduct Rules 3011(b) and (c) and 2110, as described in the Seventh Cause of Action.

Respondent William M. Dratel:

Dratel is barred from associating with any member firm in any capacity for:

- **engaging in a fraudulent trade allocation scheme in willful violation of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and in violation of NASD Conduct Rules 2120 and 2110, as described in the First Cause of Action;**

- **failing to ensure that order tickets accurately reflected account designations and times of entry in violation of NASD Conduct Rules 3110(a) and 2110, as described in the Second Cause of Action; and**

- **failing to ensure that account names or designations were placed on order tickets prior to execution of the order in violation of NASD Conduct Rules 3110(j) and 2110, as described in the Third Cause of Action.**

Dratel is also ordered to disgorge $489,000 in ill-gotten gains that he received during 2006 from his fraudulent allocation scheme.

In light of the above sanctions, the Panel majority did not impose sanctions on Dratel for his violations of the Fifth and Sixth Causes of Action:

- **failing to establish and maintain reasonable supervisory systems and procedures to achieve compliance with applicable securities laws and regulations in violation of NASD Conduct Rules 3010(a) and (b) and 2110, as described in the Fifth Cause of Action; and**

- **failing to timely update customer account information in violation of NASD Conduct Rules 3110(a) and 2110, as described in the Sixth Cause of Action.**

One panelist dissented as to the finding of liability for DGI and Dratel for the First Cause of Action. The dissenting panelist found DGI and Dratel liable for the Second and Third Causes of Action; however, the panelist stated that the liability finding was unrelated to the fraudulent trade allocation scheme in the First Cause of Action. The dissenting panelist also dissented as to the sanctions for the Second, Third, Fifth, and Seventh Causes of Action.

Respondents are ordered to jointly and severally pay the costs of this proceeding.

Appearances

For the Complainant: Samuel Barkin and Andrew T. Beirne, FINRA, DEPARTMENT OF ENFORCEMENT, New York, NY.

For Respondents: Irwin Weltz, ELLENOFF GROSSMAN & SCHOLE LLP, New York, NY.

DECISION

I. INTRODUCTION

The Department of Enforcement ("Enforcement") brought this disciplinary proceeding against Respondents The Dratel Group, Inc. ("DGI") and William M. Dratel ("Dratel"), the president and sole broker of DGI. The case concerns Respondents' allocations of day trades. A day trade is the purchase and sale (or short sale and purchase

to cover) of a security within a single trading day.[2] Enforcement alleges that the Respondents engaged in an unfair trade allocation scheme, commonly known as "cherry-picking." Enforcement also alleges violations relating to DGI's record-keeping, supervisory systems and procedures, and anti-money laundering ("AML") program.

II. PROCEDURAL HISTORY

Enforcement filed a Complaint with the Office of Hearing Officers on May 11, 2010. Respondents filed an Answer and requested a hearing. Enforcement's Complaint contains seven causes of action. In the First Cause of Action, Enforcement alleges that, from October 2005 through December 2006 (the "Relevant Period"), DGI and Dratel willfully violated Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 10b-5 thereunder, and violated NASD Conduct Rules 2120 and 2110, by engaging in a fraudulent trade allocation scheme.[3] Specifically, Enforcement alleges that Dratel cherry-picked profitable day trades for his own account while steering unprofitable (or less profitable) trades to his discretionary customers' accounts. Enforcement alleges that Dratel executed the cherry-picking scheme by purchasing a security in one of DGI's firm accounts, the Average Price Listed Account or the Principal OTC Account (collectively the "Firm Account"), and then delaying the allocation of the security until after he knew whether it had appreciated in value. Enforcement alleges that, during the Relevant Period, Dratel earned profits, totaling over

[2] In this case, day trades also refer to overnight trades. An overnight trade occurs when a security is purchased and sold (or sold short and purchased to cover) within two consecutive trading days. Throughout this decision, day trades and overnight trades are collectively referred to as "day trades."

[3] Following the consolidation of NASD and the member regulation, enforcement, and arbitration functions of NYSE Regulation into FINRA, FINRA began developing a new "Consolidated Rulebook" of FINRA Rules. The first phase of the new consolidated rules became effective on December 15, 2008. *See* FINRA Regulatory Notice 08-57 (Oct. 2008). Because the Complaint in this case was filed after December 15, 2008, the FINRA procedural rules apply. The conduct rules that apply are those that existed at the time of the conduct at issue. The applicable rules are available at www.finra.org/rules.

$530,000, on more than 80% of his personal day trades, while 25 of DGI's most active discretionary customers ("Discretionary Customers") sustained losses, collectively over $180,000, on more than 70% of their day trades.

In the Second Cause of Action, Enforcement alleges that DGI willfully violated Section 17(a) of the Exchange Act and Rules 17a-3(a)(6) and (7) thereunder, and that DGI and Dratel violated NASD Conduct Rules 3110(a) and 2110, by: (1) time-stamping blank order tickets and later filling in account names on the tickets, and (2) back-dating the time-stamp on order tickets so that the times on tickets would match the times of corresponding purchases in the Firm Account.

In the Third Cause of Action, Enforcement alleges that, from February 2005 through December 2006, DGI and Dratel violated NASD Conduct Rules 3110(j) and 2110, by failing to ensure that account names or designations were placed on order tickets before orders were executed.

At the hearing, Enforcement dismissed the Fourth Cause of Action.[4]

In the Fifth Cause of Action, Enforcement alleges that, from January 2005 through December 2007, DGI and Dratel violated NASD Conduct Rules 3010(a) and (b) and 2110, by failing to establish, maintain, and enforce a supervisory system and written procedures in order to reasonably monitor post-execution allocation of trades.

In the Sixth Cause of Action, Enforcement alleges that, from November 2004 through January 1, 2008, DGI willfully violated Section 17(a) of the Exchange Act and Rule 17a-3(a)(17) thereunder, and that DGI and Dratel violated NASD Conduct Rules

[4] The Fourth Cause of Action alleged DGI failed to record the time that orders were originated on its equity order tickets in hours, minutes, and seconds, in violation of NASD Rules 6954(a) and (b) and 2110.

3110(a) and 2110, by failing to (1) periodically update customer account information for 42 of its accounts and (2) review new account documents on a quarterly basis and memorialize the review.

Enforcement alleges in the Seventh Cause of Action that DGI violated NASD Conduct Rules 3011(b) and (c) and 2110, by failing to (1) obtain photo identification for 11 new customer accounts opened between August 2006 and January 2008 and (2) conduct independent testing of its AML program in 2006 and 2007.[5]

The Extended Hearing Panel ("Hearing Panel"), composed of a former member of FINRA's District 10 Committee, a former member of FINRA's District 3 Committee, and the Hearing Officer, conducted a hearing in New York, New York, from December 13 through 22, 2011.[6] During the hearing, Enforcement called four witnesses, including Dratel and an expert. Respondents called six witnesses. The parties filed post-hearing briefs, findings of fact, and reply briefs with the Office of Hearing Officers.

Based on a preponderance of the evidence, the Hearing Panel makes the following findings of fact and conclusions of law.

[5] The Complaint charged Respondents with violating NASD Conduct Rule 3110. However, prior to the start of the hearing, Enforcement amended the Seventh Cause of Action in the Complaint to reflect a violation of NASD Conduct Rule 3011, correcting the typographical error. Respondents did not object to the amendment and amended their Answer to correct the same typographical error.

[6] The hearing transcript is cited as "Tr," Enforcement's exhibits are cited as "CX-," and Respondents' exhibits are cited as "RX-." The parties filed joint stipulations, which are cited as "Stip."

III. FINDINGS OF FACT[7]

A. Respondents

1. The Dratel Group, Inc.

DGI is a registered broker-dealer and has been a FINRA member since 1980.[8] DGI was founded by Dratel, Dratel's late father, and another business partner.[9] Since August 1999, Dratel has been the sole owner of DGI.[10] Since 2002, DGI has operated under a waiver of the two-principal requirement.[11]

Oppenheimer & Co. ("Oppenheimer") was (and currently is) DGI's clearing firm on a fully-disclosed basis.[12] During the Relevant Period, DGI had direct access to Oppenheimer's order entry systems.[13] After DGI employees inputted trading data into Oppenheimer's order entry systems, Oppenheimer mailed trade confirmations and monthly account statements to DGI's customers.[14]

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[7] The facts contained herein are either undisputed or are findings based upon the documentary evidence and the credibility or believability of each witness. The credibility determinations were made after consideration of all the circumstances under which the witness testified, including: the relationship of the witness to the parties; the interest, if any, the witness has in the outcome of the proceeding; the witness's appearance, demeanor, and manner while testifying; the witness's apparent candor and fairness, or lack thereof; the reasonableness or unreasonableness of the witness's testimony; the opportunity of the witness to observe or acquire knowledge concerning the facts to which he or she testified; the extent to which the witness was contradicted or supported by other credible evidence; and whether such contradiction related to an important detail at issue. When necessary and appropriate, the decision specifically addresses the credibility of a witness or the weight given to a witness's testimony.

[8] Answer at 2.

[9] *Id.*

[10] *Id.*; Tr. 46-48.

[11] Answer ¶ 8.

[12] *Id.* at 2.

[13] Tr. 57.

[14] Tr. 483.

a. *DGI's Offices*

During the Relevant Period, DGI had two offices: a main office in East Hampton, New York ("East Hampton office"), and a branch office at 90 Broad St., New York, New York ("Manhattan office").[15] DGI maintained customer files and trading records in its Manhattan office. During the Relevant Period, Dratel worked out of DGI's East Hampton office, and went to the Manhattan office only once or twice a month.[16]

b. *DGI's Employees*

During the Relevant Period, DGI had two employees in the Manhattan office: Veronica Perez ("Perez"), a sales assistant, and Onolee Duncan ("Duncan"), a receptionist.[17] Perez was employed at DGI from October 2005 through September 2006.[18] Perez was primarily responsible for manually entering the trades on Oppenheimer's order entry systems.[19] She replaced DGI's former sales assistant Angela Lopez ("Lopez").[20] Lopez left DGI in September 2005 and rejoined the firm in March 2007.[21] Accordingly, she was not employed with DGI during the Relevant Period.

Duncan worked at DGI as a receptionist in the Manhattan office from 1987 until late 2011.[22] In addition to her receptionist duties, she also served as DGI's record keeper; checking trades, matching order tickets with confirmations, and filing all trading records

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[15] Tr. 51-53.

[16] Tr. 51-53, 910, 1081-82.

[17] Tr. 54-65, 909, 2085-86. At various times during the Relevant Period, DGI had an administrative assistant in the East Hampton office; however, Dratel testified that it was hard to keep employees at that location. Tr. 103.

[18] Tr. 909. Prior to joining DGI, Perez had been a sales assistant at Oppenheimer for five years. She left DGI because she was expecting a child. *Id.*

[19] Tr. 910-12.

[20] Tr. 56.

[21] Tr. 2019. Lopez worked for DGI for approximately 20 years. Tr. 2018-19.

[22] Tr. 2084-86, 2092.

and reports.[23] On occasion, Duncan filled in for Perez or Lopez if they were temporarily out of the office.[24]

2. William M. Dratel

Dratel entered the securities industry in September 1977.[25] Since August 1999, he has been the sole broker for all of DGI's customer accounts and has operated, managed, and supervised all aspects of DGI's business.[26] Dratel is also DGI's designated Chief Compliance Officer ("CCO"), AML Officer, and Financial Operations Officer.[27] He currently is (and was during the relevant periods in the Complaint) registered with FINRA in several capacities, including as a General Securities Representative, General Securities Principal, and Financial and Operations Principal.[28]

During the Relevant Period, DGI had approximately 40 customers with discretionary accounts (i.e., customers who gave Dratel authorization to buy and sell securities for their accounts without prior approval for each trade) for whom Dratel day traded.[29] Of the 40 discretionary accounts, Dratel only actively day traded in the 25 Discretionary Customers' accounts.[30] Many of the Discretionary Customers were friends

[23] Tr. 2090-92.

[24] Tr. 2089-90.

[25] Answer at 2.

[26] Tr. 46-48.

[27] CX-29, CX-30; Tr. 328.

[28] CX-1; Answer at 2.

[29] Tr. 566; CX-145, at 5-6.

[30] Enforcement excluded 15 of the 40 discretionary customer accounts that Dratel day traded because the accounts reflected two or less day trades during the Relevant Period. Tr. 695-96; CX-145, at 11. The Dissent questions the reduction of the discretionary customer accounts and argues that it could distort the results. However, Respondents do not dispute Enforcements' calculations. In fact, Dratel testified that Enforcement properly calculated the cumulative trading losses for the customers and his gains. Tr. 1115 ("[t]he cumulative trading losses [Enforcement's expert] has correct and my gains he has correct").

or family of Dratel, and long-time clients.[31] As the broker managing his Discretionary Customers' accounts, Dratel was a fiduciary with respect to those accounts.[32]

During the Relevant Period, Dratel day traded for the Discretionary Customers and also actively day traded for himself.[33] Dratel maintained five accounts at DGI, which included his personal trading account and four IRA accounts.[34] Dratel never disclosed to his customers that while he was trading in their accounts, he was also trading for his personal account.[35] Dratel's investments primarily consisted of publicly-traded equity securities.[36]

B. FINRA's Investigation

In 2006, the staff of FINRA's Member Regulation Department (the "Staff") received a surveillance report reflecting an increase in the number of As-Of Trades at DGI.[37] An As-Of Trade is a trade that did not get entered into the order entry system on the trade date and thus is inputted later on an As-Of basis to reflect the actual trade date.[38]

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[31] Tr. 1125-43, 1511-15; CX-145, at 4. During the Relevant Period, DGI had a total of 60 to 70 discretionary accounts. CX-5, at 4-6; CX-24, at 2-3; Tr. 1475. Dratel only day traded in 40 of those accounts. Tr. 566. Dratel picked the discretionary accounts he would use when executing day trades. Tr. 1476.

[32] Tr. 48-49.

[33] *Id.* All of Dratel's personal profits were generated by day trading. Tr. 503. Dratel described himself as a pure day trader. *Id.* He did not hold any stock positions; his personal account was flat at the end of each day. Tr. 503, 977. For the Discretionary Customers, day trading made up only a small percentage of their trading activity as they also had long-term investments at DGI. Tr. 503, 976-77. According to Dratel, day trading was not a significant part of the overall strategy he employed for the Discretionary Customers. Tr. 976-77.

[34] Tr. 49-50; RX-3, at 1.

[35] Tr. 223.

[36] Answer at 2.

[37] Tr. 780-83, 1216-21; CX-146.

[38] Tr. 160.

