BEFORE THE NATIONAL ADJUDICATORY COUNCIL

FINANCIAL INDUSTRY REGULATORY AUTHORITY

In the Matter of Department of Enforcement, Complainant, vs. J. W. Korth & Company Lansing, MI, Respondent.	AMENDED DECISION[1] Complaint No. 2012030738501 Dated: May 23, 2019

Respondent firm charged excessive markups on sales of municipal and corporate bonds, and excessive markdowns on purchases of corporate bonds. Held, findings and sanctions affirmed.

Appearances

For the Complainant: Christopher Burkey, Esq., Megan P. Davis, Esq., Leo F. Orenstein, Esq., Department of Enforcement, Financial Industry Regulatory Authority

For the Respondent: James W. Korth

Decision

J. W. Korth & Company ("J. W. Korth" or the "Firm") appeals a January 26, 2017 Hearing Panel decision pursuant to FINRA Rule 9311. The Hearing Panel found, that from April 2009 through December 2011, J. W. Korth violated Municipal Securities Rulemaking Board ("MSRB") Rules G-30 and G-17 by charging excessive markups on 38 sales of municipal securities. The Hearing Panel also concluded that the Firm violated NASD Rule 2440, IM-2440, and FINRA Rule 2010 by charging excessive markups on nine sales of corporate debt securities and excessive markdowns on four purchases of corporate debt securities. For these violations, the Hearing Panel censured the Firm, ordered it to pay restitution, and ordered that it retain an independent consultant with experience in establishing pricing procedures for sales and purchases of debt securities to review the Firm's pricing procedures.

J. W. Korth raises several issues on appeal. With respect to certain bond transactions at issue, J. W. Korth argues that the Hearing Panel used the wrong methodology to calculate the Firm's markups and markdowns and that the case law relied upon by the Hearing Panel was

[1] The decision is amended to include Amended Schedules A and B.

distinguishable from the facts of this case. The Firm further argues that the prices it charged its customers were justified by the time and expense the Firm dedicated to each bond transaction and the complex, specialized services it provided to its customers, and produced documents on appeal in an attempt to support this argument.

After an independent review of the record, we affirm the Hearing Panel's findings and sanctions.

I. Factual Background

A. J. W. Korth

J. W. Korth, headquartered in Lansing, Michigan, was founded in 1982 and has been a FINRA member since 1983. It is also a member of MSRB.[2] The Firm focuses its business on fixed-income products and generates the majority of its revenue from servicing financial advisers, institutions, and wealthy individuals with diversified fixed income accounts. The Firm represents that it runs a full service firm with a "heavy touch and research operation." To that end, the Firm contends that its approach is unique in the retail bond market and that it, unlike other broker-dealers focused on fixed-income sales, is capable of performing due diligence necessary to identify bonds that have a "higher intrinsic than offered value and pass[] the higher value to [its] customers."

From April 2009 through December 2011, the relevant time period at issue in this appeal, J. W. Korth provided all of its clients with a proprietary web-based system—Shop4Bonds—that enabled its customers to see the interdealer prices of bonds, without markups, for approximately 90 percent of U.S. bond offerings. J. W. Korth also researched and recommended smaller, more obscure bond issues with ratings below investment grade and bonds with complicated structures that a general, less-specialized firm may not have recommended. During the relevant time period, the Firm generated revenues of approximately $3.2 million in 2009, $3.7 million in 2010, and $2.8 million in 2011.

B. J. W. Korth's Markup/Markdown Policies and Procedures

The Firm explained that its markup and markdown procedures were designed to "balance the need for fair treatment of customers with the commission levels to representatives and the costs of maintaining all the support services, compliance, accounting, advertising and professional fees that both customers and representatives receive the benefit of." The Firm's Written Supervisory Procedures ("WSPs") identified James W. Korth, the Firm's founder, managing partner, general principal, and municipal principal, as the Designated Supervisor for "Trading and General Oversight of the Firm." He was responsible for reviewing the

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[2] MSRB is the self-regulatory organization charged with rule-making authority for municipal securities activities. *See Anthony A. Grey*, Exchange Act Release No. 75839, 2015 SEC LEXIS 3630, at *2 n.3 (Sept. 3, 2015).

reasonableness of markups and markdowns on customer trades. The Firm had at least four employees responsible for approving the pricing of each markup or markdown.

Although the Firm's WSPs did not address target profit or suggest a markup or markdown percentage on each trade, the Firm informally supplemented its procedures with its markup policy on an ad hoc basis. Prior to February 2009, the Firm's policy related to markups included a maximum of 3.5 percent internal markup/markdown limit on bond transactions. In February 2009, J. W. Korth revised its policy, raising the maximum markup or markdown to 3.9 percent. In an email to the Firm's staff, the Firm's chief compliance officer ("CCO"), Michael Gibbons, noted that:

> Jim [Korth] and I have been discussing some of our policies and we agree that due to the current environment some changes are warranted. While our costs have basically stayed the same, the market environment has created a slowdown in our trading volume. Therefore, the average cost per ticket has risen for us. While we must obviously adhere to the FINRA 2440 markup rule (5% guideline as it's known), and the FINRA Fair Dealing Rule, we have decided to allow markups of up to a 3.9% limit as opposed to our standard 3.5%. This doesn't mean that every trade should be marked at 3.9% because in many cases that would not be warranted. Please use your best judgment.

On appeal, the Firm contends that the costs and fees it incurred, combined with the unique and in-depth services it provides to its clients, justified its markups—including those that exceeded its own internal cap. Moreover, the Firm believes that it, unlike fixed income broker-dealers, is capable of performing a heightened level of due diligence that is necessary for it to identify bonds that have "intrinsic value," which allows it to offer the bonds to its customers at lower prices.

C. Bond Transactions at Issue

J. W. Korth appeals the Hearing Panel's findings that the Firm charged excessive markups in the following municipal bond transactions:[3]

- **Trades 1-7 (CUSIP No.[4] 880443BG0)**. On April 21, 2009, J. W. Korth purchased 300,000 bonds between 3:00 and 4:00 p.m. and sold the bonds to eight customers (only

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[3] FINRA's Department of Enforcement ("Enforcement") compiled the trade data for the securities the Firm sold to its customers in each of the transactions at issue. Enforcement exported the trade data from MSRB's Electronic Municipal Market Access system (EMMA) for the municipal bond transactions and produced it in Amended Schedule A, which is attached to this decision.

[4] CUSIP is an acronym for Committee on Uniform Security Identification Procedures and refers to the nine-digit, alphanumeric numbers that are used to identify securities, including bonds. The first six characters identify the issuer and are assigned in an alphabetical fashion; the

[Footnote continued on next page]

seven of which are alleged to include excessive markups) on April 22, 2009, between 4:30 and 4:40 p.m., at markups of 4.12 to 5.58 percent.

- **Trade 10 (CUSIP No. 54241AAW3).** On May 28, 2009, J. W. Korth bought 170,000 bonds in two trades at approximately 4:00 p.m. and sold 85,000 to one customer at 10:00 a.m. the following day at a 3.65 percent markup.

- **Trade 11 (CUSIP No. 6459162E6).** On June 10, 2009, J. W. Korth purchased 45,000 bonds and, within six minutes, sold the bonds to a customer at a markup of 3.89 percent.

- **Trades 12-14 (CUSIP No. 458761BE2).** On July 14, 2009, J. W. Korth purchased 25,000 bonds and sold them to a customer one minute later at a 3.48 percent markup. On July 21, 2009, the Firm purchased an additional 25,000 bonds and sold them to a customer ten minutes later at a 3.86 percent markup. On July 23, 2009, J. W. Korth bought another 60,000 bonds and sold them to a customer approximately 24 hours later at 5.47 percent markup.