FINRA monitors As-Of Trades because they can be an indicator of sales practice abuses.[39]

The Staff then initiated a special project examination to investigate the As-Of Trades at DGI. FINRA examiner Patricia Hatzfeld ("Hatzfeld") was the lead examiner on the investigation.[40] In the course of the investigation, she and the Staff examined realized profit and loss blotters for DGI. The Staff also reviewed Dratel's profits, generated in his personal account from day trading,[41] and customer losses. The Staff discovered that Dratel conducted all day trades (for himself and his customers) through the Firm Account as opposed to placing the trades directly through his personal account or his customers' accounts. Because Dratel placed day trades through the Firm Account, he needed to allocate them to his personal account or a customer account. All of the allocation instructions that the Staff reviewed were faxed to the DGI's Manhattan office after Dratel closed the particular trade position.[42]

Hatzfeld and the Staff also uncovered several altered and manipulated order tickets at DGI.[43] For example, the Staff found a purchase and sale through the Firm

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[39] Tr. 780.

[40] Tr. 780. Hatzfeld's initial review period focused on trades that took place between December 2005 and February 2006; however, the review period was expanded when she observed more As-Of Trades and customer losses. Tr. 780-81. The Dissent states that the beginning of the Relevant Period was chosen arbitrarily; however, the Relevant Period was based on the Staff's observation of As-Of Trades, customer losses, and manipulated order tickets. The Dissent also contends that Enforcement's Relevant Period is not a "representative sample size" and cites two other cherry-picking cases that utilized relevant periods of 4 to 7 years. Assuming "relative sample size" refers to the length of the relevant period, the Panel majority disagrees with the assertion that the Relevant Period was too short. The Panel majority finds that, in this case, a 15-month, or even a 12-month, review period is sufficient. As set forth below, the facts show that during this time period, Dratel cherry-picked day trades.

[41] Tr. 828-29.

[42] Tr. 830-45.

[43] *See, e.g.*, Tr. 793-814, 850-53, 1224-26, 1239-44; CX-71, CX-80, CX-93, CX-94. Hatzfeld was credible and thorough in her review of Respondents' records.

Account with a January 13, 2006 date and time-stamp.[44] The allocation instructions for the corresponding customers' order tickets were faxed to the Manhattan office on January 17, 2006.[45] The dates on each of the customer order tickets were manually altered to reflect January 13 so that they matched the date of the purchase through the Firm Account.[46]

Another instance of manipulation involved order tickets for trades without time-stamps that Hatzfeld found when she conducted an on-site visit to DGI.[47] Later, when Dratel responded to FINRA Procedural Rule 8210 requests for information, he produced these same tickets; however, the newly produced tickets were written in a *different* handwriting and included time-stamps.[48]

Similarly, after the Staff asked Dratel to make a complete production of previously requested trade documentation, Dratel produced the same order tickets that he had produced a year earlier but with *different* time-stamps.[49] The initial production reflected time-stamps indicating that the trades were executed on December 14, 2005, at 12:46 *a.m.* (well after the market closed); the second production reflected time-stamps indicating those trades were executed at December 14, 2005, at 12:48 p.m.[50] In addition, the confirmations for the trades revealed that they were not entered into the Oppenheimer

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[44] Tr. 793-95; CX-80.

[45] Tr. 796-97; CX-82.

[46] CX-80; Tr. 794-95.

[47] CX-93; Tr. 809.

[48] CX-94; Tr. 809-10. The Dissent found "no evidence that Dratel personally altered the tickets or directed anyone to alter them." However, the record is clear that Dratel, on behalf of DGI, responded to FINRA's Rule 8210 request and produced altered trade tickets for the same trades that Hatzfeld had reviewed at the on-site.

[49] Tr. 799-804, 807.

[50] CX-71, at 15-38; Tr. 807.

order entry system until December 16.[51] The Staff concluded that they could not rely on the integrity of DGI's records.[52]

In sum, in light of the Staff's observation of customer losses,[53] allocation instructions faxed after trade positions had closed,[54] and altered order tickets,[55] the Staff had concerns that Dratel was delaying trades and spreading losses across his customers' accounts, resulting in customer losses.[56]

C. Respondents' Day Trading

The Panel majority found that Dratel used the Firm Account to day trade for himself and the Discretionary Customers. Dratel's use of the Firm Account provided him with the opportunity to delay making trade allocations and the ability to allocate more profitable day trades to himself as opposed to the Discretionary Customers. The facts and surrounding circumstances of Respondents' day-trading allocation scheme are discussed below.

1. The Mechanics of Respondents' Day Trading

During the Relevant Period, Dratel executed approximately 501 day trades for his personal account and over 1,200 day trades for his Discretionary Customers.[57] Dratel's day trades were either a single, stand-alone order for himself or a Discretionary

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[51] CX-71, at 20.

[52] Tr. 808.

[53] Tr. 781.

[54] Tr. 833-35, 840-41; *see, e.g.*, CX-66.

[55] Tr. 794-95; CX-80.

[56] Tr. 781-82, 793-95, 820-21.

[57] CX-145, at 10, 12. Respondents analyzed an order allocated to multiple customers as a single day trade. Accordingly, their analysis, which is limited to 2006, reflects that Dratel executed 633 customer day trades, which comprised 423 single customer trades and 210 multiple customer day trades. RX-8 addendum at 5; RX-40, at 1, 12. When Respondents compared single customer day trades to Dratel's day trades, they determined that the percentage bought and sold through the Firm Account was almost the same. Tr. 1459.

Customer, or an aggregated, multiple-customer order, which Dratel then allocated to two or more discretionary accounts.

a. *Use of the Firm Account*

Dratel opened all day trade positions for his customers and himself through the Firm Account.[58] Dratel always used the Firm Account when trading.[59] He stated that he used the Firm Account because it was simpler, cheaper, generated fewer confirmations and order tickets, provided better execution and an average price, and allowed him to build a position for a specific stock during a trading day.[60] However, Dratel acknowledged that (1) he saved no money on ticket charges by trading through the Firm Account unless he did four or more purchases of the same stock on the same day,[61] and (2) he could have executed his personal trades directly into his account as opposed to using the Firm Account.[62] Dratel also admitted that when he purchased a stock by placing an order through the Firm Account, it was not possible to determine which account the trade was designated for by reviewing the Firm Account order ticket.[63] Further, none of DGI's trade tickets is numbered or coded in any way, enabling Dratel to create a ticket,

[58] Tr. 61-63, 68.

[59] Tr. 89, 322.

[60] Tr. 487-97, 68-69, 71-72, 85-90, 315-23, 499-501, 1172, 1961; CX-16, at 2; CX-18, at 2.

[61] Tr. 71-72, 317-19, 321. When Dratel executed a single purchase trade through the Firm Account, it cost him an additional $17.50 per trade. Dratel executed 426 day trade purchases for his personal account in 2006, 364 of which were single purchases. RX-41, at 4. By executing those 364 single purchases through the Firm Account, Dratel incurred an additional $6,370 in ticket charges (364 x $17.50).

[62] Tr. 136.

[63] Tr. 1109-10, 1783-84.

discard it, and then create a new ticket.[64] Accordingly, as Dratel acknowledged, no one would know if an order ticket was thrown out.[65]

b. *Direct Access to Oppenheimer's Systems*

Oppenheimer provided DGI with direct access to its order entry systems via terminals in DGI's offices, which allowed DGI to independently enter and allocate trades.[66] Employees in DGI's Manhattan office entered all of the orders and allocations.[67]

DGI, through Dratel, placed all of its orders for real-time direct market transactions, i.e., purchases into the Firm Account from the "Street," through Oppenheimer's market order management system, known as OMS.[68] OMS provided the time a trade was originally routed and executed in hours, minutes, and seconds.[69] DGI used Oppenheimer's back-office system, FiNet, to allocate trades from the Firm Account to customer accounts or Dratel's personal account.[70] DGI also used FiNet to process cross-trades, i.e., securities transactions between customer accounts or between Dratel's personal account and a customer account.[71] FiNet only recorded the trade, not the time of order entry or execution.[72] Accordingly, the Manhattan staff could enter trades in FiNet at any time.[73]

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[64] Tr. 1109-10.

[65] Tr. 1111.

[66] Tr. 57.

[67] Tr. 90-93, 1336-37, 1685-86.

[68] Tr. 58, 1619. OMS closed at 4:00 p.m. when the market closed. Tr. 1619-20, 2042.

[69] Tr. 64.

[70] Tr. 58, 1619.

[71] Tr. 57-59.

[72] Tr. 2065-66.

[73] Tr. 2065.

Perez was the person primarily responsible for manually entering trades on OMS and FiNet during the Relevant Period.[74] For real-time market purchases and sales, Dratel called Perez (or Duncan in her absence) and provided her with the orders to place through OMS.[75] Perez entered the orders and gave Dratel the execution prices and order identification numbers from OMS execution reports over the phone so that Dratel could record them on the OMS order tickets for stock purchases in the Firm Account.[76] When Dratel called in an OMS order for the Firm Account, he did not identify the customer or customers for whom the stock was being purchased.[77]

c. *Completion of Order Tickets*

Both Dratel and the Manhattan office staff shared the task of completing order tickets. When initiating day trades through the Firm Account, Dratel completed the OMS order tickets.[78] He time-stamped the OMS tickets, noting the order entry and execution

[74] Tr. 909-10, 2089-90.

[75] Tr. 90-92.

[76] Tr. 187.

[77] Tr. 91-92, 911-12, 931-32. During the hearing, Dratel occasionally stated that he would tell his sales assistant the name of the customer. Tr. 1069-70. This testimony was in response to leading questions from his counsel. *Id.* However, the Panel majority notes that, when Dratel was asked open-ended, non-leading questions from his counsel regarding how he placed the orders, Dratel did not testify that he told his sales assistant the identity of the customer. Tr. 1019, 1202-03. In addition, when responding to a question from one of the panelists, Dratel stated: "I would tell them [the Manhattan staff] to stamp the tickets. I wouldn't necessarily give them the allocation at that moment. I'll say stamp six tickets now." Tr. 1910. Perez also testified that Dratel did not give her the customer's name when he placed an order on OMS. Tr. 912. Then, under aggressive questioning by Respondents' counsel, she testified that Dratel "sometimes" gave the customer name. Tr. 920. Lopez, the sales assistant prior to the Relevant Period, responded to open-ended, non-leading questions and described the OMS order process. Tr. 2026, 2035. On each of those occasions, she did not mention that Dratel ever informed her of the customer name at the time of the OMS order. *Id.* In fact, she specifically testified that, after receiving the OMS order, "sometime during the day he will send me the other side of the ticket, which makes that [Firm] account flat. And then he'll send me allocation, or if it's a one plain ticket he'll fax it over to me. And I had to input the other side of that ticket and -- and the allocation, I would go into FiNet." Tr. 2035.

[78] Tr. 185-86.

time.[79] The OMS tickets bore the account number for the Firm Account; however, the tickets did not identify the name or account number of the customer to whom the trade would ultimately be allocated.[80]

For trades involving a single account, Dratel also completed the FiNet order tickets; however, he never entered the orders into the Oppenheimer system. It was Dratel's practice to time-stamp blank FiNet order tickets when he executed an order through OMS, and then fill in the customer account name and number.[81] As noted above, because the tickets were not numbered, Dratel had the ability to discard a FiNet order allocation ticket or simply wait to complete the ticket later in the day.

For multiple-customer trades, the Manhattan staff completed the FiNet order tickets.[82] Dratel testified that he either time-stamped blank FiNet order tickets to match the execution time of the OMS trade, or instructed the Manhattan staff to time-stamp blank FiNet order tickets and then hold them until he sent the allocation instructions.[83] However, Dratel's testimony on this point is somewhat inconsistent. At another point during the hearing, Dratel stated that "I think sometimes [I sent blank tickets] when they were super busy or doing other stuff I would stamp the tickets and mail them to them."[84] Dratel also testified that he would "give [the Manhattan staff] the allocation *and the time*

[79] Tr. 186. The horizontal time-stamp reflected the order entry time, and the vertical time-stamp reflected the order execution time. Tr. 1529-30, 1634; RX-39, at 30. A diagonal time-stamp signified that the price was changed. Tr. 1635.

[80] Tr. 186.

[81] *See, e.g.*, CX-66, CX-67.

[82] Tr. 188, 1685.

[83] Tr. 184-90, 188-89, 1910-11.

[84] Tr. 1079.

of the tickets."[85] Whichever method Dratel utilized, the Manhattan staff did not complete the FiNet order tickets until after Dratel provided them with the allocation instructions, which included the names of the customers.[86]

When completing FiNet order tickets, Dratel's assistant, Perez, rolled back the time-stamp every day to make sure that the time on the FiNet order ticket matched the time on the corresponding OMS order ticket.[87] While Perez felt uncomfortable with this procedure because she had never processed tickets in this manner at her previous firm, she followed it because Lopez and Duncan trained her to complete the FiNet order tickets in that manner.[88] She specifically recalled Duncan stating, "That's how they do it in the office."[89]

DGI maintained all original tickets in its Manhattan office.[90] On a daily basis, Dratel faxed all order tickets to the Manhattan office to be entered into the Oppenheimer system.[91] He also mailed the original tickets, either on the trade day or the next day, to the Manhattan office.[92] Duncan, DGI's record keeper, maintained and preserved all documentation at the Manhattan office; she never discarded any documentation.[93]

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[85] Tr. 1360.

[86] Tr. 189-90, 1910-11.

[87] Tr. 918, 933-35. Perez was very credible. Unlike Lopez and Duncan, she was not a long-time employee of DGI. Further, she appeared to have no animosity toward Dratel.

[88] Tr. 918.

[89] Tr. 918.

[90] Tr. 1714-15, 1724, 2050.

[91] Tr. 1715-16, 1724. Generally, Dratel did not write allocation instructions for trades on behalf of only one customer; however, there were order tickets for all trades. Tr. 1422.

[92] Tr. 1715, 1724, 2050.

[93] Tr. 2050, 2121.

d. *Allocation of Day Trades*

Dratel wrote allocation instructions on a separate sheet of paper or on an order ticket.[94] As stated above, Dratel never entered FiNet order tickets into the Oppenheimer system. Instead, after he closed the positions,[95] he faxed allocation instructions to the Manhattan office for his administrative staff to enter the trades on FiNet.[96] FiNet order tickets could be entered in the FiNet system until it closed at 7:00 or 8:00 p.m.[97] The Manhattan staff worked after regular business hours until all the FiNet order tickets were entered.[98] Trades could also be entered retroactively via As-Of Trades on the next business day.[99]

Perez manually entered trades in FiNet based on Dratel's allocation instructions.[100] She testified that Dratel gave those instructions either by phone or by fax.[101] Perez further testified that when Dratel was doing a day trade, he did not provide written or oral

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[94] *See, e.g.*, CX-61, at 48 (allocation sheet faxed to the Manhattan office at 5:03 p.m. on May 30, 2006); CX-99, at 1 (Feb. 8, 2006 trade, with the allocation between Dratel and a customer written on an order ticket and faxed to the Manhattan office on Feb. 9, 2006, to be inputted on an As-Of basis on Feb. 8, 2006); CX-103 (Feb. 28, 2006 multiple-customer allocation written on an order ticket); Tr. 1716.

[95] *See infra* note 106 and accompanying text.

[96] Tr. 2027-29, 2035, 2039, 2066.

[97] Tr. 516-17, 923, 1619.

[98] Tr. 159, 516.