- **Trades 15-19 (CUSIP No. 38122NPA4).** On July 31, 2009. J. W. Korth purchased 95,000 bonds at 11:27 a.m. and, less than 20 minutes later, sold 50,000 bonds to two customers at a markup of 3.79 percent. At approximately 12:30 p.m., the Firm sold an additional 25,000 bonds at a 3.79 percent markup. J. W. Korth purchased an additional 200,000 bonds at 1:45 p.m. and immediately sold 185,000 to a customer at a 3.1 percent markup. At 1:56 p.m., the Firm purchased 180,000 bonds and sold them at 2:05 p.m. at a 3.1 percent markup.

- **Trades 20-21 (CUSIP No. 86657MAL0).** On September 2, 2009, at 12:00 p.m., J. W. Korth purchased 45,000 bonds, and at 4:00 p.m. on September 3, sold 20,000 bonds at a markup of 8.33 percent. At approximately 11:00 a.m. on September 4, the Firm sold 25,000 bonds at an 8.33 percent markup.

- **Trades 22-26 (CUSIP No. 196458MN0).** On January 28, 2010, J. W. Korth purchased 250,000 bonds at 3:50 p.m., and at 4:10 p.m., it sold 70,000 bonds to three customers at a markup of 3.71 percent. On January 29, 2010, between 10:30 a.m. and 10:42 a.m., the Firm sold an additional 120,000 bonds to five customers at a markup of 3.71 percent. At 10:53 a.m., J. W. Korth purchased an additional 280,000 bonds, 100,000 of which it sold five minutes later at a 3.71 percent markup. The following business day, February 1, 2010, the Firm sold 200,000 bonds to one customer at a 3.71 percent markup.

[cont'd]

seventh and eighth characters (which can be alphabetical or numerical) identify the type of security, and the last digit is used as a check digit.
See http://www.msrb.org/msrb1/emma/pdfs/LocatingCUSIPsinvestor.pdf.

- **Trades 29-32 (CUSIP No. 74514LJU2)**. On February 17, 2010, at 9:02 a.m., J. W. Korth purchased 600,000 bonds and sold 440,000 bonds to seven customers between 9:15 a.m. and 11:25 a.m. at a markup of 4.05 percent.

- **Trade 35 (CUSIP No. 574205FK1)**. On March 2, 2010, J. W. Korth purchased 100,000 bonds and sold the bonds on March 3, 2010, at a markup of 5.87 percent.

- **Trade 36 (CUSIP No. 696507PF3)**. On March 12, 2010, J. W. Korth purchased 60,000 bonds and sold the bonds five days later on March 17, 2010, at a markup of 6.82 percent.

- **Trades 43-44 (CUSIP No. 130178FP6)**. On May 5, 2010, J. W. Korth purchased 195,000 bonds, and sold the bonds on May 7, 2010, at a markup of 5.63 percent. The Firm purchased an additional 75,000 bonds on May 11, 2010, and sold the bonds on May 12, 2010, at a markup of 3.31 percent.

- **Trades 45-49 (CUSIP No. 589664AU5)**. On July 19, 2010, J. W. Korth purchased 300,000 bonds at 3:35 p.m. and sold the bonds the next day, between 9:43 a.m. and 1:25 p.m., to nine customers at a markup of 3.6 percent.

- **Trade 51 (CUSIP No. 26822LGS7)**. On December 8, 2011, J. W. Korth purchased 270,000 bonds, and sold 100,000 on December 9, 2011, at a markup of 4.72 percent.

J. W. Korth appeals the Hearing Panel's findings that the Firm charged excessive markups in the following corporate bonds:[5]

- **Trades 2 and 4 (CUSIP No. 40429CCW0)**. On April 8, 2009, J. W. Korth charged 5.3 percent markups on sales to two customers after holding the bonds in inventory for approximately two hours.

- **Trade 5 (CUSIP No. 12628PAE3)**. On April 21, 2009, J. W. Korth charged its customer a 3.48 percent markup after holding the bonds in inventory for 13 minutes.

- **Trade 6 (CUSIP No. 01903QAA6)**. On April 24, 2009, J. W. Korth charged its customer a 5.56 percent markup after holding the bonds in inventory for 28 minutes.

- **Trade 7 (CUSIP No. 02003MAF1)**. On May 15, and June 24, 2009, J. W. Korth charged its customer a 3.9 percent markup after holding the bonds in inventory for three minutes.

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[5] For the corporate bonds, Enforcement exported the trade data from FINRA's Trade Reporting and Compliance Engine ("TRACE") through FINRA's Web Integrated Audit Trail ("WIAT") and produced it in Amended Schedule B, which is attached to this decision.

- **Trade 8 (CUSIP No. 78442FEH7).** On June 24, 2009, J. W. Korth charged its customer a 3.47 percent markup after holding the bonds in inventory for one minute.

- **Trade 9 (CUSIP No. 78442FAX6).** On January 22, 2010, J. W. Korth purchased bonds from a customer and simultaneously sold them in interdealer transactions. J. W. Korth charged the customer a markdown of 3.75 percent.

- **Trade 10 (CUSIP No. 34537OBM1).** On March 1, 2010, J. W. Korth purchased bonds from a customer and simultaneously sold them in interdealer transactions. J. W. Korth charged the customer a markdown of 3.65 percent.

- **Trade 11 (CUSIP No. 02687QBW7).** On March 12, 2010, J. W. Korth purchased bonds from a customer and simultaneously sold them in interdealer transactions. J. W. Korth charged the customer a markdown of 3.57 percent.

- **Trade 12 (CUSIP No. 34537OVM1).** On March 16, 2010, J. W. Korth purchased bonds from a customer and sold them in interdealer transactions three minutes later. J. W. Korth charged the customer a markdown of 3.75 percent.

- **Trades 13 and 14 (CUSIP No. 420122AB9).** On October 14, 2010. J. W. Korth charged two customers 3.75 percent markups after holding the bonds in inventory for one minute.

- **Trade 18 (CUSIP 90400XAC8).** On December 7, 2011, J. W. Korth charged its customer a 3.24 percent markup after holding the bonds in inventory for less than one hour.

II. Procedural Background

Enforcement filed the complaint on December 10, 2014. Cause one alleged that J. W. Korth charged unfair prices on sales of municipal securities in 44 transactions, in violation of MSRB Rules G-30 and G-17.[6] Cause two alleged that J. W. Korth charged unfair prices on sales or paid unfair prices in purchases of corporate bonds and collateralized mortgage obligations

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[6] FINRA's By-Laws provide that its members and persons registered with members agree to comply with MSRB Rules, and FINRA is authorized to impose sanctions for violations of MSRB Rules. *See* FINRA By-Laws Article IV, § 1(a)(1) (agreement by firms); FINRA By-Laws Article V, § 2(a)(1) (agreement by registered persons); FINRA By-Laws Article XIII, § 1(b) (authorization to impose sanctions for violation of MSRB Rules).

("CMOs") in 18 transactions, in violation of NASD Rule 2440, IM-2440-1, and FINRA Rule 2010.[7]

After the Firm withdrew its request for oral argument, the Hearing Panel considered the matter on the record, which included the parties' briefs and Enforcement's two expert reports. For cause one, the Hearing Panel found that J. W. Korth's markups on municipal bond sales in excess of three percent were not fair and reasonable as to Trades 10-19, 22-26, 29-32, 35, and 43-51. In addition, the Hearing Panel found that J. W. Korth's markups on municipal bond sales in excess of 3.5 percent were not fair and reasonable in Trades 1-7, 20, 21, and 36.[8]

For cause two, the Hearing Panel concluded that J. W. Korth's markups and markdowns on corporate bonds in excess of three percent were not fair and reasonable as to Trades 2, 4-14, and 18.[9]

This appeal followed.

III. Discussion

A. Applicable Rules

MSRB and FINRA rules obligate their respective member firms to deal fairly with customers and require member firms to charge prices that are fair and reasonable.

MSRB Rule G-30 requires municipal securities dealers to charge prices that are of a "fair and reasonable amount, taking into account all relevant factors." MSRB Rule G-30.[10] The rule provides several factors that may be relevant in determining the fairness and reasonableness of municipal securities transaction prices, including: the fair market value of the securities at the time of the transaction, in the best judgment of the broker; the expense involved in effecting the transaction; the fact that the broker is entitled to a profit; and the total dollar amount of the transaction. *Id.* MSRB has also issued interpretive guidance setting forth additional factors that

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[7] FINRA Rule 2121 superseded NASD Rule 2440, IM-2440-1, and IM-2440-2, effective May 9, 2014. *See* SR-FINRA-2014-023, http://www.finra.org/industry/rule-filings/SR-FINRA-2014-023, Exchange Act Release No. 72208, 79 Fed. Reg. 30,675 (May 21, 2014). NASD Rule 2440, IM-2440-1, and IM-2440-2 were applicable during the relevant period.

[8] The Hearing Panel dismissed Enforcement's allegations as to six sales of municipal bonds, concluding that Enforcement did not meet its burden, or that the record supported the markups charged by the Firm. Enforcement did not appeal these findings.

[9] The Hearing Panel dismissed Enforcement's allegations as to five trades (three sales of CMOs and two corporate bond sales). Enforcement did not appeal these findings.

[10] FINRA has jurisdiction to enforce MSRB Rules pursuant to Section 15B of the Securities Exchange Act of 1934 ("Exchange Act"), 15 U.S.C. § 78o-4(c)(5).

may be relevant, including: the availability of the security in the market; the price or yield of the security; the maturity of the security; and the nature of the professional's business. MSRB Interpretations of Rule G-30, Report on Pricing (Sept. 26, 1980).[11] MSRB has advised that (in determining whether a municipal bond has been fairly and reasonably priced) the "most important" consideration is "the resulting yield to a customer." *Id.* at 3, P 13.

Similarly, NASD Rule 2440 provides that if a member "sells for his own account to his customer, he shall . . . sell at a price which is fair, taking into consideration all relevant circumstances."[12] The rule itemizes some of the factors relevant to the analysis, "including market conditions with respect to such security at the time of the transaction, the expense involved, and the fact that [the firm] is entitled to a profit." *Id.*

Both MSRB and FINRA have "just and equitable" rules. MSRB Rule G-17 provides that, "[i]n the conduct of its municipal securities or municipal advisory activities, each broker, dealer, municipal securities dealer, and municipal advisor shall deal fairly with all persons and shall not engage in any deceptive, dishonest, or unfair practice." A firm that charges unfair prices in sales of municipal securities violates both MSRB Rules G-17 and G-30. *See Grey*, 2015 SEC LEXIS 3630, at *16-17.

FINRA Rule 2010 provides that "[a FINRA] member, in the conduct of its business, shall observe high standards of commercial honor and just and equitable principles of trade." NASD IM-2440-1 states that "[i]t shall be deemed a violation of [FINRA] Rule 2010 . . . for a member to enter into any transaction with a customer in any security at any price not reasonably related to the current market price of the security."

B. Markup/Markdown Analysis

Under MSRB and FINRA rules, the determination of whether pricing on a markup or markdown is excessive requires a two-step analysis. The first step is to determine the appropriate prevailing market price. *See Mark David Anderson*, Exchange Act Release No. 48352, 2003 SEC LEXIS 3285, at *23 (Aug. 15, 2003) (holding that a dealer charges excessive markups when he charges retail customers prices not reasonably related to the prevailing market price); MSRB Supplementary Material G-30.01(c) ("A 'fair and reasonable' price bears a reasonable relationship to the prevailing market price of the security."). After that determination is made, the fact finder "must determine whether the markups [or markdowns], as calculated based on prevailing market price, were fair and reasonable." *Grey*, 2015 SEC LEXIS 3630, at *18.

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[11] Available at http://www.msrb.org/Rules-and-Interpretations/MSRB-Rules/General/Rule-G-30.aspx?tab=2)

[12] NASD IM-2440-1 and NASD IM-2240-2 provide additional guidance on pricing and markups and markdowns.

1. Determining Prevailing Market Price – Contemporaneous Cost

The prevailing market price generally is "the price at which dealers trade with one another, i.e., the current inter-dealer market." *Alstead Dempsey & Co.*, 47 S.E.C. 1034, 1035 (1984). When a dealer acquires a bond in interdealer trades closely related in time to the customer transactions, the dealer's contemporaneous cost is presumed to be "the best measure of prevailing market price."[13] *Grey*, 2015 SEC LEXIS 3630, at *17. This standard "recognizes that the prices paid for a security by a dealer in actual transactions closely related in time to its sales are normally a highly reliable indication of the prevailing market." *See, e.g., First Honolulu Sec., Inc.*, 51 S.E.C. 695, 697 (1993); *Alstead Dempsey & Co.*, 47 S.E.C. at 1035.

To determine contemporaneous cost, the SEC generally looks to a broker-dealer's interdealer purchases within five business days of the retail sale at issue. *See Grey*, 2015 SEC LEXIS 3630, at *19. However, in appropriate circumstances, the SEC will also look at interdealer trading outside this five-day window. *See First Honolulu*, 51 S.E.C. at 699.

FINRA, the SEC, and the federal courts have consistently held that a broker-dealer's contemporaneous cost of acquiring a security provides the best evidence of the prevailing market price, absent any countervailing evidence:

> When a dealer is not a market maker, and absent countervailing evidence, the SEC has announced that: 'a dealer's contemporaneous cost is the best evidence of the current market. That standard, which has received judicial approval, reflects the fact that prices paid for a security by a dealer in actual transactions closely related in time to his retail sales are normally a highly reliable indication of prevailing market price.'

Grandon, 147 F.3d. at 189 (*quoting Alstead, Dempsey & Co.*, 47 S.E.C. at 1035); NASD IM-2440-2 (specifies with respect to debt securities that the prevailing market price is presumptively established by the broker-dealer's contemporaneous cost).

The presumption that contemporaneous cost is the best measure of prevailing market price may be overcome, but the burden is on the broker-dealer to present evidence sufficient to show that contemporaneous cost is not indicative of the market. *See Grey*, 2015 SEC LEXIS 3630, at *19.

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[13] Contemporaneous cost is generally defined as "the retail market price that the dealer paid for a security in actual transactions close in time to its retail sales." *See Grandon v. Merrill Lynch & Co.*, 147 F. 3d 184, 187 (2d Cir. 1998).

2. Determining Whether the Markup/Markdown Is Fair and Reasonable

Once the prevailing market price has been determined, the next step is to consider whether the markup over or markdown under the prevailing market price is fair and reasonable.[14] As stated above, MSRB and FINRA rules highlight several relevant factors to be considered in determining the fairness and reasonableness of municipal securities transaction prices, including the type of security; the fair market value of the security; the expense involved in effecting the transaction; the fact that the broker is entitled to a profit; and the yield to the customer.