[99] *E.g.*, CX-13, CX-14, CX-80, CX-81, CX-82, CX-83. The Dissent states that the As-Of Trades had nothing to do with the cherry-picking scheme. However, as stated above, As-Of Trades permitted Dratel to enter trades after he knew how the stock had performed. Dratel's explanation of the As-Of Trades is unsupported. Dratel testified that the As-Of Trades were reprocessed trades as a result of an error from the previous day. Tr. 160, 535-38. However, there was no documentary evidence presented at the hearing reflecting that an As-Of Trade was sent on a trade date and then resent the next business day. Dratel asserted that the documentation may have been lost or thrown out, tr. 127-28, 1657, 140, but Duncan, who was in charge of record keeping at DGI, never threw any documents away. Tr. 2121.

[100] Tr. 912-22. Lopez also testified that she entered the trades into FiNet when Dratel sent them. Tr. 2028.

[101] Tr. 912.

instructions until *after* he closed out the position.[102] Perez specifically remembered the timing of Dratel's instructions because he usually gave her instructions when she prepared a report after the market closed.[103] Moreover, she explained that, on days when there was a large quantity of trades to be allocated, instructions would come in even later.[104]

The documentary evidence corroborates Perez's testimony. For example, a review of FiNet customer order tickets revealed that the time-stamps on the tickets were manipulated. Some tickets reflect times in the middle of the night, such as 3:20 a.m. or 12:46 a.m., instead of during market hours.[105] In addition, when Hatzfeld, the FINRA lead investigator, reviewed numerous faxed order tickets and allocation instructions produced by Respondents, each document reflected that Dratel faxed it from the East Hampton Office to the Manhattan office after he closed the stock position.[106] Respondents did not present any documentation reflecting that they sent written allocation instructions prior to closing out a stock position.

Dratel testified that he sometimes gave oral allocation instructions; however, he could not say how frequently he gave oral allocation instructions, or point to any

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[102] Tr. 912-13. Duncan, who was the only other employee in the Manhattan office during the Relevant Period, did not contradict this. The Panel majority found Perez to be credible on this point as well. *See supra* note 87.

[103] Tr. 913-14, 938-40.

[104] Tr. 931.

[105] *See* CX-125, at 5-13 (customer orders are completed at 3:20 p.m.; however, the corresponding FiNet customer order tickets are stamped at 3:20 *a.m.*); Tr. 194; *see also* CX-71, at 17-19 (customer order tickets reflect a 12:46 *a.m.* time-stamp).

[106] Tr. 840-41, 844-45. Dratel stated that he may have faxed the same allocation instruction two or three times in one day. Tr. 127, 1657. Dratel also asserted that faxes "may have gotten lost under something." Tr 127-28, 1657. Dratel explained that the Manhattan staff did not keep every fax, tr. 140; however, Duncan, the record keeper at DGI throughout the Relevant Period, testified that she never threw anything out. Tr. 2121. Indeed, Dratel testified that Respondents produced all of their information to FINRA. Tr. 143.

evidence as to when or what time he gave those instructions.[107] Regarding written allocation instructions, Dratel's testimony is contradictory. He testified that he faxed allocation instructions throughout the day.[108] However, when responding to a question from one of the panelists, he stated, "I wouldn't necessarily fax it right away.... I'm sometimes saying five o'clock or four o'clock."[109]All of the allocation sheets in evidence reflected that Dratel faxed them to the Manhattan office after he closed out a particular stock position. Further, as noted above, Duncan never threw out any documentation.

Dratel also testified that if there was not any evidence of an allocation fax associated with a particular order, it was because he handed the allocation instructions to his staff when he was in the Manhattan office.[110] However, it is undisputed that Dratel was in the Manhattan office only one or two times a month.[111]

Dratel asserted that he made all allocation decisions before he bought a particular stock and the order tickets reflect the actual time he bought the stock for his customers.[112] The Panel majority did not credit Dratel's assertion for several reasons. First, when Dratel purchased stock through the Firm Account, he time-stamped blank tickets. Second, he acknowledged that under his ticket writing and allocation system, he could discard tickets and create new ones.[113] Third, the documentary evidence included several examples of FiNet order tickets where the time-stamp was either manually altered or

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[107] Tr. 97, 150.

[108] Tr. 138.

[109] Tr. 1914-15. Although she did not work at DGI during the Relevant Period, Lopez also testified that sometimes Dratel sent allocation faxes after 4:00 p.m. Tr. 2036.

[110] Tr. 109, 1088.

[111] Tr. 910-11, 1081, 2037.

[112] Tr. 129, 136, 1366.

[113] Tr. 1109-11.

reflected an incorrect date or time, such as a 12:46 *a.m.* time-stamp when the market was closed.[114]

The Panel majority finds that Respondents had the opportunity to delay making allocations, and did so.

2. Examples of Respondents' Day Trade Allocations

A review of Dratel's day trading in 2006 reveals that, on 26 occasions, he traded the same stock, on the same day, as his customers.[115] The day trades listed below reflect Dratel's personal day trades, identified by account number [redacted] and highlighted in bold, together with his Discretionary Customers' trades.

Symbol	Purchase Date	Gain/Loss	Account
CTXS	**1/19/06**	**1,351.42**	[redacted]
CTXS	1/19/06	(821.49)	[redacted]
AMZN	2/2/06	5,358.02	[redacted]
AMZN	**2/2/06**	**3,658.68**	[redacted]
AMZN	2/2/06	3,568.68	[redacted]

[114] *See, e.g.*, CX-71, at 17-25 (order tickets reflecting time-stamps at 12:46 *a.m.*); CX-80, at 3-7 (manually altered dates); *compare* CX-93, at 3 *with* CX-94, at 2 (order tickets for the same trade; one from on-site without a time stamp and one from a later Rule 8210 request bearing a time stamp with the correct time but the wrong date); Tr. 810-11 (Hatzfeld explaining the discrepancy), Tr. 1694 (Dratel discussing CX-94 and acknowledging that there were two tickets for the same trade, one undated and one with the wrong date). The following are additional examples of altered tickets:

CX-83 reflects order tickets for cross-trades on January 18, 2006. The order ticket for one customer is time-stamped at 2:22 p.m., while the order ticket for the other side of the cross-trade is stamped at 12:22 p.m. *Compare* CX-83, at 6 *with* CX-83, at 10. CX-84 also reflects customer cross-trades on January 18, 2006. The customer order tickets reflect a time-stamp of 10:06 *p.m.*, not a.m. CX-84, at 4-7. CX-85, the allocation instruction for the trades in CX-83 and CX-84, reflects that Respondents faxed it to the Manhattan office at 5:16 p.m., after the market closed on January 18, 2006. Tr. 204, 1670-71.

RX-20 includes order tickets for Apple trades on March 29, 2006. The first OMS order ticket is stamped at 9:57 *p.m.*, with the date manually altered. RX-20, at 4. Dratel testified that, after seeing the wrong time-stamp, he changed the date on the ticket and "fixed" the clock on his time-stamp machine. Tr. 207. In the same exhibit, two FiNet customer order tickets are time-stamped at 10:59 *p.m.* RX-20, at 7-8.

[115] *See* CX-139, RX-4. There were actually 27 occasions. However, because the parties' exhibits reflected different sales prices for the customer sale of MDCC on September 27, 2006, the MDCC stock was not used in this example. That said, in both parties' exhibits, Dratel received the more profitable trade. *Compare* CX-139, line 1130 *with* RX-4, at 32 (MDCC trade on Sept 27, 2006). Dratel acknowledged that he day traded the same stock on the same day as the DGI customers, but stated that such simultaneity rarely occurred. Tr. 976.

Symbol	Purchase Date	Gain/Loss	Account
AMZN	2/2/06	1,779.34	[redacted]
RMD	**2/8/06**	**1,317.46**	
RMD	2/8/06	578.73	
ECL	**3/9/06**	**457.59**	
ECL	3/9/06	407.59	
NRPH	**3/24/06**	**(556.57)**	
NRPH	3/24/06	(829.85)	
AAPL	**3/29/06**	**3,766.17**	
AAPL	3/29/06	2,642.22	
AAPL	3/29/06	1,758.15	
AAPL	3/29/06	934.04	
PLCE	**4/10/06**	**1,514.13**	
PLCE	4/10/06	(767.27)	
PLCE	4/10/06	(875.45)	
UARM	4/26/06	(720.57)	
UARM	4/26/06	(720.57)	
UARM	4/26/06	(720.57)	
UARM	4/26/06	(720.57)	
UARM	4/26/06	(1,431.14)	
UARM	4/26/06	(1,431.14)	
UARM	**4/26/06**	**(1,431.14)**	
HEES	5/12/06	(478.35)	
HEES	5/12/06	(478.35)	
HEES	5/12/06	(634.47)	
HEES	5/12/06	(634.47)	
HEES	5/12/06	(946.70)	
HEES	**5/12/06**	**(1,501.16)**	
OSIP	**7/5/06**	**1,827.72**	
OSIP	7/5/06	1,348.32	
MWRK	**7/17/06**	**(466.40)**	
MWRK	7/17/06	(580.50)	
MWRK	7/17/06	(580.50)	
MWRK	7/17/06	(694.60)	
NTAP	8/17/06	(500.99)	
NTAP	**8/17/06**	**(500.99)**	
JOSB	**8/31/06**	**1,188.47**	
JOSB	8/31/06	32.79	
JOSB	8/31/06	32.79	
FCX	**9/15/06**	**1,662.57**	
FCX	9/15/06	464.19	
RHAT	**9/27/06**	**1,888.72**	
RHAT	9/27/06	1,088.72	

Symbol	Purchase Date	Gain/Loss	Account
HLX	**10/3/06**	**(590.88)**	[redacted]
HLX	10/3/06	(620.88)	[redacted]
HLX	10/3/06	(1,141.76)	[redacted]
MU	**10/6/06**	**2,908.04**	[redacted]
MU	10/6/06	1,369.02	[redacted]
AMTD	**10/11/06**	**1,318.14**	[redacted]
AMTD	10/11/06	179.73	[redacted]
NVEC	**10/19/06**	**1,278.86**	[redacted]
NVEC	10/19/06	1,168.85	[redacted]
GRMN	10/23/06	(751.53)	[redacted]
GRMN	**10/23/06**	**(751.53)**	[redacted]
AMED	10/25/06	(465.66)	[redacted]
AMED	10/25/06	(465.66)	[redacted]
AMED	10/25/06	(465.66)	[redacted]
AMED	**10/25/06**	**(465.66)**	[redacted]
GRMN	**11/1/06**	**2,297.85**	[redacted]
GRMN	11/1/06	2,222.85	[redacted]
DAKT	**11/15/06**	**2,307.93**	[redacted]
DAKT	11/15/06	1,568.95	[redacted]
BIG	**11/16/06**	**1,809.20**	[redacted]
BIG	11/16/06	(750.72)	[redacted]
BIG	11/16/06	(750.72)	[redacted]
SRDX	11/17/06	2,241.79	[redacted]
SRDX	11/17/06	(278.20)	[redacted]
SRDX	11/17/06	(705.51)	[redacted]
SRDX	11/17/06	(705.51)	[redacted]
SRDX	**11/17/06**	**(705.51)**	[redacted]
SRDX	11/17/06	(1,493.49)	[redacted]
SRDX	11/17/06	(1,604.27)	[redacted]
SRDX	11/17/06	(1,887.47)	[redacted]
X	**11/20/06**	**1,917.66**	[redacted]
X	11/20/06	(882.24)	[redacted]

According to Dratel, when he traded the same stock as his customers, he lost money and his customers received the same or better execution price.[116] In reality, while

[116] Tr. 508.

Dratel testified that he put his customers' interests first,[117] he received the greatest profit, or incurred the least loss, on 20 of the 26 above trades. Although he used the same day-trading strategy for himself as he did for his customer accounts,[118] the above table reflects that with respect to the 26 trades Dratel realized profits of $25,500.77, while the Discretionary Customers earned only $1,207.94.

During 2006, Dratel also day traded the same stocks as his customers on different days.[119] Dratel's day trades of the Citrix Systems, Inc. (CTXS) stock exemplify his allocation of more profitable trades to himself. Between January 19 and October 19, 2006, Dratel executed 20 CTXS day trades.[120] For all of the 20 CTXS trades, Dratel determined which accounts would receive each CTXS trade. As a result of his allocations, Dratel received seven CTXS trades, all of which were profitable, totaling $14,755.88.[121] In contrast, the Discretionary Customers received 13 CTXS day trades, only one of which was profitable, resulting in losses of $8,462.36.[122]

3. Profits and Losses from Day Trading

Dratel's day trading on behalf of his Discretionary Customers during the entire Relevant Period (October 2005 through December 2006) resulted in losses on 72% of their day trades, causing them to incur cumulative day-trading losses of approximately $185,748.[123] In contrast, during the same period, Dratel generated profits of approximately $534,779 on his personal day trades; 83% of his personal day trades were

[117] Tr. 325.

[118] Tr. 2000-01.

[119] *See* CX-139, RX-4.

[120] Tr. 1797-98.

[121] Tr. 1784-99; CX-139, at lines 37, 390, 549, 609, 652, 810, 1023.

[122] Tr. 1784-98; CX-139, at lines 40, 619, 624, 632, 634, 662, 666, 761, 762, 800, 801, 1005, 1275.

[123] CX-145, at 12.

profitable.[124] Dratel's average monthly equity for his personal account during the Relevant Period was approximately $34,437.[125]

A breakdown of the relative gains and losses in dollars for Dratel and his Discretionary Customers, on a quarterly basis during the Relevant Period, is as follows:[126]

	Dratel	Discretionary Customers
Oct. - Dec. 2005	45,078	42,415
Jan. - Mar. 2006	136,428	66,011
Apr. - June 2006	140,499	(52,962)
July - Sept. 2006	147,813	(92,755)
Oct. - Dec. 2006	64,961	(148,457)

As reflected above, Dratel and his Discretionary Customers profited to almost an equal degree in the last quarter of 2005. However, the disparity between their profits and losses greatly increased in 2006. In 2006, Dratel's profits totaled $489,701.[127] In contrast, the Discretionary Customers suffered cumulative day-trading losses of approximately $228,163.[128]

Respondents do not dispute that Dratel profited while the Discretionary Customers lost money.[129] In fact, Dratel testified that "[t]he cumulative trading losses [Enforcement's expert] has correct and my gains he has correct."[130] Further, the calculations that Respondents presented are very close to the figures presented by

[124] *Id.* at 10.

[125] CX-141, at 3.

[126] CX-145, at 15.

[127] *Id.*

[128] *Id.*; Tr. 231.

[129] Tr. 1002-03.

[130] Tr. 1115.