In addition, FINRA's markup rule, NASD IM-2440-1, provides a five percent benchmark for markups (the "5 % Policy"). It notes, however that the 5% Policy is only a guide and that a markup of less than five percent may be considered unfair and unreasonable. NASD IM-2440-1(a)(1), (4). Furthermore, "[d]etermination of the fairness of mark-ups must be based on a consideration of all the relevant factors, of which the percentage of mark-up is only one." NASD IM-2440-1(a)(5). Unlike FINRA's markup rule, MSRB Rule G-30 provides no threshold percentage for determining what constitutes a reasonable markup. However, the SEC and FINRA both have stated that markups on municipal securities should fall below five percent absent extraordinary circumstances.[15] *First Honolulu*, 51 S.E.C. at 698 ("[A]lthough some markups on municipal bonds may reach 5%, that figure might be acceptable in only the most exceptional cases."); *see also, Inv. Planning, Inc.*, 51 S.E.C 592, 595 (1993) (finding markups of 4 percent and above on various corporate bonds and municipal securities improper, and stating that such markups "represent extraordinary charges for ordinary transactions"). In fact, FINRA and the SEC have consistently held that a significantly lower markup is customarily charged in the sale of debt securities. *Anderson*, 2003 SEC LEXIS 1935, at *24; *First Honolulu*, 51 S.E.C. at 698.

C. J. W. Korth Charged Excessive Markups

J. W. Korth appealed the Hearing Panel's determination that it violated MSRB Rules G-30 and G-17 by charging excessive markups in 38 sales of municipal securities and NASD Rule 2440, IM-2440, and FINRA Rule 2010 by charging excessive markups in nine sales of corporate debt securities and excessive markdowns in four purchases of corporate debt securities. We affirm the Hearing Panel's findings.

1. Prima Facie Case of Excessive Markups

For both the municipal and corporate debt securities transactions on appeal, Enforcement provided sufficient evidence, including expert testimony, that not only supports the use of

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[14] The markup on a security is defined as "the difference between the price charged to the customer and the prevailing market price." *Grandon*, 147 F. 3d at 189.

[15] MSRB has stated that "[a]s a general matter, the NASD's rules of fair practices do not apply to municipal securities transactions. Accordingly, the '5% policy' does not apply to municipal securities transactions." MSRB Report on Pricing, at n.1.

contemporaneous cost as the prevailing market price, but also establishes that the markups and markdowns J. W. Korth charged were unfair. In addition to Enforcement's evidence, the Hearing Panel conducted its own independent review of the trade data and agreed with Enforcement's assessment as to 38 municipal transactions and 13 corporate transactions. We discuss Enforcement's prima facie case and the Hearing Panel's findings below.

a. Expert Testimony

i. Charles Paviolitis

Enforcement relied on Charles Paviolitis ("Paviolitis") to provide an expert opinion on the municipal bond transactions at issue in this case. Paviolitis reviewed documents in the record, including the trade data. He also independently researched and reviewed trade data derived from EMMA, relevant official statements, ratings information, and material event notices related to the municipal transactions. Paviolitis concluded that there were no interdealer trades that would reflect a contemporaneous market significantly different from the Firm's interdealer purchase prices and that J. W. Korth's contemporaneous cost was the best evidence of prevailing market price. In addition, Paviolitis opined that the industry norm was to charge markups ranging from 0.25 percent to three percent and that the Firm's 3.9 percent internal policy related to markups on municipal bond transactions was inconsistent with the custom and practice in the municipal bond market during the relevant period of time.[16]

ii. Vikram Kapoor

Enforcement relied on Vikram Kapoor ("Kapoor") to provide expert opinion on the corporate bond transactions. Kapoor reviewed the documents in the record, including TRACE data for a two-month period surrounding the transactions at issue. Kapoor's review of the TRACE data revealed that there were no other interdealer transactions in the corporate bonds between the time the Firm acquired the bonds and the time the Firm sold the bonds to its customers. Given the lack of interdealer transactions and the proximity between the Firm's acquisition and disposition of the bonds, Kapoor opined that contemporaneous cost was the most appropriate, and in fact the only, method of determining prevailing market price for the transactions at issue. Furthermore, Kapoor used a three percent threshold to calculate excessive markups and markdowns. Kapoor concluded that J. W. Korth "had a statistically significant

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[16] Paviolitis opined that the appropriate markup for the Firm's municipal bond transactions at issue in this case should not have exceeded 2 percent. The Hearing Panel rejected this conclusion and we agree. Applicable case law (and even Paviolitis himself) suggests that the three percent maximum markup on debt securities is an appropriate benchmark. *See, e.g.*, *Grey*, 2015 SEC LEXIS 3630, at *35 (noting respondent's own concession that markups exceeding three percent are suspect and probably excessive); *Anderson*, 2003 SEC LEXIS 1935, at *36 (noting that markups on debt securities of three to 3.5 percent may be excessive).

higher markup on the securities at issue than the highest markup of the other dealers with a 95 percent degree of confidence."[17]

b. The Hearing Panel's Analysis

The Hearing Panel independently analyzed the same trade data reviewed by Enforcement's experts. Based on that review, the Hearing Panel agreed with the experts that the prevailing market price should be determined based on the Firm's contemporaneous costs. The Hearing Panel found that, with respect to the municipal bond transactions, most of Korth's purchases occurred only one to two days prior to its sales to customers and that no intervening interdealer trades occurred. With respect to the corporate bond transactions, the Hearing Panel found that all of the trades occurred on the same day as the Firm's sales to its customers.

After concluding that the Firm's contemporaneous costs were the best indicator of the prevailing market price, the Hearing Panel next calculated what it determined to be a fair and reasonable markup or markdown for each transaction at issue. Based on the relevant trade data, and taking into consideration factors relevant to pricing, such as the nature of the bonds, their maturity and yield, issue size, and liquidity, the Hearing Panel found that a markup or markdown of three percent was fair and reasonable for most of the bonds. For the remaining transactions (municipal bond Trades 1-7, 20-21, 36), the Hearing Panel found that the markup or markdown should not have exceeded 3.5 percent. Specifically, the Hearing Panel made the following findings with respect to the municipal bonds:

- **Trades 1-7**. The Hearing Panel agreed with Enforcement's expert Paviolitis that this was not a particularly obscure bond, but the Hearing Panel found that Paviolitis failed to give sufficient consideration to the fact that this bond had a 20-year average maturity and the effect of this on the customers' yield. Based on the Hearing Panel members' experience in the municipal bond industry, it concluded that 3.5 percent would have been an acceptable markup for this bond, given its yield and maturity.

- **Trade 10**. The Hearing Panel concluded that this bond had a large issue size and an average amount of liquidity. Given the short amount of time that the Firm held these bonds, and the reasonable size of the customer trade, the Hearing Panel determined that the Firm's markup was not fair and reasonable to the extent that it exceeded three percent.

- **Trade 11**. The Hearing Panel noted that at a similar time on the same day as this trade, another firm purchased 10,000 bonds at a higher price, yet sold them to a customer at a price lower than J. W. Korth's retail sales price. Based on Hearing Panel members'

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[17] While the Hearing Panel concurred with Kapoor's 3 percent base line markup/markdown, it noted that the figures in Kapoor's report did not always comport with the trading records produced by Enforcement. Thus, rather than rely solely on Kapoor's report, the Hearing Panel conducted its own independent review of trade data.

municipal bond experience, it found that the Firm's markup was excessive to the extent that it exceeded three percent.

- **Trades 12-14**. Even though the Firm held some bonds overnight, the Hearing Panel found that it did not demonstrate any change in the market during that time, and nothing in the trade data suggested that a change occurred. Because the Firm did not produce evidence to justify its markups, the Hearing Panel found that a three percent markup would have been fair and reasonable.

- **Trades 15-19**. The Hearing Panel noted that this was a large issue with active trading during July 2009 and that the Firm appeared able to buy and sell these bonds quickly. Because the Firm did not produce evidence to justify its markups, the Hearing Panel found that a three percent markup would have been fair and reasonable.