Enforcement. Dratel calculated his profits from day trading in 2006 as $489,000.[131] And, according to Respondents, the Discretionary Customers incurred losses of approximately $180,000 during the Relevant Period, and approximately $201,677 in 2006.[132]

While Enforcement's and Respondents' calculations are very close, the parties differ on the appropriate methodology for counting trades. Respondents assert that the trades should be counted on a per stock basis as opposed to a per customer basis.[133] Accordingly, under Respondents' methodology, a multiple-customer order for a particular stock for four customers would be considered one trade as opposed to four.[134] The Panel majority does not accept Respondents' approach for several reasons. First, Respondents' approach would not enable an accurate comparison to be made between Dratel's profits and losses and the customers' profits and losses because often Dratel participated in a multiple-customer order with his customers. Second, an unfair trade allocation scheme could occur even if only one stock was involved. For example, if stock ABC was purchased at 9:00 a.m. for $2.00 a share, purchased again at 11:00 a.m. for $3.00 a share, and sold at 3:00 p.m. for $5.00 a share; an allocation of the initial purchase of stock ABC at $2.00 a share would be the more profitable trade. Lastly, the relevant case law counts trades on a per customer basis.[135]

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[131] Tr. 230, 1516.

[132] RX-1, at 1-2.

[133] Tr. 228.

[134] *Id.*

[135] *See e.g., SEC v. K.W. Brown & Co.*, 555 F. Supp. 2d 1275, 1304 (S.D. Fla. 2007); *James C. Dawson*, Admin. Proc. File No. 3-13579, 2010 SEC LEXIS 2561, at *9 (July 23, 2010).

Even using Respondents' methodology for counting trades, Dratel acknowledged that, in 2006, 82% of his 426 personal day trades were profitable.[136] During that same year, as shown below, Dratel spread unprofitable trades over multiple-customer accounts. According to Respondents, Dratel executed 633 customer day trades (calculated on a per stock basis): (i) 423 single customer trades, of which 252 were profitable; and (ii) 210 multiple-customer day trades, of which only 25 were profitable.[137] Dratel's single customer trades generated profits of $225,269,[138] whereas the multiple-customer trades sustained losses of $453,432, resulting in a success rate of only 12%.[139]

4. Context for Respondents' Day-Trading Allocations

Enforcement presented evidence of Dratel's financial condition and argued that it provided a motive for the fraudulent day-trading allocation scheme. The Panel majority concludes that Respondents engaged in a fraudulent day-trading allocation scheme and finds that Dratel's financial condition supported that conclusion. While Dratel denied having financial problems in 2005 through 2006,[140] the record reveals that, during the time leading up to the Relevant Period, Dratel's financial condition was strained.

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[136] Tr. 229-30, 1758; RX-9 addendum, at 2.

[137] RX-8 addendum, at 5; RX-40, at 1, 12. The profitable multiple-customer trades are as follows (listed by date and symbol): 1/11/06-AAPL; 2/02/06-NTRI; 2/09/06-RMD; 2/10/06-AAPL; 2/10/06-AAPL; 3/08/06-FCX; 3/10/06-ECL; 3/14/06-AMD; 3/14/06-AMD; 3/23/06-MRVL; 3/29/06-AAPL; 3/29/06-AAPL; 4/20/06-ET; 4/27/06-MNST; 7/11/06-GOOG; 8/31/06-JOSB; 9/15/06-FCX; 9/19/06-GOOG; 9/26/06-AVID; 10/06/06-MU; 10/11/06-AMTD; 6/15/06-STYL; 6/26/06-ZMH; 7/24/06-ATML; 11/13/06-SPLS. RX-4, at 1, 4, 5, 8-11, 13, 14, 22, 28, 30-32, 34, 44, 45, 47.

[138] RX-40, at 1, 12.

[139] The multiple-customer losses of $453,432 are calculated by subtracting the single customer profits of $225,269 from the Discretionary Customers' cumulative day trading losses of $228,163. The 12% success rate is derived by dividing the 25 profitable multiple-customer trades by the 210 total multiple-customer trades.

[140] Tr. 521-22.

In 2002 and 2003, Dratel had realized losses of $34,439 in his personal account, and $252,173 in his four IRA accounts.[141] In 2004 and 2005, Dratel's realized losses totaled $144,981 in his personal account, and $115,509 in his IRA accounts.[142] Dratel also settled two customer arbitrations in 2002 and 2005, paying the customers a total of $233,000.[143]

Dratel's losses in his personal account were exacerbated in 2004 and 2005, because he compensated DGI customers for losses they incurred from his management of their accounts. Dratel structured these payments as internal cross-trades between his personal account and the customers' accounts. Specifically, Dratel purchased securities directly from his customers' accounts at prices that were well above the current market price, and then sold them at the market price for a significant loss.[144] According to Dratel, the purpose of the customer payments was to indemnify them for losses resulting from his "egregious mistakes" in handling their accounts.[145] Dratel also admitted that he did cross-trades to provide lost profits to customers after an "event" occurred that caused the stock's price to rise.[146] Dratel did not inform his customers about the cross-trades or the reasons why he did them.[147]

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[141] RX-42, at 1.

[142] *Id.*

[143] CX-1, at 15-16, 18.

[144] Tr. 1751-53; *see* Tr. 374-449 (discussing Dratel's numerous customer purchases at above market prices).

[145] Tr. 377-79, 381, 384-85, 388-91, 399, 404-05, 1992-93. Dratel did not do cross-trades for every mistake he made, but only for "certain egregious losses." Tr. 399. He also did not always take the customer's whole loss, or take the loss for every customer affected by his egregious mistakes. Tr. 399, 403-04, 1751-53, 1992. Dratel explained that he had executed internal cross-trades previously to keep customers from suffering losses due to his mistakes. Tr. 384-85.

[146] Tr. 439-42.

[147] Tr. 404, 1753.

In 2005, Dratel was also faced with substantial personal expenses. His home had a mortgage slightly below $4.2 million,[148] which he refinanced with an interest only loan.[149] In late 2005, he identified a "much less expensive" house to buy, and decided to sell his current home.[150] Because his home had not sold and he did not have sufficient equity in his accounts to complete his new home purchase, he borrowed $434,000 from a customer in July 2006.[151] Dratel structured his customer loan as an interest only loan; however, it was due in full in three years.[152] Because Dratel was unable to sell his first home, it was later placed into foreclosure.[153]

D. DGI's Inaccurate and Misleading Books and Records

During 2006, Dratel executed approximately 850 day trades for himself or a single customer.[154] On those occasions, Dratel admitted that he did not time-stamp or fill out the FiNet allocation order tickets for those trades until after the underlying OMS orders were *executed*.[155] Pursuant to Dratel's practice of time-stamping order tickets, the order entry time on the FiNet allocation order tickets actually reflected the execution time on the OMS order ticket for the underlying market order, not the time that Dratel *entered* the underlying order.[156]

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[148] Tr. 366.

[149] Tr. 365-66, 369.

[150] Tr. 370-72, 522.

[151] CX-32; Tr. 522. Dratel acknowledged that DGI's procedures prohibited borrowing money from customers. Tr. 1995-96.

[152] CX-32.

[153] Tr. 355.

[154] RX-9 addendum; RX-40, at 1.

[155] Tr. 1978-79.

[156] *See, e.g.*, RX-13, at 3, 5; RX-14, at 3, 5; RX-17, at 5-9; RX-18, at 3-6.

NASD Conduct Rule 3110(j), which became effective on January 31, 2005, states that "[b]efore any customer order is executed, there must be placed on the memorandum for each transaction, the name or designation of the account (or accounts) for which such order is to be executed." Between February 2005 and December 2006, Dratel executed over 210 multiple-customer day trades.[157] The customer names and account numbers were not placed on the FiNet customer order tickets for any of these trades until several hours after the orders were executed; or, in cases where Dratel mailed blank, time-stamped order tickets to the Manhattan office, one or two days later.[158]

Further, when completing the FiNet order tickets, Perez routinely rolled back the time on DGI's time-stamp machine (as she was trained to do). The objective was to ensure that the date and time on the FiNet order tickets matched the time on the

[157] *See* CX-138, lines 34-40, 50-61, 66-75, 88-95, 106-07, 121-28, 132-37, 139-40, 150-54, 168-76, 187-88, 189-96, 206-208, 211-212, 214-215 (reflecting 15 multiple-customer trades from February 2005 through September 2005); CX-138, lines 217-18, 219-21, 229-32, 233-40, 276-89, 301-02, 306-07, 321-22, 354-56 (reflecting 9 multiple-customer trades from October 2005 through December 2005); CX-139, lines 17-18, 22-24, 56-57, 86-95, 102-03, 136-40, 148-49, 150-51, 153-54, 155-56, 192-95, 200-01, 230-33, 237-38, 246-47, 257-61, 262-63, 285-86, 292-93, 301-02, 328-31, 347-48, 350-53, 354-55, 365-66, 371-72, 397-98, 403-05, 406-08, 410-11, 423-28, 434-40, 445-46, 452-53, 462-63, 465-74, 486-89, 494-97, 502-03, 513-16, 523-26, 529-33, 547-48, 557-58, 563-65, 567-68, 573-75, 576-79, 581-82, 589-90, 593-95, 597-604, 607-08, 620-21, 635-36, 639-41, 645-47, 673-74, 676-77, 683-85, 691-94, 724-28, 734-38, 740-43, 744-45, 748-51, 752-53, 754-55, 761-62, 763-64, 767-69, 770-71, 773-776, 777-86, 787-90, 793-97, 800-01, 805-06, 807-08, 813-14, 815-24, 831-32, 841-46, 847-48, 849-50, 856-60, 861-63, 870-71, 875-82, 885-89, 890-97, 907-08, 919-20, 931-32, 938-39, 940-41, 942-45, 949-53, 954-57, 961-65, 983-84, 987-88, 989-92, 995-97, 999-1001, 1010-13, 1014-17, 1025-31, 1035-43, 1046-52, 1055-64, 1070-75, 1079-80, 1081-85, 1087-88, 1090-91, 1093-98, 1101-04, 1121-22, 1139-40, 1142-47, 1150-54, 1165-70, 1176-79, 1198-1201, 1205-07, 1213-18, 1222-27, 1231-32, 1242-48, 1251-61, 1272-74, 1281-91, 1299-1309, 1317-24, 1330-40, 1344-59, 1365-70, 1375-82, 1392-99, 1404-1414, 1416-17, 1420-24, 1426-28, 1430-32, 1436-40, 1449-50, 1456-57, 1463-69, 1474-83, 1492-1500, 1505-06, 1513-19, 1527-29, 1538-39, 1547-50, 1554-58, 1562-63, 1565-66, 1573-79, 1581-91, 1596-99, 1601-04, 1608-11, 1616-17, 1619-23, 1629-31, 1633-35, 1638-43, 1650-51(reflecting approximately 195 multiple-customer day trades in 2006). Respondents' exhibits reflect 210 multiple-customer day trades in 2006. *Compare* RX-8 addendum, at 5 (633 total customer day trades in 2006) *with* RX-41, at 1, 12 (423 single account customer day trades in 2006).

[158] Tr. 184-90, 1910-11; *see, e.g.*, CX-66, CX-67.

corresponding OMS order ticket for the Firm Account.[159] Accordingly, the date and time on the FiNet order tickets always matched the stamp on the OMS order ticket.

E. DGI's Inadequate Supervisory System and Procedures

As the Chief Compliance Officer and only registered principal at DGI, Dratel was solely responsible for supervising DGI's activities, including the establishment, maintenance, and enforcement of DGI's supervisory system and written supervisory procedures.[160] DGI's supervisory system failed to address the conflict inherent in Dratel's day trading for his personal account and his simultaneous day trading for the Discretionary Customers' accounts. In fact, Dratel failed to recognize the conflict and asserted that there was no potential conflict of interest.[161] At no time did Dratel disclose to his Discretionary Customers that he day traded for his personal account at the same time he day traded for their accounts.[162] Further, DGI's procedures did not require disclosure, monitoring, or remediation of potential conflicts of interest.[163]

Prior to 2007, DGI's supervisory system and procedures failed to address allocations or proper order ticket completion.[164] There were no systems and procedures to prevent improper post-execution allocation of trades.[165] Dratel acknowledged that DGI's procedures did not address the supervision of day trading.[166]

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[159] Tr. 917-18.

[160] CX-29, at 6-7; CX-30, at 4-6; Tr. 328.

[161] Tr. 136-37, 1994-96.

[162] Tr. 222-23.

[163] CX-29, CX-30.

[164] *See* CX-29.

[165] *Id.* Dratel admitted that DGI had no policies or procedures to determine whether trades of equal risk would be allocated to himself or his customers. Tr. 268.

[166] Tr. 1994.

Although DGI updated its procedures in 2007, the revised procedures contained no provisions that required or established a means to verify that allocation instructions were formulated before customer orders were executed through the Firm Account.[167] Further, the revised procedures did not require that the account name or designation be placed on a customer order ticket before order execution.[168]

DGI, through Dratel, also failed to enforce its written supervisory procedures in effect from September 2004 through January 2007. Dratel, the designated sales supervisor, was responsible for ensuring that all "employee or employee-related orders are so designated on the order ticket."[169] However, Dratel failed to comply with this procedure. None of the order tickets for Dratel's trades executed through the Firm Account contained any indication that the trade was for Dratel.[170] Similarly, the procedures required that "each [Registered Representative] effecting a trade for any discretionary account must designate the account number prior to entering any order."[171] Again, Dratel failed to provide the account number prior to entering the order on numerous customer order tickets that were executed through the Firm Account.[172]

F. DGI's Failure to Update Customer Account Information

Exchange Act Rule 17a-3(a)(17)(i)(B)(1), sometimes referred to as the "thirty-six month rule," requires broker-dealers to periodically update customer account records

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[167] *See* CX-30.

[168] *See* CX-30.

[169] CX-29, at 1, 6-8, 43; CX-30, at 1.

[170] Tr. 328-30.

[171] CX-29, at 47.

[172] Tr. 331.

every 36 months.[173] During a 2008 routine examination of DGI, the Staff found that DGI, through Dratel, failed to periodically update customer account records.[174] Dratel admitted that, as of September 2008, DGI had not timely updated customer account information for 42 customers, and advised the Staff that he was in the process of updating the information.[175] Dratel asserted that Oppenheimer's year-end account verification profiles satisfied DGI's obligation to update customer account records.[176] However, Oppenheimer's account verification profiles did not contain the required customer information, such as employment status, annual income, net worth, and investment objectives.[177] Except for the customer's name and address, all of the Oppenheimer account verification profiles were identical.[178] Further, Dratel acknowledged that neither he nor Oppenheimer ever received any of the account verification profiles back from the DGI customers.[179]

G. DGI's Deficient Anti-Money Laundering Program

Dratel was (and currently is) DGI's AML Compliance Officer. As such, he was responsible for the administration of DGI's AML compliance program.[180] DGI's Compliance procedures required that DGI exercise due diligence when opening new customer accounts.[181] The due diligence included gathering information on the identity of

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[173] 17 C.F.R. § 240.17a-3(a)(17)(i)(B)(1).

[174] CX-33, at 7; CX-34, at 9-10.

[175] CX-34, at 9-10; CX-35, at 3.

[176] Tr. 473-75.

[177] *See* RX-44; *compare* CX-46 *with* RX-44, at 46-48; Tr. 461-62.

[178] *See* RX- 44. All of the forms listed investment experience as none, which Dratel acknowledged was not accurate. Tr. 568.

[179] Tr. 569.

[180] CX-41, at 1.

[181] *Id.* at 2.

a customer and verifying the customer's identity.[182] DGI's AML procedures required verification of a customer's identity through documents, such as a valid driver's license or passport.[183] The AML procedures emphasized that if a DGI employee cannot verify the identity of a prospective customer, the account cannot be opened and the employee is required to contact the AML officer.[184] Dratel acknowledged that DGI opened 11 accounts, from August 2006 through January 2008, without timely obtaining photo identification for each new customer.[185]

DGI also failed to conduct timely independent testing of its AML compliance program during years 2006 and 2007. In March 2008, DGI had an independent test of its AML compliance program performed for the year 2007.[186] Then, in November 2008, almost two years after the end of calendar year 2006, DGI had an independent test of its AML compliance program performed for 2006.[187]

IV. CONCLUSIONS OF LAW

A. Timeliness of Certain Causes of Action

Respondents assert that the allegations in the First, Second, Third, Fifth and Sixth Causes of Action are time-barred.[188] Respondents cite to several Securities and Exchange Commission ("SEC") cases to support their statement that the Causes of Action are time-

[182] *Id.* at 2-3.

[183] *Id.* at 3. DGI's AML procedures provided for certain exceptions that are not at issue in this case. *Id.*

[184] *Id.* at 4.

[185] Tr. 453; CX-33, at 4; CX-35, at 2. After FINRA instructed DGI to obtain the documentation, DGI sent letters to its new customers asking them to provide photo identification. CX-37.

[186] Tr. 455-56; CX-33, at 4; CX-35, at 2; CX-40, at 1.

[187] CX-38, at 1.

[188] Respondents' Post-Hr'g Br. at 27-29; Answer ¶¶ 65, 70.

barred; namely, *William D. Hirsh*,[189] *Jeffrey Ainley Hayden*,[190] and *Department of Enforcement v. Morgan Stanley DW Inc.*[191] In *Hirsh*, the delay between the first misconduct to the filing of the complaint was 8 years, 11 months; the delay between the last misconduct and the filing of the complaint was 8 years. In *Hayden*, the delay between the first misconduct to the filing of the complaint was 13 years, 9 months; the delay between the last misconduct and the filing of the complaint was 6 years, 7 months. In *Morgan Stanley*, the delay between the first misconduct to the filing of the complaint was 8 years; the delay between the last misconduct and the filing of the complaint was 7 years.

At the outset, the SEC has emphasized that no statute of limitations applies to self-regulatory organization (SRO) proceedings.[192] That said, the time between the Causes of Action alleged here and the filing of the Complaint are less than those alleged in *Hirsh*, *Hayden*, and *Morgan Stanley*. The Complaint was filed in May 2010. The earliest misconduct alleged in the Complaint was November 2004; 5 years, 6 months prior to the filing of the Complaint. The last misconduct alleged in the Complaint was January 2008; 2 years, 5 months prior to the filing of the Complaint. Thus, even a mechanical application of the cases cited by Respondents does not support their assertion.

Further, to establish the defense based on the alleged unfairness of the time between the offenses charged and the filing of the complaint, Respondents must

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[189] *William D. Hirsh*, Exchange Act Release No. 43691, 2000 SEC LEXIS 2703 (Dec. 8, 2000).

[190] *Jeffrey Ainley Hayden*, Exchange Act Release No. 42772, 2000 SEC LEXIS 946 (May 11, 2000).

[191] *Dep't of Enforcement v. Morgan Stanley DW Inc.*, No. CAF000045, 2002 NASD Discip. LEXIS 11 (N.A.C. July 29, 2002).

[192] *Hirsh*, Exchange Act Release No. 43691, 2000 SEC LEXIS 2703, at *19.

demonstrate that the delay caused actual prejudice.[193] Respondents have neither alleged nor demonstrated any prejudice. Accordingly, the Hearing Panel finds that none of the Causes of Action in the Complaint is time-barred.

B. Respondents' Day Trading

The First Cause of Action alleges that Respondents engaged in a fraudulent trade allocation scheme, i.e., cherry-picking, and failed to disclose material information to DGI's Discretionary Customers, in willful violation of Section 10(b) of the Exchange Act, Rule 10b-5 thereunder, and in violation of NASD Conduct Rules 2120 and 2110.

1. Legal Standard

Exchange Act Section 10(b), Exchange Act Rule 10b-5, and NASD Conduct Rule 2120 prohibit fraudulent and deceptive practices in connection with the offer, purchase, or sale of a security.[194] Violations of Section 10(b) of the Exchange Act and Rule 10b-5 may be established through direct or circumstantial evidence.[195]

Section 10(b) of the Exchange Act provides that it is "unlawful for any person ... to use or employ, in connection with the purchase or sale of any security ..., any

[193] *Dep't of Enforcement v. Kaweske*, No. C07040042, 2007 NASD Discip. LEXIS 5, at *39 (N.A.C. Feb. 12, 2007) (citing *Dep't of Enforcement v. Apgar,* No. C9B020046, 2004 NASD Discip. LEXIS 9, at *25 (N.A.C. May 18, 2004)); *see also James Gerard O'Callaghan*, Exchange Act Rel. No. 57840, 2008 SEC LEXIS 1154, at *32 (May 20, 2008).

[194] *Alvin W. Gebhart*, Exchange Act Release No. 53136, 2006 SEC LEXIS 93, at *59 (Jan. 18, 2006). *See also Basic v. Levinson*, 485 U.S. 224, 239 n.17 (1988); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12 (1976). Misrepresentations and omissions are also inconsistent with just and equitable principles of trade and therefore are a violation of NASD Conduct Rule 2110.

[195] *SEC v. Ginsburg*, 362 F.3d 1292, 1298 (11th Cir. 2004); *see also Donald M. Bickerstaff*, 52 S.E.C. 232, 1995 SEC LEXIS 982, at *14-16 (1995) (affirming violation of predecessor rule to NASD Conduct Rule 2110 based on circumstantial evidence); *Keith Springer*, 55 S.E.C. 632, 2002 SEC LEXIS 364, at *19 (Feb. 13, 2002) ("circumstantial evidence can be more than sufficient to prove a violation of the securities laws") (citations omitted).

manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe."[196]

Exchange Act Rule 10b-5 makes it unlawful "[t]o employ any device, scheme, or artifice to defraud; to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances in which they were made, not misleading; or to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security."[197] To establish a violation of Rule 10b-5, and NASD Conduct Rule 2120,[198] Enforcement must prove by a preponderance of the evidence that Respondents: (1) made misrepresentations or omissions of material facts; (2) with scienter; and (3) in connection with the purchase or sale of a security.[199]

Liability for material omissions is "'premised upon a duty to disclose arising from a relationship of trust and confidence between parties to a transaction.'"[200] A registered

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[196] 15 U.S.C. § 78j(b).

[197] 17 C.F.R. § 240.10b-5.

[198] NASD Conduct Rule 2120 is FINRA's antifraud rule and is similar to Section 10(b) and Rule 10b-5. *Market Regulation Comm. v. Shaughnessy*, No. CMS950087, 1997 NASD Discip. LEXIS 46, at *24 (N.B.C.C. June 5, 1997), *aff'd*, 53 S.E.C. 692 (1998).

[199] *SEC v. Berger*, 244 F. Supp. 2d 180, 188 (S.D.N.Y. 2001); *Kaweske*, No. C07040042, 2007 NASD Discip. LEXIS 5, at *25-26; *Dep't of Enforcement v. Frankfort*, No. C02040032, 2007 NASD Discip. LEXIS 16, at *21 (N.A.C. May 24, 2007); 17 C.F.R. § 240.10b-5; *see SEC v. Softpoint, Inc.*, 958 F. Supp. 846, 865 (S.D.N.Y. 1997) (finding that the jurisdictional requirements of the federal antifraud provisions are broadly construed), *aff'd*, 159 F.3d 1348 (2d Cir. 1998). Notably, "[FINRA] does not need to prove investor reliance, loss causation, or damages in an action under Section 10(b)." *SEC v. Credit Bancorp*, 195 F. Supp.2d 475, 490-91 (S.D.N.Y. 2002); *SEC v. Merchant Capital*, 483 F.3d 747, 766-69 (11th Cir. 2007) (Eleventh Circuit does not mention any of these elements when listing elements the SEC must prove to show violations of 10(b)).

In addition, violations of Section 10(b) and Exchange Act Rule 10b-5 must involve the use of any means or instrumentalities of transportation or communication in interstate commerce, or the mails, or any facility of any national securities exchange. *See, e.g., SEC v. Hasho*, 784 F. Supp. 1059, 1106 (S.D.N.Y. 1992). In this case, the requirement of interstate commerce is satisfied, inter alia, because all of Respondents' Discretionary Customers received confirmations in the mail reflecting the day-trading purchases.

[200] *Dep't of Enforcement v. Kesner*, No. 2005001729501, 2010 FINRA Discip. LEXIS 2, at *19 (N.A.C. Feb. 26, 2010) (quoting *Chiarella v. United States*, 445 U.S. 222, 230 (1980)).

representative owes a duty to his clients to disclose material information fully and completely, including material adverse facts.[201]

A violation of NASD's antifraud rule or Exchange Act Rule 10b-5 is also a violation of NASD Rule 2110. "It is well established that a violation of a Commission or NASD rule or regulation is inconsistent with just and equitable principles of trade, and is therefore also a violation of Rule 2110."[202]

2. Respondents Violated the Anti-Fraud Rules

Respondents engaged in a cherry-picking scheme. In reaching this conclusion, the Panel majority considered: (1) Dratel's credibility;[203] (2) the fact that Dratel worked alone and unsupervised in the East Hampton office;[204] (3) his fiduciary role with regard to the Discretionary Customers' accounts; (4) Dratel's failure to segregate his personal day trades from the Discretionary Customers' trades; (5) the origination of all day trades in the Firm Account, which provided the opportunity to delay allocations; (6) his ability to select the day trades to allocate to the Discretionary Customers; (7) Dratel's practice of time-stamping blank tickets; (8) Dratel's failure to record the customer name and account number on the order tickets when the orders were initially entered; (9) the lack of any

[201] *Frankfort*, No. C02040032, 2007 NASD Discip. LEXIS 16, at *20; *Kesner*, 2010 FINRA Discip. LEXIS 2, at *19.

[202] *Kirlin Sec.*, Exchange Act Rel. No. 61135, 2009 SEC LEXIS 4168, at *59-60, n.81 (Dec. 10, 2009).

[203] The Panel majority concluded that Dratel was not credible, as discussed in a number of places throughout this decision.

[204] The Dissent relies on the testimony of Dratel's assistants, Perez, Lopez, and Duncan, each of whom indicated that they had no knowledge of Dratel's alleged cherry-picking. However, unlike the Dissent, the Panel majority notes that, because Dratel worked alone in East Hampton, his assistants in the Manhattan office were unable to observe his practices. He only worked at the Manhattan office once or twice a month. Further, after hearing the testimony and observing the demeanor of Perez, Lopez, and Duncan, the Panel majority does not believe Dratel's assistants would have had the ability to detect Respondents' cherry-picking scheme. While they were apparently qualified to perform administrative and ministerial tasks for Dratel, he directed their actions. They exhibited very little initiative and performed their jobs in a perfunctory manner. It was clear, from observing their interactions with Dratel, that none of the Manhattan employees would have challenged Dratel if there was ever a question about what was right or wrong.

documentation reflecting allocations prior to a stock position being closed out; (10) the resetting of the time-stamp to ensure that the time on the FiNet allocation order tickets matched the time on the OMS order tickets, as well as the manually altered tickets; (11) the day trade allocations examples (discussed above); (12) the disparity in day-trading profits and losses for Dratel and the Discretionary Customers; and (13) Dratel's financial circumstances.

In 2006, Respondents' day-trading allocation scheme resulted in profits for Dratel of almost $500,000, while his Discretionary Customers sustained losses of more than $200,000.[205] The Panel majority finds that this disparity cannot be explained by market forces and it is more likely than not that it was caused by cherry-picking. The cherry-picking scheme operated as a fraud on the Discretionary Customers.[206]

Respondents also violated Rule 10b-5 through their material omissions. Dratel failed to disclose to his Discretionary Customers that he was (1) day trading for himself at the same time he was day trading for them and (2) allocating more profitable trades to himself. A fact is material if there is a substantial likelihood that a reasonable investor would have considered the fact important in making an investment decision, and disclosure of the omitted fact would have significantly altered the total mix of information available.[207] The Panel majority finds that reasonable investors would have

[205] *See supra* notes 129-32 and accompanying text. Dratel and his Discretionary Customers made almost the same amount of money during the last quarter of 2005. In addition, the examples of unfair trade allocations discussed above all occurred in 2006. Accordingly, in finding that Respondents violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and violated NASD Conduct Rules 2120 and 2110, as described in the First Cause of Action, the Panel majority used 2006 as the applicable time period, not the Relevant Period.

[206] *See SEC v. K.W. Brown*, 555 F. Supp. 2d 1275, 1304.

[207] *Basic*, 485 U.S. at 231-32.

considered Dratel's simultaneous day trading, and the subordination of their interests, to be material when deciding whether to place their money with and trust in Respondents.

Scienter is the "intent to deceive, manipulate or defraud."[208] Scienter may be established by a showing of recklessness that involves an "'extreme departure from the standards of ordinary care, ... which presents a danger of misleading buyers and sellers that is either known to the [actor] or is so obvious that the actor must have been aware of it.'"[209] A company's scienter may be imputed from that of the individuals controlling it.[210] As the president and sole owner of DGI, Dratel's mental state may be imputed to DGI. The Panel majority finds that Respondents acted with scienter. It is clear from the facts that Dratel knowingly put his interests ahead of the Discretionary Customers by allocating more profitable day trades to himself. He was a fiduciary of the Discretionary Customers' accounts, and yet he failed to put their interest ahead of his own.

Respondents' cherry-picking scheme satisfies the "in connection with the purchase or sale" requirements of Section 10(b) of the Exchange Act and Rule 10b-5. Respondents' scheme involved numerous buy and sell orders for securities.[211]

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[208] *Ernst & Ernst v. Hochfelder*, 425 U.S. at 193.

[209] *The Rockies Fund, Inc. v. SEC*, 428 F.3d 1088, 1093 (D.C. Cir. 2005) (citing *Steadman v. SEC*, 967 F.2d 636, 641-42 (D.C. Cir. 1992) (quoting *Sundstrand Corp. v. Sun Chemical Corp.*, 553 F.2d 1033, 1044-45 (7th Cir. 1977))). Proof of scienter is not required to establish that a misrepresentation or omission violates Conduct Rule 2110.

[210] *See SEC v. Blinder, Robinson & Co.*, 542 F. Supp. 468, 476 n.3 (D. Colo. 1982) (*citing SEC v. Manor Nursing Ctrs., Inc.*, 458 F.2d 1082, 1096-97 nn.16-18 (2d Cir. 1972)).