- **Trades 20-21**. The Hearing Panel noted that the Internal Revenue Service commenced an investigation into the tax exempt status of these bonds. The Hearing Panel considered the size of the issue (small), the limited trading in the bond, the nature of the bond at issue, the size of J. W. Korth's sales to its customers, and the fact that the Firm did not buy and sell these bonds within hours or even on the same day. The Hearing Panel found that the Firm's 8.33 percent markups were not fair and reasonable, but that a markup of 3.5 percent would have been fair.

- **Trades 22-26**. The Hearing Panel noted that this bond was not heavily traded during the days at issue and that the issue size was small. During the course of two days, the Firm committed its capital to purchase in excess of 500,000 bonds, part of which it held for two days. The Hearing Panel noted, however, that J. W. Korth did not memorialize or document the work that it undertook to purchase and sell the bond. Because the Firm did not produce evidence to justify its markups, the Hearing Panel found that a three percent markup would have been fair and reasonable.

- **Trades 29-32**. The Hearing Panel considered the level of trading in these bonds and the fact that they are floating-rate bonds linked to the Consumer Price Index. The Hearing Panel speculated that these factors could suggest that the Firm expended additional time and manpower on researching and locating buyers for these bonds. The Firm however, provided no evidence documenting any efforts that it undertook to purchase and sell these bonds. In the absence of such evidence, the Hearing Panel concluded that three percent would be a fair markup on these trades.

- **Trade 35**. The Hearing Panel noted that the Firm's purchase and sale occurred approximately one hour apart and there is no evidence that the market moved during that time.[18] Because the Firm did not produce evidence to justify its markups, the Hearing Panel found that a three percent markup would have been fair and reasonable.

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[18] The Hearing Panel's finding concerning the timing of the purchase and sale of this security is incorrect. In fact, the purchase and sale occurred one day apart (March 2 and March

[Footnote continued on next page]

- **Trade 36**. The Hearing Panel noted that this bond was a small issue and that on March 17, 2010, the day of J. W. Korth's sale, rating agency Fitch changed the credit outlook for the bonds from negative to stable and affirmed the rating of BBB-. The Hearing Panel reasoned that in order for it to determine what effect, if any, the March 17 event had on trading, it would need to review trade data for trading days subsequent to March 17. However, without this evidence, the Hearing Panel gave consideration only to the material events and concluded that a markup of 3.5 percent would have been fair and reasonable.

- **Trades 43-44**. The Hearing Panel noted that the Firm's purchases and sales occurred quickly and that nothing in the trading records suggests changes in the market for this security. Because the Firm did not produce evidence to justify its markups, the Hearing Panel found that a three percent markup would have been fair and reasonable.

- **Trades 45-49.** The Hearing Panel noted that the Firm's purchases and sales occurred quickly and that nothing in the trading records suggests changes in the market for this security. The Firm's markup reduced the customer's yield, and it did not produce evidence to substantiate the reasonableness of its markups. Furthermore, other firms sold this security to customers the day before J. W. Korth's sales at significantly lower prices. As such J. W. Korth's markups in excess of three percent were not fair and reasonable.

- **Trade 51**. The Hearing Panel noted that the purchase and sale occurred approximately one day apart and that there was no evidence that the market moved during that time. Because the Firm did not produce evidence to justify its markups, the Hearing Panel found that a three percent markup would have been fair and reasonable.

The Hearing Panel further made the following findings with respect to the corporate bonds:

- **Trades 2 and 4**. The Hearing Panel observed little trading in this security and noted that another interdealer trade occurred on April 8, 2009, at the same price as J. W. Korth's purchase, while other dealers' sales to customers on that day occurred at significantly lower prices than J. W. Korth's retail sales prices. The Hearing Panel concluded that the Firm did not present any evidence to substantiate a change in the market or other circumstances that would justify a markup in excess of three percent.

- **Trades 5-8**. The Hearing Panel found that J. W. Korth did not present any evidence to substantiate a change in the market, a change in ratings, additional services that the Firm provided, or other circumstances that would justify markups in excess of three percent.

[cont'd]

3, 2010). However, this error is harmless—there is no evidence that the market moved over the course of that day.

- **Trades 9-12.** The Hearing Panel concluded that J. W. Korth did not present any evidence to substantiate a change in the market, a change in ratings, additional services that the Firm provided, or other circumstances that would justify markdowns in excess of three percent.

- **Trades 13 and 14**. The Hearing Panel concluded that J. W. Korth did not present any evidence to substantiate a change in the market, a change in ratings, additional services that the Firm provided, or other circumstances that would justify markups in excess of three percent.

- **Trade 18**. The Hearing Panel noted that all other interdealer transactions that day occurred at or below J. W. Korth's purchase price. It also reviewed the trading in these securities on the relevant days, considered other interdealer transactions on those days, and looked at other dealers' sales to customers. The Hearing Panel concluded that the Firm did not present any evidence to substantiate a change in the market, a change in ratings, additional services that the Firm provided, or other circumstances that would justify a markup in excess of three percent.

On the basis of the record and prevailing case law, we find that Enforcement met its burden to show that contemporaneous cost represents the prevailing market price for the bond transactions in this matter. We also adopt the Hearing Panel's findings that the Firm's markups or markdowns in excess of three or 3.5 percent were unfair based on the record. On appeal, J. W. Korth argues that some of the Firm's markups and markdowns should not have been calculated using contemporaneous cost, but rather using interdealer quotes. It further contends that regardless of the methodology used, it has presented sufficient evidence to justify its markups and markdowns on each trade. We address the Firm's arguments below.

2. J. W. Korth Failed to Rebut the Presumption that Contemporaneous Cost Is the Appropriate Measure of the Prevailing Market Price or Demonstrate <u>That Its Markups Were Fair</u>

For most of the 38 municipal bonds at issue on appeal, the Firm does not dispute that Enforcement properly calculated the prevailing price using contemporaneous cost. For the remaining transactions, J. W. Korth attempts to rebut this presumption by claiming that its markups should be calculated based not on the Firm's contemporaneous cost but rather on the best available interdealer quotes or bid/ask at the time of the customer transaction. In any event, regardless of the methodology used, the Firm argues that each and every markup was fair and reasonable given the nature of the transactions and amount of research conducted by the Firm.

a. <u>The Hearing Panel Properly Shifted the Burden to the Firm</u>

As an initial matter, J. W. Korth argues that the Hearing Panel improperly shifted the burden to the Firm to justify its markups or markdowns because the case law cited by the Hearing Panel relies on a five percent markup as the threshold to shift the burden to a firm, and not a three or 3.5 percent markup, as used by the Hearing Panel. The Firm argues this provides

an independent basis for dismissing the charges against it. We disagree and find that the Hearing Panel properly shifted the burden to J. W. Korth to justify any markups or markdowns that exceeded three percent or, in several cases, 3.5 percent.

Rather than focus on standards to determine the fairness or reasonableness of a markup, as articulated in MSRB and FINRA rules, the Firm incorrectly concentrates on the actual numeric percentage discussed in several SEC decisions. The Firm points to, by way of example, *First Honolulu* and *Steven P. Sanders*,53 S.E.C. 889, 895 (1998). The Firm asserts that in these cases, the SEC shifted the burden to respondent to justify its markups on municipal or corporate bonds when the markup was more than 5 percent. It thus argues that it is only when FINRA presents evidence that a firm's markup met or exceeded five percent that the burden shifts to a firm to show that the facts surrounding these transactions justified higher markups. We disagree. Rather, the burden shifts to a respondent to justify its markup once FINRA presents evidence that a firm's markup is unfair or unreasonable, *regardless of the numeric percentage*. It is well-settled that markups and markdowns on municipal and corporate securities may be excessive although they are substantially below five percent. The SEC previously has shifted the burden to a respondent where the markup was below five percent. For example, in *Mark David Anderson*, the respondent's markups on municipal bonds ranged from 1.42 percent to five percent, and the SEC shifted the burden to the respondent to justify the markups. *Anderson*, 2003 SEC LEXIS 3285, at *29. Here, the Hearing Panel's shifting of the burden to J. W. Korth to "explain why, notwithstanding the evidence to the contrary, [its] pricing was fair" was wholly consistent with well-established SEC precedent. *Id.* (quoting *Richard R. Perkins*, 51 S.E.C. 380, 383 n.16 (1993)); *see also Grey*, 2015 SEC LEXIS 3630, at *18 ("Once the relevant enforcement party presents evidence demonstrating that the markups were excessive, the dealer may introduce evidence to attempt to justify the markups."); *Donald T. Sheldon*, 51 S.E.C. 59, 77 (1992) (once the Division of Enforcement presented evidence establishing the excessiveness of the markups, "the burden shifted to [respondent] to refute that evidence"), *aff'd*, 45 F.3d 1515 (11th Cir. 1995).