[211] *See SEC v. Zandford*, 535 U.S. 813, 819 (2002) (stating that the SEC has consistently adopted a broad reading of the phrase "in connection with the purchase or sale of any security"); *SEC v. Rana Research, Inc.*, 8 F.3d 1358, 1362 (9th Cir. 1993) ("in connection with" requirement satisfied if the "fraud . . . somehow 'touch[es]' upon securities transactions" (quoting *SEC v. Clark*, 915 F.2d 439, 449 & n.18 (9th Cir. 1990) ("in connection with" requirement more broadly construed in SEC actions than in private actions)).

3. Respondents' Arguments

a. *Customers are Friends and Family*

Respondents point out that the Discretionary Customers affected by the alleged cherry-picking scheme are individuals with whom Dratel has lengthy and close relationships (friends, family members, and long-time customers).[212] Respondents argue that not only would Dratel never cherry-pick from his long-time customers, he would do anything he could to help them. The Panel majority finds that the fact that Dratel's customers were his friends and family is not a defense to the fraudulent trade allocation charge. In fact, despite his relationship to the Discretionary Customers, the evidence demonstrates that Dratel engaged in a fraudulent trade allocation scheme.[213]

Moreover, Dratel's testimony regarding the help he gave his customers revealed his lack of candor with the Staff and further demonstrated that he was not credible. To exemplify the type of assistance he provided his customers, Dratel described payments he made to his customers, the manner in which he provided the payments, and the information he provided to FINRA regarding those payments. This testimony clearly shows that Dratel was not forthright with FINRA during its investigation. Dratel's customer payments and his statements to FINRA are described below.

Between January 1, 2008 and February 17, 2011, Dratel paid $156,575 to long-time customers when they experienced account declines as a result of the market collapse in 2008 through 2009.[214] Dratel described the payments as gifts to his customers, and

[212] Tr. 49, 1124-43, 1511-15.

[213] It is not unheard of for friends and family to be defrauded in a cherry-picking scheme. *See, e.g., James C. Dawson*, Admin. Proc. File No. 3-13579, 2009 SEC LEXIS 4143, *17-21(Dec. 18, 2009), *aff'd*, 2010 SEC LEXIS 2561 (July 23, 2010).

[214] RX-43.

asserted that he made these payments because it was the right and moral thing to do.[215] Dratel stated that he wanted to continue to provide some of his customers with the monthly check that they were used to receiving.[216] Initially, Dratel made the payments through DGI.[217] Dratel treated the payments as commission adjustments, and identified them as expenses for tax purposes.[218]

In June 2009, a FINRA examiner questioned Dratel regarding his payments to customers.[219] The examiner told Dratel that he should not make customer payments through the firm.[220] Thereafter, Dratel began paying his customers from his personal checking account.[221]

Then, in November 2009, when Dratel provided investigative testimony to FINRA,[222] he failed to disclose that he was making payments to his customers. The specific questions and answers provided are as follows:

Question:	Are these customers still receiving checks from their accounts?
Answer:	No.
Question:	Is there any reason why, why they're not receiving checks in their account?
Answer:	You came in and asked, and I told you. Once you said I shouldn't be doing it, I stopped doing it.

[215] RX-43; Tr. 335-39, 362-63, 477-85, 1444-45.

[216] Tr. 477.

[217] Tr. 343-45.

[218] Tr. 563. When responding to a question from a panelist, Dratel stated that the payments were treated as commission adjustments and reported as expenses for tax purposes. *Id.* In contrast, when responding to a question from Enforcement, Dratel denied that the payments were booked as commission adjustments. Tr. 336-37.

[219] Tr. 343-45.

[220] Tr. 344-45.

[221] Tr. 335, 345.

[222] Tr. 349.

Question: What do you mean?

Answer: This is from June. Tom [the examiner] came in and said you do some of this stuff, maybe you shouldn't be doing it. So I figured let me stop it right now....

Question: What about if they need a monthly check?

Answer: I spoke to them and they understood that they're not getting them for a while until their account goes up.[223]

At the hearing, Dratel admitted that at the time he provided his investigative testimony to FINRA, he was paying some of his customers out of his personal account.[224]

b. *Customers Made Money Overall*

Respondents argue that the fact that the Discretionary Customers made money overall is yet another factor that demonstrates that they did not cherry-pick. They asserted that it is important to review the Discretionary Customers' overall profits and losses over several years. Respondents emphasized that, from 1999 through 2006, the Discretionary Customers made approximately $1.7 million overall whereas Dratel made $860,000 from his day trading.[225]

Unlike the Dissent, the Panel majority rejects Respondents' argument for two reasons. First, the Discretionary Customers' overall profits, which include investments that were not day trades, are not relevant to the issues in this case. Respondents cite *SEC*

[223] Tr. 349-50.

[224] Tr. 350.

[225] RX-56; Tr. 1490-1515. The Dissent accepted the financial data presented by Respondents for the 1999 through 2006 time period. However, as discussed above, Respondents' financial data related to the customers' *overall* profits and included investments unrelated to day trades. Accordingly, it was not relevant to this proceeding.

v. Slocum, Gordon & Co.[226] in support of their position that overall profits are relevant to the cherry-picking allegation. However, in *Slocum*, the defendants' trading strategy involved both short-term and long-term trades.[227] Accordingly, the customers' overall profits were properly taken into account in determining their gain or loss. Here, unlike *Slocum*, the trading at issue is restricted to day trades executed within one or two business days, not long-term trades.[228] As such, evidence of the Discretionary Customers' overall profits is not relevant to the issue of whether Respondents engaged in a fraudulent day-trading allocation scheme.

Second, the financial data in Respondents' summary exhibit RX-56, reflecting overall profits and losses for the Discretionary Customers and Dratel, is not reliable. While Dratel testified that he "rarely" did cross-trades with customers and never did cross-trades at prices away from the market,[229] when confronted with the trading data, he conceded that he did internal customer cross-trades at above market prices.[230] During 2004 and 2005, Dratel purposefully took losses in his account via internal cross-trades, and his Discretionary Customers experienced greater than normal gains on those transactions.[231] As a result, the Discretionary Customers' overall profits were inflated, and Dratel's profits were artificially depressed. As such, the Panel majority cannot rely

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[226] *SEC v. Slocum, Gordon & Co.*, 334 F. Supp. 2d 144 (D.R.I. 2004). The Dissent also relies on *Slocum*; however, for the reasons discussed above, the Panel majority found that *Slocum* was distinguishable.

[227] *Id.* at 151-53.

[228] In addition, according to Respondents, day trades represented a small percentage of the Discretionary Customers investments at DGI. Tr. 503, 976-77.

[229] Tr. 198-99, 215-16. While the DGI customers received confirmations reflecting the cross-trades, the confirmations did not disclose that the counter party to the cross-trade was Dratel, and Dratel never told his customers that he did internal cross-trades with them. Tr. 216.

[230] Tr. 373-79, 1752.

[231] Tr. 383.

on RX-56. The Panel majority also considers RX-56 to be an improper attempt to cast purposeful losses as *actual* day-trading losses.

c. *Different Day Trading Strategies*

Respondents also assert that the disparity in profits and losses was due to the fact that Dratel used a "more aggressive" or "riskier" day trading strategy for himself than for his Discretionary Customers.[232] Respondents explained that Dratel used an online subscription service in 2006, which provided stock recommendations and day trading ideas on a daily basis, to assist him in selecting the riskier trades for himself.[233]

The Panel majority does not accept Dratel's assertion for several reasons. First, Dratel's detailed description of his different trading strategies at the hearing differed from his investigative testimony. During his investigative testimony, Dratel testified that the strategy he used to day trade for his customers during 2005 and 2006 did not differ from his own day-trading strategy.[234] Dratel testified: "I day trade the same way for everyone. ... Day trading is day trading."[235] He also testified that there was "usually no difference" in how he selected stocks to trade for himself versus the stocks he selected to trade for customers.[236] Regarding the selection of "riskier stock," Dratel stated that "[s]ometimes I might have done a stock myself that was either up or down a real lot, because that might be a little - that might have a little more intraday risk."[237] When there was a "riskier

[232] Tr. 233, 250-52.

[233] Tr. 1012-16, 1025.

[234] Tr. 222-25, 309-10, 311-12.

[235] Tr. 310.

[236] Tr. 313.

[237] Tr. 313.

stock," Dratel stated that he "usually" took it for himself; however, he also gave the riskier stocks to customers.[238]

At the hearing, Dratel testified that it was the *application* of his strategy that was more aggressive for his personal account than for the Discretionary Customers' accounts.[239] However, as demonstrated above, on 26 occasions, Dratel traded the same stock as his customers, on the same day. Dratel conceded that when executing those trades, he used the same day-trading strategy for himself as for his customers.[240] On those trades, Dratel realized profits of $25,500.77, while his customers made only $1,207.94. When trading the same stock, on the same day, using the same strategy, Dratel made over 21 times more than his customers.

In addition, Dratel allocated more overnight trades, which were riskier, to the Discretionary Customers. Dratel testified that it is "absolutely" riskier "to hold a position overnight than it is to buy and sell it on the same day."[241] Similarly, the SEC has noted that "[t]rue day traders do not own any stocks overnight because of the extreme risk that prices will change radically from one day to the next, leading to large losses."[242] Therefore, conducting day trades within a single trading day is a more conservative strategy. However, in 2006, of approximately 1,164 customer day trades,[243] approximately 323 of the customer day trades, roughly 27%, were held overnight.[244]

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[238] Tr. 314-15.

[239] Tr. 234-35.

[240] Tr. 2000-01.

[241] Tr. 219.

[242] Day Trading: Your Dollars at Risk, http://www.sec.gov/investor/pubs/daytips.htm.

[243] CX-145, at 49. These statistics are based on the number of customers who were allocated trades.

[244] *See* CX-139. This is the total of number of trades shown on CX-139 held for 1 day or -1 day (i.e., short sales).

Conversely, Dratel held approximately 21 of his personal day trades overnight, representing 5% of the 423 day trades he did in 2006.[245]

While Respondents presented several "Day Trade Examples"[246] to demonstrate that Dratel used a riskier strategy for himself, they failed to convince the Panel majority that the day trades he allocated to himself were more aggressive. When presenting various day trades to demonstrate his differing strategies, Dratel selected trades from particular trading days and submitted the pertinent online subscription service information to provide examples of the stock recommendations. However, he failed to discuss the other trades he did on the same day. For example, on February 27, 2006, Dratel traded AMT for customers, which he stated had a very strong recommendation on the online subscription service but ended up as an unprofitable trade.[247] That same day, Dratel executed two day trades for himself – HURC and NFI – both of which were profitable.[248] Dratel did not provide any information on the HURC and NFI trades at the hearing.[249] In addition, Dratel did not claim that AMT had a better recommendation than HURC and NFI or explain why he gave himself two profitable trades while his customers received an unprofitable one. Lastly, he failed to establish that the trades he gave to himself were riskier.

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[245] *Id.* Dratel's overnight trades (by symbol and sale date) were as follows: IMGC-1/5/06; ARXT-1/5/06; PL-1/10/06; MTW-1/12/06; LMS-1/19/06; MTSN-1/24/06; PLT-1/26/06; DSCP-2/1/06; GVA-2/7/06; RMD-2/9/06; VLCM-2/15/06; HURC-2/23/06; AMED-2/23/06; APSG-3/1/06; WYNN-3/7/06; ECL-3/10/06; ACLI-3/16/06; LAZ-3/21/06; STLD-3/30/06; DSCO-4/5/06; BIOV-9/6/06. *Id.*

[246] Respondents' exhibits included 27 day-trading examples. RX-11 - RX-38. Dratel testified regarding approximately 17 of the examples.

[247] RX-16; RX-4, at 7; Tr. 1063-66.

[248] RX-4, at 7.

[249] Dratel reviewed every trade in 2006, tr. 1016-17; however, he failed to address the HURC and NFI trades, which he executed on the same day as AMT, when discussing the AMT trades. Tr. 1062-66.

In sum, the Panel majority does not accept Dratel's assertion that he took the riskier day trades for himself, resulting in profits of nearly $500,000 in 2006, and gave the more conservative day trades to his Discretionary Customers, resulting in collective losses of more than $200,000.

4. Conclusion

The Panel majority finds that DGI and Dratel violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and violated NASD Conduct Rules 2120 and 2110, by engaging in a fraudulent trade allocation scheme, as described in the First Cause of Action.

By engaging in the fraudulent day-trading allocation scheme and failing to disclose the scheme, Respondents willfully violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. A finding of willfulness does not require a determination that Respondents intended to violate the federal securities laws or NASD's Rules.[250] Rather, the Panel majority need only find that Respondents voluntarily committed the act that constituted the violation,[251] i.e., engaging in a fraudulent trade allocation scheme. Here, the Panel majority finds that the Respondents committed the fraudulent trade allocation scheme with scienter, the intent to defraud or deceive. Accordingly, the Panel majority finds that Respondents' conduct was willful.

C. DGI's Books and Records

The Second Cause of Action alleges that DGI willfully violated Section 17(a) of the Exchange Act and Rules 17a-3(a)(6) and (7) thereunder, and DGI and Dratel violated

[250] *Dep't of Enforcement v. Kraemer*, No. 2006006192901, 2009 FINRA Discip. LEXIS 39, at *16 (N.A.C. Dec. 18, 2009).

[251] *Id.*

NASD Conduct Rules 3110(a) and 2110. Exchange Act Rules 17a-3(a)(6) and (7) require that a memorandum of each order be made that includes the time of receipt, *entry*,[252] and execution, as well as the *account* for which the order is entered. NASD Conduct Rule 3110(a) requires member firms to make and preserve books and records as required by the Exchange Act Rules 17a-3 and 17a-4.

DGI and Dratel failed to complete the order memoranda (i.e., order tickets) as required under the Exchange Act and NASD Conduct Rules. First, pursuant to Dratel's method of writing order tickets, the time of order entered on the FiNet allocation order tickets actually reflected the time of order execution, not the time the underlying order was entered.[253] Second, in furtherance of the cherry-picking scheme, Respondents created order tickets for allocations to make it appear that the allocation had been made at the time of the purchase in the Firm Account rather than later in the day or the next business day. Dratel's sales assistant completed the FiNet order tickets when she received the allocation instructions, which was after the position was closed.[254] On almost a daily basis, Perez rolled back the time on DGI's time-stamp machine to ensure that the time on the FiNet allocation order tickets matched the time on the corresponding OMS market order ticket.[255]

The Third Cause of Action alleges that Respondents violated NASD Conduct Rule 3110(j), which became effective on January 31, 2005. NASD Rule 3110(j) states, "Before any customer order is executed, there must be placed on the memorandum for

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[252] Time of entry means when the broker transmits the order or instruction for execution. 17 C.F.R. § 240.17a-3(a)(6).

[253] *See, e.g.*, RX-13, at 3, 5; RX-14, at 3, 5; RX-17, at 5-9; RX-18, at 3-6.

[254] Tr. 188-90, 1910-11.