The fairness of the markup depends on the criteria articulated in MSRB and FINRA rules and the facts and circumstances unique to each trade, not a hard and fast percentage. *See First Honolulu*, 51 S.E.C. at 701 ("The NASD, as proponent of the issue, had the burden of introducing prima facie evidence of the excessiveness of the markups. The NASD met this burden by presenting evidence that the transactions at issue existed, the size of the transactions, the nature of the securities, the prices paid by [respondents] contemporaneously, and the prices charged to the customers. Once the NASD presented evidence of the markups, the burden shifted to [respondents] to refute this evidence."). We are therefore unpersuaded by the Firm's argument and deny its request to dismiss the allegations on these grounds.

In a similar vein, the Firm further argues that "nowhere in the rules does it indicate anything saying 3% is or was the threshold of fairness." The Firm misreads the Hearing Panel's decision. The Hearing Panel did not conclude that any markup or markdown of more than three

percent on a bond transaction is per se unfair.[19] Rather, as discussed above, based on the facts and circumstances surrounding the particular transactions at issue here, the Hearing Panel concluded that *in this case*, markups in excess of three percent, or in several cases 3.5 percent, were unfair and unreasonable.

b. J. W. Korth Failed to Rebut the Presumption that Contemporaneous Cost Is the Best Indicator of Prevailing Market Price for the Trades at Issue

J. W. Korth argues that its markups and markdowns should be calculated not from the Firm's contemporaneous costs but, rather, based on interdealer quotes or bid/ask. J. W. Korth has failed to offer any basis for departing from the general rule against using offers and bids to determine prevailing market price. Instead, the Firm argues that deference should be shown to its business acumen: "Considering the nature of our business and services we provide and the experience level of our staff, it is logical that we are qualified to use our best judgment in determining when a dealer's quote does or does not accurately reflect the market when bonds are concerned."

Enforcement's experts opined that J. W. Korth's bid/ask method of calculating markups and markdowns is inconsistent with industry practice and resulted in customer harm. Paviolitis stated that the Firm's bid/ask methodology was "an extreme departure from the methodology universally employed by other dealers, which resulted in higher prices and lower yields to its customers." Kapoor similarly opined that the Firm's bid/ask methodology was not a reliable way to determine the prevailing market price for a corporate bond.

Indeed, the SEC has repeatedly held that bids/offers, which by definition have not been validated by the market through actual interdealer transactions, are not a reliable indicator of market price. This is because "quotations only propose a transaction; they do not reflect the actual result of a completed arms-length sale." *Alstead, Dempsey & Co.*, 47 S.E.C. at 1036. The SEC has held that "quotations that are not validated by comparison with actual inter-dealer transactions should not be relied on to establish prevailing market price in determining an appropriate retail markup." *Dennis Todd Lloyd Gordon*, Exchange Act. Release No. 57655, 2008 SEC LEXIS 819, at *47-48 (Apr. 11, 2008); *Thomas F. White & Co.*, 51 S.E.C. 932, 935 (1994) ("The Commission has repeatedly stated that quotations are generally not a reliable indication of market price . . . actual transactions are the most reliable evidence of prevailing market price.").

The Firm argues that it acted as a market maker for several bond transactions, which would justify its reliance on quotations. *See First Honolulu*, 51 S.E.C. at 698 ("a broker-dealer that does not make a market may not rely upon quotations where actual inter-dealer transactions exist as evidence of the market"). Section 3(a)(38) of the Exchange Act defines "market maker"

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[19] For example, the Hearing Panel concluded that the markups on five trades (Trades 8 and 9 on Amended Schedule A and Trades 15, 16, and 17 on Amended Schedule B) — all of which exceeded three percent — were not excessive.

as "any dealer who, with respect to a security, holds himself out (by entering quotations in an inter-dealer communications system or otherwise) as being willing to buy or sell such security for his own account on a regular or continuous basis." 15 U.S.C. § 78c(a)(38). The Firm has not demonstrated that it was willing to buy and sell each particular bond on a regular or continuous basis and therefore cannot designate itself as a market maker.

The Hearing Panel agreed with Enforcement's experts, and we affirm the Hearing Panel's findings that the Firm has failed to rebut the strong presumption that contemporaneous cost is the best measure of the prevailing market price for the relevant transactions.

c. J. W. Korth Failed to Demonstrate that Its Markups and Markdowns Were Fair

In addition to challenging Enforcement's methodology for calculating markups, the Firm also argues that, regardless of how the markups and markdowns were calculated, their size was justified by the special services J. W. Korth provided to its customers. As explained above, J. W. Korth bears the burden of demonstrating that the markups charged over the prevailing market price were fair. The Hearing Panel concluded that J. W. Korth failed to produce evidence to substantiate the reasonableness of its markups or to demonstrate that it provided exceptional services or incurred significant costs so as to justify the markups.

On appeal, the Firm was given an opportunity to provide evidence demonstrating the exceptional services or costs it incurred to justify the fairness of the markups at issue.[20] The evidence it presented, however, does not justify the fairness of the Firm's pricing. The Firm provided, among other things, financial statements, auditors reports, newspaper articles, bond offering documents, Shop-4-Bond tickets, emails and instant messages discussing particular bonds, and screenshots of comparable bonds to support the markups it charged.[21] We find that the Firm's narrative arguments concerning the bond transactions in its brief are conclusory in nature and are not supported by the evidence presented. Neither the documents nor its briefs substantiate the Firm's claim that the markups and markdowns were warranted based on the

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[20] The Firm was given permission to present documentary evidence that existed contemporaneous with the bond transactions at issue in an effort to justify its markups and markdowns. Included in this production were three documents that were drafted several years after the transactions at issue occurred and therefore did not conform with the parameters established for production: An email dated August 23, 2017, from Michael Gibbons providing a post hoc justification for the pricing level of one of the corporate bonds; an undated email providing a post hoc justification for the pricing level of a corporate bond; and an affidavit from James W. Korth dated August 30, 2017, providing a post hoc rationalization for the pricing for two bond sales. Because these documents were not contemporaneous with the bond transactions at issue and were testimonial in nature, we did not consider them in our evaluation of the evidence.

[21] This evidence was appended to the Firm's reply brief, which provided descriptions of each transaction at issue and the Firm's arguments justifying its markups or markdowns.

Firm's cost of providing its purportedly special services to customers. While the evidence does demonstrate that the Firm engaged in due diligence, as it was required to do, the Firm has failed to show that its services were any different from those provided by other broker-dealers that recommend fixed income securities to their customers, or to quantify its claim of additional costs that it could recoup only by charging excessive markups and markdowns.