[255] Tr. 917-18.

each transaction, the name or designation of the account (or accounts) for which such order is to be executed." From February 2005 through December 2006, Dratel executed over 210 multiple-customer day trades.[256] For all of these trades, the customer names and account numbers were not placed on the customer order tickets until several hours after the order was executed; or, in cases where blank, time-stamped order tickets were mailed to the Manhattan office, one or two days later.[257]

The Panel majority finds that DGI violated Exchange Act Rules 17a-3(a)(6) and (7), and DGI and Dratel violated NASD Conduct Rules 3110(a) and 2110, as described in the Second Cause of Action. Applying the above standard for willfulness, the Panel majority finds that DGI's violation of Exchange Act Rules 17a-3(a)(6) and (7) was willful. The Panel majority also finds that DGI and Dratel violated NASD Conduct Rules 3110(j) and 2110, as described in the Third Cause of Action.

D. DGI's Supervisory Systems and Procedures

The Fifth Cause of Action alleges that Respondents violated NASD Conduct Rules 3110(a) and (b) and 2110. NASD Rule 3110(a) requires Respondents to establish a "system to supervise the activities of each registered representative, registered principal, and other associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable NASD Rules." NASD Conduct Rule 3110(b) requires that, as part of a supervisory system, a firm's written procedures "are reasonably designed to achieve compliance with applicable securities laws and regulations, and with the applicable Rules of NASD." The standard of "reasonableness" is determined based on the particular circumstances of each case. A

[256] *See supra* note 157.

[257] *See supra* notes 158 and 159 and accompanying text.

violation of Conduct NASD Conduct Rule 3110 also is a violation of NASD Conduct Rule 2110, which requires member firms to observe high standards of commercial honor and just and equitable principles of trade.

DGI's supervisory system for day trading was inadequate on several levels. At the outset, because DGI was a one representative firm, Dratel supervised both his own day trading and the trading he did for his Discretionary Customers. Dratel was also responsible for DGI's policies and procedures. During the Relevant Period, DGI, through Dratel, failed to ensure that the firm had adequate policies and procedures. As discussed above, DGI's procedures were inadequate in a number of ways, including, but not limited to: (1) the failure to monitor and address conflicts of interest, (2) the failure to ensure that a customer's name or designation be placed on a customer order ticket before the order was executed, and (3) the failure to require that allocation instructions be formulated and documented before a customer order was executed through the Firm Account. Further, as discussed above, DGI, through Dratel, failed to enforce its written supervisory procedures. While DGI's procedures required that employee orders be so designated on the order ticket, none of Dratel's order tickets for his personal trades executed through the Firm Account contained any indication that the trade was for him.[258] Similarly, contrary to DGI's procedures,[259] Dratel failed to provide the customer account number prior to entering the order on numerous customer order tickets that were entered through the Firm Account.[260]

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[258] Tr. 328-30.

[259] CX-29, at 47.

[260] Tr. 331.

The Hearing Panel finds that Respondents violated NASD Conduct Rules 3010(a) and (b) and 2110, as described in the Fifth Cause of Action.

E. DGI's Customer Account Information

The Sixth Cause of Action alleges that, from November 2004 through January 1, 2008, DGI willfully violated Section 17(a) of the Exchange Act and Rule 17a-3(a)(17) thereunder, and DGI and Dratel violated NASD Conduct Rules 3110(a) and 2110, by failing to: (1) periodically update customer account information for 42 of their accounts, and (2) review new account documents on a quarterly basis and memorialize the review.

Exchange Act Rule 17a-3(a)(17)(i)(B)(1), the "thirty-six month rule," requires broker-dealers to periodically update customer account records every 36 months.[261] Exchange Act Rule 17a-3(a)(17)(i)(A) requires firms to make and keep current

> [a]n account record including the customer's or owner's name, tax identification number, address, telephone number, date of birth, employment status (including occupation and whether the customer is an associated person of a member, broker or dealer), annual income, net worth (excluding value of primary residence), and the account's investment objectives. In the case of a joint account, the account record must include personal information for each joint owner who is a natural person; however, financial information for the individual joint owners may be combined.[262]

The Rule requires firms to maintain records demonstrating that they have furnished to their customers, "at intervals no greater than thirty-six months, a copy of the account record or an alternate document with all the information required by paragraph (a)(17)(i)(A)."[263] In addition, the Rule requires that the "account record or alternate document furnished to the customer or owner shall include or be accompanied by

[261] 17 C.F.R. § 240.17a-3(a)(17)(i)(B)(1).

[262] 17 C.F.R. § 240.17a-3(a)(17)(i)(A).

[263] 17 C.F.R. § 240.17a-3(a)(17)(i)(B)(1).

prominent statements that the customer or owner should mark any corrections and return the account record or alternate document to the member, broker or dealer, and that the customer or owner should notify the member, broker or dealer of any future changes to information contained in the account record."[264]

The primary purpose of Rule 17a-3(a)(17) is to provide regulators with access to books and records to enable them to review for compliance with suitability rules.[265] The requirements of Rule 17a-3(a)(17) also allow customers to review the information regarding their account to ensure that the firm has correct information on file. NASD Conduct Rule 3110(a) requires Respondents to make and preserve firm records in conformity with NASD Conduct Rules and Exchange Act Rule 17a-3.

Dratel acknowledged that, as of September 2008, DGI had not timely updated customer account information for these 42 customers, and advised that he was in the process of doing so.[266] The account verification profiles sent by Oppenheimer did not satisfy the Exchange Act Rule 17a-3(a)(17)(i)(B)(i) requirement because they did not contain information about the customer's employment status, annual income, net worth, or investment objectives.

The Hearing Panel finds that DGI violated Exchange Act Rule 17a-3(a)(17)(i)(B)(i), and applying the above standard for willfulness, the DGI's violation of Exchange Act Rule 17a-3(a)(17)(i)(B)(i) was willful. The Hearing Panel also finds that DGI and Dratel violated NASD Conduct Rules 3110(a) and 2110, by failing to periodically update customer account information for 42 of their accounts. Because

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[264] *Id.*

[265] *Books and Records Requirements for Brokers and Dealers Under the Securities Exchange Act of 1934*, Exchange Act Release No. 44992, 2001 SEC LEXIS 2278, at *18 (2001).

[266] Tr. 465-67; CX-31; CX-32; CX-34, at 9-10; CX-35, at 3; CX-39.

Enforcement did not charge Respondents with a violation of NASD Rule 3010(a), the Hearing Panel does not find a violation for Respondents' failure to review new account information on a quarterly basis.

F. DGI's Anti-Money Laundering Program

The Seventh Cause of Action, pertaining to DGI's AML Compliance program, alleges that DGI violated NASD Conduct Rules 3011(b) and (c) and 2110. NASD Conduct Rule 3011(b) requires the establishment and implementation of policies, procedures, and internal controls reasonably designed to achieve compliance with the Bank Secrecy Act and the implementing regulations thereunder. Here, the applicable implementing regulation at issue is 31 C.F.R. 103.122 – Customer Identification Programs ("CIP") for Broker-Dealers ("Section 103.122"). Section 103.122 requires, among other things, that a broker-dealer's procedures provide the method for verifying the identity of each customer within a reasonable time before or after the customer's account is opened.

DGI's AML procedures required that verification of a customer's identity be made through documents, such as a valid driver's license or passport.[267] From August 2006 through January 2008, DGI opened accounts for 11 new customers but failed to timely obtain photo identification for any of the 11 new customers.

NASD Conduct Rule 3011(c) requires a member firm to conduct independent testing of its AML compliance program on an annual, calendar-year basis. "The rule establishes an expectation that ... the independent testing should be performed at least

[267] CX-41, at 3. DGI's AML procedures allowed for certain exceptions that are not applicable here.

once each calendar year."[268] In 2008, DGI had independent tests of its AML compliance program performed for years 2006 and 2007.[269] While these tests satisfied the requirement for 2008, they did not satisfy the requirements for 2006 or 2007.[270] Accordingly, DGI failed to conduct timely independent testing of its AML compliance program during years 2006 and 2007.

The Hearing Panel finds that DGI violated NASD Conduct Rules 3011(b) and 2110 by failing to obtain photo identification for the new accounts, and violated NASD Rules 3011(c) and 2110 by failing to conduct independent testing of its AML compliance program during years 2006 and 2007.

V. SANCTIONS

A. Respondents' Day Trading

1. Sanction Guidelines

For misrepresentations or material omissions of fact, the FINRA Sanction Guidelines ("Guidelines") recommend a fine of $2,500 to $50,000 and a suspension of up to 30 business days for negligent misconduct. For intentional or reckless misconduct, they recommend a fine of $10,000 to $100,000 and a suspension of 10 business days to two years, or in egregious cases a bar.[271]

Regarding Respondents' fraudulent day-trading allocation scheme, the Panel majority concluded that Respondents' misconduct was egregious. The misconduct was a flagrant breach of DGI's customers' trust. As the SEC stated, "There could not be a more

[268] FINRA Notice to Members 06-07.

[269] CX- 38, at 1; CX-40, at 1.

[270] CX-33, at 4.

[271] FINRA Sanction Guidelines at 90 (2011). In addition, the fine amount may be increased to take into consideration the respondent's financial benefit from the misconduct. *Id.* n.2.

blatant breach of a fiduciary duty or the exercise of a higher degree of scienter than ... deliberately allocating ... trades [a registered representative] knew were more profitable than the trades he allocated to the accounts of his clients, all of whom were family and friends."[272]

2. Principal Considerations

The Panel majority considered the Principal Considerations in the Guidelines and identified several aggravating factors. At the outset, Respondents' misconduct was intentional. Respondents deliberately delayed allocation of trades until they knew whether or not those trades were profitable. Respondents also deliberately falsified order tickets to make it appear that they had allocated trades timely.[273]

Respondents' cherry-picking scheme demonstrated a pattern of misconduct with numerous customers over a substantial period.[274] On virtually a daily basis, Dratel allocated profitable trades to himself. In so doing, he falsified numerous order tickets, and continuously violated DGI's supervisory procedures.

Dratel profited from his misconduct while causing direct financial injury to his customers who relied on his day trading on their behalf.[275] During 2006, Dratel earned profits of almost $500,000. Conversely, the Discretionary Customers suffered losses of over $200,000.

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[272] *James C. Dawson*, 2009 SEC LEXIS 4143, at *17.

[273] Tr. 184-90, 1910-14.

[274] Guidelines at 6 (Principal Consideration Nos. 8 & 9).

[275] Guidelines at 6-7 (Principal Consideration Nos. 11 & 17).

At no time did Dratel accept responsibility for his misconduct.[276] He even refused to acknowledge that conducting his personal day trades while simultaneously day trading for his Discretionary Customers presented a conflict. Dratel dismissed the idea that his simultaneous trading created a conflict of interest stating that he "knew ... who was buying what."[277] Dratel also concealed his misconduct.[278] He never disclosed his cherry-picking scheme to his customers, or even notified them that he was trading for himself while also trading their accounts. In addition, Respondents provided FINRA with inaccurate documentary information during its investigation of his cherry-picking scheme.[279]

3. Conclusion

The Panel majority concludes that Dratel's continued participation in the securities industry creates an unacceptable risk to the investing public. It is evident from his repeated disregard of the federal antifraud provisions and NASD's investor protection rules that Dratel should not remain in the securities industry. Accordingly, the Panel majority concludes that a bar is the appropriate sanction for Dratel's violation of Section 10(b) of the Exchange Act and Rule 10b-5, and NASD Conduct Rules 2120 and 2110. The Panel majority found no mitigating factors that would warrant permitting Dratel to remain in the securities industry. The Panel majority also orders Dratel to disgorge

[276] Guidelines at 6 (Principal Consideration No. 2).

[277] Tr. 136-37.

[278] Guidelines at 6 (Principal Consideration No. 10).

[279] Guidelines at 7 (Principal Consideration No. 12).

$489,000 in ill-gotten gains that he received during 2006 from his fraudulent day-trading allocation scheme.[280]

For DGI, the Panel majority determines that the appropriate remedial sanction is a (1) a $100,000 fine, and (2) a permanent bar from the activity of day trading.

B. DGI's Books and Records

For recordkeeping violations, such as violations of NASD Conduct Rule 3110 and Exchange Act Rule 17a-3, the Guidelines recommend a fine of $1,000 to $10,000, and a suspension for firms and responsible individuals for up to 30 business days. Where the violations are egregious, the Guidelines recommend a fine ranging between $10,000 and $100,000, and consideration of individual bars and firm expulsions. In addition to the Principal Considerations, the Guidelines direct the adjudicators to consider the nature and materiality of the inaccurate or misleading information in the records.

Respondents created inaccurate order tickets and refused to acknowledge this misconduct. Respondents' books and records violations involved numerous order tickets and continued for an extended period of time. These violations enabled Respondents to carry out their cherry-picking scheme. Because these violations arise out of or relate to the cherry-picking scheme, the Panel majority will aggregate or "batch" them for the purpose of assessing sanctions.[281] Accordingly, the sanctions assessed against DGI and

[280] The Panel majority found that Dratel engaged in a fraudulent day-trading allocation scheme throughout 2006. Dratel calculated his day trading profits as $489,000 for 2006. Tr. 1516. The Panel majority finds that $489,000 represents the direct financial gain that Dratel obtained as a result of his misconduct, and accepts Dratel's calculation as a reasonable approximation of his unjust enrichment. *See SEC v. First City Fin. Corp., Ltd.*, 890 F.2d 1215, 1231 (2d Cir. 1989) (noting that a disgorgement figure must reasonably approximate the amount of unjust enrichment but not necessarily prove the precise amount of ill-gotten gains).

[281] Guidelines at 4 (General Principle No. 4); *see, e.g., Dep't of Enforcement v. Reynolds*, No. CAF990018, 2001 NASD Discip. LEXIS 65, at *66-67 & n.42 (N.A.C. June 22, 2001) (aggregating or "batching" sanctions for violations of Section 17(b) of the Securities Act of 1933 based on material omissions with sanctions for violations under NASD Conduct Rules 2110 and 2210 based on the same omissions).

Dratel for the First Cause of Action will also apply to the Second and Third Causes of Action.

C. DGI's Supervisory Systems and Procedures

For the violation of NASD Conduct Rule 3010(a), the Guidelines recommend a fine of $5,000 to $50,000, suspension of the responsible individuals in all supervisory capacities for up to 30 business days, and limiting the activities of appropriate branch offices or departments for up to 30 business days. In egregious cases, the Guidelines suggest limiting activities of the branch office or department for a longer period or suspending the firm with respect to any or all activities or functions for up to 30 business days, and suspending the responsible individual in any or all capacities for up to two years or barring the responsible individual.[282] The Guidelines set forth the following considerations when determining the appropriate sanction for a failure to supervise: (1) the quality and degree of the supervisor's implementation of the firm's supervisory procedures and controls; (2) whether respondent ignored "red flag" warnings that should have resulted in additional supervisory scrutiny; and (3) the nature, extent, size, and character of the underlying misconduct.[283]

The Guidelines for NASD Conduct Rule 3010(b), regarding deficient written supervisory procedures, recommend a fine between $1,000 and $25,000. In egregious cases, the Guidelines suggest individual suspensions of up to one year and firm suspensions of up to 30 business days, and continuing thereafter until the supervisory procedures conform to requirements. In addition to the Principal Considerations, the Guidelines require adjudicators to consider whether the deficiencies allowed the violation

[282] Guidelines at 103.

[283] *Id.*

to occur or escape detection and whether the deficiencies made it difficult to determine the individual responsible for specific areas of supervision or compliance.

The Hearing Panel found no evidence of any effective supervisory controls for DGI's allocation of day trades. DGI operated as a one-man shop and Dratel supervised himself. Thus, Dratel's ability to engage in cherry-picking was unfettered.

DGI, through Dratel as its CCO, failed to ensure that DGI had appropriate procedures in place to ensure that unfair trade allocations did not occur. In addition DGI, through Dratel, routinely failed to enforce its procedures. On a daily basis, Dratel disregarded DGI's procedures concerning the completion of order tickets for employee and discretionary accounts.

In light of Respondents' deficient supervision and their failure to establish, maintain, and enforce reasonable supervisory procedures, the Panel majority finds that the appropriate remedial sanction is at the upper end of the Guidelines for DGI and Dratel. Accordingly, the Panel majority determines that DGI's sanction is a $50,000 fine, and Dratel's sanction is a $50,000 fine and a 30-day suspension as a principal from association with any FINRA member. Because the Panel majority barred Dratel for the violations in the First, Second, and Third Causes of Action, the Panel majority will not impose the sanctions against Dratel for the Fifth Cause of Action.

D. DGI's Customer Account Information

For DGI's violation of Section 17(a) of the Exchange Act and Rules 17a-3(a)(17) thereunder, and Respondents' violation of NASD Conduct Rules 3110(a) and 2110, the Hearing Panel applied the above guidelines for record keeping violations. Maintaining accurate customer account records is essential in the securities industry to ensure that a registered representative "knows his customer." The Hearing Panel found Respondents'

misconduct to be serious and determined that the appropriate remedial sanction for DGI is a $10,000 fine, and for Dratel, a $10,000 fine and a one-week suspension in all capacities from association with any FINRA member. However, because the Panel majority barred Dratel for the violations in the First, Second, and Third Causes of Action, the Hearing Panel will not impose the sanctions against Dratel for the Sixth Cause of Action.

E. DGI's Anti Money Laundering Program

The Guidelines do not specifically address violations of NASD Conduct Rule 3011. However, in substance, the rules requiring firms to implement AML programs are supervisory requirements. Accordingly, the Hearing Panel considered the above guidelines for supervisory violations in determining the appropriate remedial sanction in this case.[284]

The Hearing Panel found that DGI's misconduct was serious. It is important as a matter of national policy that every FINRA member implements an effective AML program. Independent testing is a critical component to ensure that a firm maintains an effective AML program. In addition to failing to obtain the photo identification for certain customers, DGI also failed to timely conduct independent AML testing for two years. The Panel majority concludes that the appropriate sanction under the facts and circumstances of this case is a $25,000 fine. This sanction will remediate DGI's violations and deter others from engaging in similar misconduct.

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[284] *See Dep't of Enforcement v. Domestic Sec., Inc.*, No., 2005001819101, 2008 FINRA Discip. LEXIS 44, at *21 n.9 (N.A.C. Oct. 2, 2008).

VI. ORDER

Based on careful consideration of all the evidence, the Panel majority, and the Hearing Panel regarding the Sixth Cause of Action, impose the following sanctions:

A. DGI

DGI is fined a total of $185,000 and barred from engaging in day trading for the violations in the First, Second, Third, Fifth, Sixth, and Seventh Causes of Action.

DGI is fined $100,000 and barred from day trading for:

- engaging in a fraudulent trade allocation scheme in willful violation of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and in violation of NASD Conduct Rules 2120 and 2110, as described in the First Cause of Action;
- failing to ensure that order tickets accurately reflected account designations and times of entry in willful violation of Section 17(a) of the Exchange Act and Rules 17a-3(a)(6) and (7) thereunder, and in violation of NASD Conduct Rules 3110(a) and 2110, as described in the Second Cause of Action; and
- failing to ensure that account names or designations were placed on the order tickets prior to execution of orders in violation of NASD Conduct Rules 3110(j) and 2110, as described in the Third Cause of Action.

DGI is fined $50,000 for failing to establish and maintain a reasonable supervisory system and procedures to achieve compliance with applicable securities laws and regulations in violation of NASD Conduct Rules 3010(a) and (b) and 2110, as described in the Fifth Cause of Action.

DGI is fined $10,000 for failing to timely update customer account information in willful violation of Section 17(a) of the Exchange Act and Rule 17a-3(a)(17) thereunder, and in violation of NASD Conduct Rules 3110(a) and 2110, as described in the Sixth Cause of Action.

DGI is fined $25,000 for failing to obtain photo identification for new customer accounts and failing to conduct independent testing of its Anti-Money Laundering program in 2006 and 2007 in violation of NASD Conduct Rule 3011(b) and (c) and 2110, as described in the Seventh Cause of Action.

B. Dratel

Dratel is barred from associating with any member firm in any capacity for:

- engaging in a fraudulent trade allocation scheme in willful violation of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and in violation of NASD Conduct Rules 2120 and 2110, as described in the First Cause of Action;
- failing to ensure that order tickets accurately reflected account designations and times of entry in violation of NASD Conduct Rules 3110(a) and 2110, as described in the Second Cause of Action; and
- failing to ensure that account names or designations were placed on order tickets prior to execution of orders in violation of NASD Conduct Rules 3110(j) and 2110, as described in the Third Cause of Action.

Dratel is also ordered to disgorge $489,000 in ill-gotten gains that he received during 2006 from his fraudulent day-trading allocation scheme.

In light of the above sanctions, the Panel majority did not impose sanctions on Dratel for the following violations:

- failing to establish and maintain a reasonable supervisory system and procedures to achieve compliance with applicable securities laws and regulations in violation of NASD Conduct Rules 3010(a) and (b) and 2110, as described in the Fifth Cause of Action; and
- failing to timely update customer account information in violation of NASD Conduct Rules 3110(a) and 2110, as described in the Sixth Cause of Action.

In addition, the Respondents, jointly and severally, are ordered to pay the costs of this proceeding in the total amount of $16,077.60, which include an administrative fee of $750 and hearing transcript costs of $15,327.60.

The bar shall become effective immediately if this Decision is FINRA's final disciplinary action in this disciplinary proceeding. The remaining sanctions shall become effective on a date set by FINRA, but not earlier than 30 days after this Decision becomes FINRA's final disciplinary action.[285]

Maureen A. Delaney
Hearing Officer
For the Majority of the Extended
Hearing Panel

[285] The Hearing Panel considered all of the parties' arguments. They are rejected or sustained to the extent that they are inconsistent with the views expressed herein.

DISSENT

Panelist, dissenting, in part:

I respectfully dissent with respect to the finding of liability on the First Cause of Action, the alleged fraudulent allocation scheme (cherry-picking). I find DGI and Dratel liable for the record keeping violations described in the Second and Third Causes of Action; however, my finding of liability does not relate to the fraudulent day-trading allocation scheme in the First Cause of Action. I also dissent as to the sanctions for the Second, Third, Fifth, and Seventh Causes of Action.

Dratel has been day trading for himself and customers since at least 1999, and has always used the Firm Account as a price average account; there was no change in the way he conducted his business during the Relevant Period, and no change in the mechanics of his record keeping or order transmission. Enforcement's investigation was triggered by an increase in As-Of Trades, which were unconnected to cherry-picking, as were the multitude of problems with order tickets and altered or incorrect time-stamps. Since there was no direct evidence of cherry-picking, Enforcement's entire case was circumstantial and built exclusively on the statistical unlikelihood of Dratel's day trading success being attributable to anything other than cherry-picking. However, I believe that Enforcement did not establish a credible statistical case. It is axiomatic that the accuracy of statistics is dependent on the adequacy of the sample size. Here, Enforcement's expert appeared to "cherry-pick" data to obtain the desired results, leading me to find that the circumstantial evidence (i.e., the statistical difference between Dratel's success rate and his customers' losses) was unreliable.

To begin, the Relevant Period of October 2005 through December 2006, as well as the previous nine months used for comparison purposes, was arbitrary. The start date was determined by an increase in As-Of Trades that appeared to be unrelated to the alleged cherry-picking. Further, Dratel had engaged in day trading for his own accounts and DGI's discretionary customer accounts for at least seven years, and there was no testimony that either the 15-month Relevant Period or the prior nine months used for comparison was a representative sample size. My review of other "cherry-picking" cases reveals that the relevant period began either with (1) the opening of an account at issue[286] or (2) the hiring of a problem employee.[287] Further, when a case did not provide information about a triggering event, sample periods of four or seven years were used.[288] A different time-frame could produce very different results. For example, Dratel maintains that from 1999 through 2006, his clients made $1.7 million overall and he made $860,000 from day trading.

Second, there was further arbitrary manipulation of the sample size: Enforcement's expert reduced the number of accounts he included in his statistical analysis of day trading from 40 to 25 (eight of which were profitable), because 15 accounts engaged in only one or two day trades during the Relevant Period. No other explanation was given to justify the exclusion of these accounts. It is easy to see that reducing an already small sample size arbitrarily can result in wildly distorted results. For

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[286] *James C. Dawson*, Admin. Proc. File No. 3-13579, 2010 SEC LEXIS 2561 (July 23, 2010) (review period of April 2003 through December 2005, when the clearing broker discovered suspicious trading); *Stephen Jay Mermelstien*, Admin. Proc. File No. 3-13713, 2009 SEC LEXIS 4164 (Dec. 14, 2009) (review period of August 2000 through December 2003, beginning with the launching the hedge fund).

[287] *Keith Springer*, 2002 SEC LEXIS 364 (review period of September 1995 through March 2006); *SEC v. K.W. Brown*, 555 F. Supp. 2d 1275, 1304 (review period of September 2002 through June 2006).

[288] *See Melhado, Flynn &Assoc.*, Admin. Proc. File No. 3-12574, 2011 SEC LEXIS 1662 (May 11, 2011) (utilizing a review period of January 2001 through April 2005); *SEC v. Slocum, Gordon & Co.*, 334 F. Supp. 2d 144 (D.R.I. 2004) (review period was 1996-2000).

example, a selection of ten accounts (25% of the total) that happened to include the eight profitable accounts could have led to a finding that 80% of Respondents' clients made money on day trades. Conversely, if a broker decided to allocate all losing trades to the customers who only day traded once or twice, the results could have similarly skewed the statistics because these accounts would have been overlooked. The elimination of accounts that engaged in only one or two day trades seems particularly problematic because Enforcement's theory was that Respondent Dratel sprinkled losing day trades around to different accounts in order to help conceal his cherry-picking. It should also be noted that Enforcement's expert, while eliminating 15 accounts because of the small number of day trades, did not eliminate the single instance in which Dratel obtained a better day-trading price than his customer.

Third, Enforcement's methodology in counting trades was not explained or defended. When Respondents questioned the use of trades rather than stocks to compute gains and losses, the expert was unable to defend his methodology, and repeatedly conceded that there were many ways to compute the statistics without explaining why the method he chose was appropriate. The "cherry-picking" cases I reviewed all seem to discuss "trades," although the methodology does not seem to have been disputed; however, the expert's inability to defend his methodology undermined the reliability and objectivity of his calculations.

Fourth, there were additional errors in the expert report that further undermined the expert's credibility. For example, at least one trade was not a day trade.

In *SEC v. Slocum, Gordon & Co.*, the court stated that the "mere opportunity for possible fraud does not translate into actual wrongdoing."[289] The court did not find cherry-picking despite a witness who testified directly about the cherry-picking, the firm's 98% success rate versus a 49% unrealized customer loss rate, the existence of allocation forms that were only partially completed at the time of the transactions, the commingling of client and firm funds, and reallocation of transactions. In *Slocum*, the court stated that two clerical employees would have to have known about the cherry-picking scheme, and those employees denied any knowledge of the cherry-picking. Here, Perez, Lopez, and Duncan similarly testified that they had no knowledge of Dratel's alleged cherry-picking. Perez, Lopez, and Duncan also testified that they had never seen Dratel do anything improper or direct them to do anything improper. Because none of them is currently employed by DGI (and, in fact, Duncan and Lopez had been recently laid off), they have no motivation to lie. Any hesitancy in testifying can be explained by a general discomfort with the situation.

The *Slocum* Court also considered the overall profitability of the client accounts. Dratel's customer accounts were profitable, and day trading represented an extremely small percentage of the customers' trades. The 40 accounts at issue here had an undisputed 26.5% overall gain during the Relevant Period.

Lastly, Dratel's clients were family, friends, and long-term family friends. Dratel has been a broker for many years, and there was no evidence of his intent to harm his clients. While there were other irregularities in Dratel's business practices, such as his customer cross-trades at above market prices and payments to his customers, they were

[289] *SEC v. Slocum, Gordon & Co.*, 334 F. Supp. 2d 144, 171.

not charged in the Complaint and they demonstrate a concern for his customers rather than intent to harm them.

Because I do not think Enforcement presented a prima facie case, I do not find it necessary to review the adequacy of Respondents' exhibits or his testimony. However, I do not interpret the inclusion of the losses Dratel incurred as a result of customer crosses at above-market prices in RX-56 as a deliberate attempt to deceive the Panel. Respondent Dratel brought these crosses to the Panel's attention in an attempt to demonstrate his "fairness" to customers. Their inclusion in RX-56, along with other errors in the exhibit, seems another example of carelessness, sloppiness, and inattention to detail, not fraud. I would dismiss the First Cause of Action with respect to both Respondents.

I also dissent with regard to the two record keeping violations described in the Second and Third Causes of Action. For the Second Cause of Action, which pertains to manually altered order tickets, I find that there is no evidence that Dratel personally altered the tickets or directed anyone to alter them. However, Dratel was DGI's sole proprietor, sole broker, and CCO; I would therefore find a record keeping violation for both Respondents, but not a violation tied to a scheme to defraud.

The Third Cause of Action relates to Dratel's failure to maintain contemporaneous records of allocations. Dratel's records for aggregated or multiple-customer trades consisted of time-stamped tickets and allocation sheets with fax hashings after the close of the market or the completion of the buy and sell for the particular trade. While Dratel's staff did not confirm his account of intra-day transmissions or discarded faxes, all three witnesses (Lopez, Duncan, and Perez) stated that they had never seen Dratel do anything improper and that he never directed them to do anything improper.

Dratel's record keeping may be sloppy and ambiguous; however, without evidence of cherry-picking it is not clear that allocations were made (as opposed to transmitted) after the fact. I would find a record keeping violation unrelated to cherry-picking.

Because I did not find that the Second and Third Causes of Action related to fraud or cherry-picking, or were otherwise egregious, I recommend the following sanctions:

- For Dratel, a fine of $10,000 and a 30-day suspension in all capacities for each cause of action, for a total of $20,000 in fines and a 60-day suspension in all capacities for both counts;
- For DGI, a fine of $10,000 for each cause of action, for a total of $20,000 in fines.

For the Fifth Cause of Action, I recommend that Dratel be fined $10,000 and suspended in all capacities for 21 days, and that DGI be fined $10,000. For the Seventh Cause of Action, I recommend a $5,000 fine for DGI.

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