In its brief, the Firm chastises the Hearing Panel for failing to understand the complex nature of the bonds and repeatedly states that the Firm was "willing to do the work to understand [the security] and present it to the investor while other dealers passed it by and consequently its pricing was a value to its customers." The Firm notes that it often "required extensive research to make recommendation[s] to customers." However, the Firm does not quantify the time or expense that it supposedly devoted to each transaction, much less establish that its expenses were unusual. *See Robert Marcus Lane*, Exchange Act Release No. 74269, 2015 SEC LEXIS 558, at *35-36 (Feb. 13, 2015) (rejecting argument that markups were justified by "extensive credit analysis and valuable services that were indirectly paid for only through bond transactions" because respondent failed to provide proof of the claim); *Gordon*, 2008 SEC LEXIS 819, at *49 (rejecting argument that respondent's markups were justified by the extra effort that the firm devoted to executing the transactions at issue because respondent provided no documentation to validate the claim); *Dep't of Enforcement v. David Lerner Assoc.*, Complaint No. 20050007427, 2012 FINRA Discip. LEXIS 44, at *71 (FINRA Hearing Panel Apr. 4, 2012) (rejecting argument that respondent's exceptional services justified its markups because respondents did not introduce evidence that services provided were superior to those provided by other bond dealers).

The evidence does not demonstrate that any of the Firm's services were extraordinary or that they justified the size of the Firm's markups and markdowns. A firm cannot, "in seeking a profit, . . . pass along to the customer [its] expenses if the total would unreasonably exceed the prevailing wholesale price." *Inv. Planning, Inc.*, 51 S.E.C. 592, 597 (1993). Even J. W. Korth's CCO noted that that not "every trade should be marked at 3.9% because in many cases that would not be warranted."

The Firm also maintains that several of the bond transactions involved substantial risk. For municipal bond Trade 35, for example, J. W. Korth notes that it "bought these bonds with no orders in hand" and that it was a "high risk to dealer." In Trades 45-49, the Firm notes the "large risk we took" in purchasing the bonds. However, "a dealer is not entitled to charge excessive prices because it is at risk." *Shamrock Partners, Ltd.*, 53 S.E.C. 1008, 1014 (1998); *see also Lake Sec., Inc.*, 51 S.E.C. 19, 23 (1992) ("Applicants were not entitled to charge an excessive markdown because [the firm] was in a risk position."); *James E. Ryan*, 47 S.E.C. 759, 763 (1982) (stating that broker-dealer is "not entitled to charge customers excessive mark-ups simply because it is in a risk position").

Finally, J. W. Korth concedes that in some instances it used markups and markdowns to get paid for other work the Firm did for the same customer that was unprofitable. This is not an acceptable justification. The "fact that [a respondent] may not have made a profit on one transaction cannot justify an excessive markup in an unrelated transaction with the same customer." *Staten Sec. Corp.*, 47 S.E.C. 766, 768-69 (1982); *see also Inv. Planning, Inc.*, 51

S.E.C. at 597 ("[T]he price charged in each transaction must be fair. Accordingly, a lack of profit on some transactions for a customer cannot justify excessive markups on others.").

* * *

In sum, we affirm the Hearing Panel's findings that contemporaneous cost is the appropriate indicator of the prevailing market price in this instance and that J. W. Korth failed to rebut this presumption. We further affirm that J. W. Korth has not proffered sufficient evidence to support its contention that it invested unusually significant time, energy, or expense into each of the bond sales at issue to justify its markups and markdowns. At most, it has shown only that it engaged in basic due diligence before recommending a bond, as required of all broker-dealers. Therefore, we find that the Firm violated MSRB Rules G-30 and G-17 by charging excessive markups on 38 sales of municipal securities, and NASD Rule 2440, NASD IM-2440, and FINRA Rule 2010 by charging excessive markups in nine sales of corporate debt securities and excessive markdowns in four purchases of corporate debt securities.

IV. Sanctions

For its unfair markups and markdowns, the Hearing Panel censured the Firm, ordered it to pay restitution in the amount of $29,268 to affected customers, and ordered that it retain an independent consultant. J. W. Korth argues that an order of restitution is not warranted for any of the transactions at issue, and that the Hearing Panel should not have imposed any sanction, because the Firm's markups and markdowns were fair. For the reasons set forth below, we affirm these sanctions.

A. A Censure and Retention of an Independent Consultant Are Appropriate to Remediate J. W. Korth's Misconduct

In determining the appropriate sanctions for this misconduct, we have considered FINRA's Sanction Guidelines ("Guidelines"), including the violation-specific guideline, the General Principles Applicable to All Sanction Determinations, and the Principal Considerations in Determining Sanctions.[22]

For excessive markups and/or markdowns, the Guidelines recommend a fine of $5,000 to $73,000 plus, if restitution is not ordered, the gross amount of the excessive markups or markdowns.[23] In addition, in cases of negligent misconduct, the Guidelines recommend suspending the respondent in any or all capacities for a period of 10 to 30 business days and requiring demonstrated corrective action with respect to the firm's markup/markdown policy or

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[22] *See FINRA Sanction Guidelines* (2017), http://www.finra.org/sites/default/files/2017_April_Sanction_Guidelines.pdf [hereinafter *Guidelines*].

[23] *Id.* at 92. This Guideline also applies to MSRB Rule G-30.

commission policy. In egregious cases, adjudicators should consider imposing a suspension in any or all capacities for up to two years or a bar.[24]

In calculating an appropriate remedial sanction, the Hearing Panel drew several conclusions concerning the Firm's misconduct with which we agree and which warrant a departure from the Guidelines. The Hearing Panel concluded that the Firm's misconduct was aberrant and did not exhibit a pattern of charging excessive markups.[25] The Hearing Panel found that the Firm's misconduct was not intentional or reckless, but rather the Firm attempted, albeit unsuccessfully in some instances, to calculate fair markups.[26] The Hearing Panel also noted that the Firm employed multiple layers of oversight for its pricing practices. We agree with the Hearing Panel that these factors support a sanction lower than recommended by the Guidelines, which we find is appropriately remedial under these facts and circumstances.

We also affirm the Hearing Panel's order that the Firm retain an independent consultant, who is acceptable to Enforcement, with experience in establishing pricing procedures for debt securities, to review the Firm's pricing procedures to help ensure that J. W. Korth does not charge prices in excess of what is fair and reasonable, taking into consideration all relevant factors. An independent consultant will assist the Firm going forward and help ensure that it remains compliant with MSRB and FINRA rules.

B. Restitution Is Appropriate

The Hearing Panel ordered that J. W. Korth make restitution to the customers listed on Amended Schedules A and B in the amount of $29,268. The Guidelines instruct adjudicators to order restitution where it is appropriate to remediate misconduct and necessary to "restore the status quo ante for victims who would otherwise unjustly suffer loss." We may order restitution "when an identifiable person . . . has suffered a quantifiable loss proximately caused by a respondent's misconduct."

The Firm unfairly marked up or marked down bond transactions, thereby reducing the yield to its customers. We also find that its customers suffered a quantifiable loss, proximately caused by the Firm's unfair markups and markdowns. We therefore affirm the Hearing Panel's restitution order subject to recalculation as described below.[27]

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24 *Id.*

25 *Id.* at 8 (Principal Considerations in Determining Sanctions No. 15).

26 *Id.* (Principal Considerations in Determining Sanctions No. 13).

27 As the Hearing Panel noted, Amended Schedule A lists the full dollar amount of the Firm's markups on the municipal bond trades and does not break out the dollar amount for those trades in which a markup of over 3 percent was deemed unfair (Trades 10-19, 22-26, 29-32, 35, and 43-51), or where the markup in excess of 3.5 percent was deemed unfair (Trades 1-7, 20-21, and 36). Accordingly, the Hearing Panel performed in its own calculations and determined that

[Footnote continued on next page]

C. Pre-Judgment Interest

The Hearing Panel also ordered that J. W. Korth pay prejudgment interest at the rate set forth in Section 6621(a) of the Internal Revenue Code, 26 U.S.C. § 6621(a)(2), from the date of the customer sale. We note that some of these sales occurred more than 10 years ago and the interest accrued would be substantial when compared with the total amount of restitution awarded. While we agree with the Hearing Panel that prejudgment interest is appropriate, we find that it would be unwarranted under the circumstances to require the Firm to pay prejudgment interest accruing since the customer sales. We considered that the total amount of restitution owed each customer is relatively low. We also considered our downward departure from the Guidelines and the underlying nature of the violations. Therefore, under the facts and circumstances present here, we order the Firm to pay prejudgment interest at the rate set forth in Section 6621(a) of the Internal Revenue Code, 26 U.S.C. § 6621(a)(2) from December 10, 2014, the date Enforcement filed the complaint.

V. Conclusion

J. W. Korth violated MSRB Rules G-30 and G-17 by charging excessive markups in 38 sales of municipal securities and violated NASD Rule 2440, NASD IM-2440, and FINRA Rule 2010 by charging excessive markups in nine sales of corporate debt securities and excessive markdowns in four purchases of corporate debt securities. For these violations, we censure the Firm and order it to pay restitution of approximately $29,268, subject to final calculation, to the customers identified on Amended Schedules A and B.[28] We also order that the Firm retain an independent consultant with experience in establishing pricing procedures for sales and purchases of debt securities for the limited purpose of reviewing the Firm's pricing procedures. Finally, we impose appeal costs of $1,681.52.

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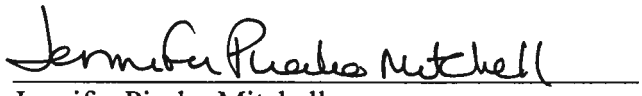
the markups in excess of three percent on the relevant trades to be approximately $15,479 and the markups in excess of 3.5 percent on the relevant trades to be approximately $6,159. On Amended Schedule B, which reflects the corporate bond trades and uses the three percent guideline for all the trades, the approximate amount is $7,630. We affirm the Hearing Panel's approximate restitution calculations. For each trade, however, the Firm is directed to calculate the precise excess markup or markdown, with Enforcement's approval, and to pay restitution accordingly.

[28] If J. W. Korth is unable to locate a customer, unpaid restitution should be paid to the appropriate escheat, unclaimed-property, or abandoned-property fund for the state of the customer's last known address. Satisfactory proof of payment of the restitution, or of reasonable and documented efforts undertaken to effect restitution, shall be provided to Enforcement no later than 90 days after the date when this decision becomes final.

On Behalf of the National Adjudicatory Council,



Jennifer Piorko Mitchell,
Vice President and Deputy Corporate Secretary

Municipal Securities Transactions
2009-2011
(Amended Schedule A)

Item	Customer Name	Purchase Date	Trade Date	Total Par Value	Description of Security	CUSIP	Sale Price	Customer's Total Cost	Purchase Price	Markup in Dispute	% Markup	$ Markup	$ Excessive Markup
1	KLT	4/21/2009	4/22/2009	$25,000.00	Tenn Energy Acq Gas Rev	880443BG0	90.730	$22,682.50	87.1396	Yes	4.12%	$897.60	$244.05
2	AET	4/21/2009	4/22/2009	$110,000.00	Tenn Energy Acq Gas Rev	880443BG0	90.910	$100,001.00	87.1396	Yes	4.33%	$4,147.44	$1,271.83
3	FP	4/21/2009	4/22/2009	$40,000.00	Tenn Energy Acq Gas Rev	880443BG0	91.000	$36,400.00	87.1396	Yes	4.43%	$1,544.16	$498.48
4	MS	4/21/2009	4/22/2009	$25,000.00	Tenn Energy Acq Gas Rev	880443BG0	91.320	$22,830.00	87.1396	Yes	4.80%	$1,045.10	$391.55
5	DDT	4/21/2009	4/22/2009	$20,000.00	Tenn Energy Acq Gas Rev	880443BG0	91.320	$18,264.00	87.1396	Yes	4.80%	$836.08	$313.24
6	RP	4/21/2009	4/22/2009	$15,000.00	Tenn Energy Acq Gas Rev	880443BG0	91.320	$13,698.00	87.1396	Yes	4.80%	$627.06	$227.06
7	JHWRT	4/21/2009	4/23/2009	$55,000.00	Tenn Energy Acq Gas Rev	880443BG0	92.000	$50,600.00	87.14	Yes	5.56%	$2,673.00	$1,235.19
8	JHWRT	5/5/2009	5/5/2009	$50,000.00	Richland Co SC Environmental Rev	76363PAC9	97.122	$48,560.75	93.476	No	3.90%	$1,822.75	$420.61
9	JHWRT	5/19/2009	5/19/2009	$50,000.00	Pinal Co AZ Indl Dev Auth Rev	722045BE0	100.595	$50,297.50	97.4	Yes	3.28%	$1,597.50	$136.50
10	ML	5/28/2009	5/29/2009	$85,000.00	Long Beach CA Fin Auth Rev	54241AAW3	91.200	$77,520.00	87.988	No	3.65%	$2,730.20	$486.51
11	GLIRA	6/10/2009	6/10/2009	$45,000.00	New Jersey Econ Dev	645916ZE6	97.400	$43,830.00	93.75	No	3.89%	$1,642.50	$376.88
12	MIRT	7/14/2009	7/14/2009	$25,000.00	Interlocken CO	458761BE2	94.375	$23,593.75	91.204	No	3.48%	$792.75	$108.72
13	RW	7/21/2009	7/21/2009	$25,000.00	Interlocken CO	458761BE2	94.375	$23,593.75	90.87	No	3.86%	$876.25	$194.72
14	TG	7/23/2009	7/24/2009	$60,000.00	Interlocken CO	458761BE2	95.847	$57,508.20	90.876	Yes	5.47%	$2,982.60	$1,346.83
15	RP	7/31/2009	7/31/2009	$25,000.00	Golden Tobacco	38122NPA4	63.350	$15,837.50	61.036	No	3.79%	$578.50	$120.73
16	FP	7/31/2009	7/31/2009	$25,000.00	Golden Tobacco	38122NPA4	63.350	$15,837.50	61.036	No	3.79%	$578.50	$120.73
17	KLT	7/31/2009	7/31/2009	$25,000.00	Golden Tobacco	38122NPA4	63.350	$15,837.50	61.035	No	3.79%	$578.75	$120.99
18	AET	7/31/2009	7/31/2009	$185,000.00	Golden Tobacco	38122NPA4	64.440	$119,214.00	62.5	No	3.10%	$3,589.00	$120.25
19	AET	7/31/2009	7/31/2009	$180,000.00	Golden Tobacco	38122NPA4	64.440	$115,992.00	62.5	No	3.10%	$3,492.00	$117.00
20	PJT	9/2/2009	9/3/2009	$20,000.00	Sumter Landing	86657MAL0	78.000	$15,600.00	72	Yes	8.33%	$1,200.00	$768.00
21	MJ	9/2/2009	9/4/2009	$25,000.00	Sumter Landing	86657MAL0	78.000	$19,500.00	72	Yes	8.33%	$1,500.00	$960.00
22	CT	1/28/2010	1/28/2010	$30,000.00	Colorado Cult &Edl	196458MN0	92.000	$27,600.00	88.711	No	3.71%	$986.70	$188.30
23	EH	1/28/2010	1/28/2010	$30,000.00	Colorado Cult &Edl	196458MN0	92.000	$27,600.00	88.711	No	3.71%	$986.70	$188.30
24	PST	1/28/2010	1/29/2010	$20,000.00	Colorado Cult &Edl	196458MN0	92.000	$18,400.00	88.711	No	3.71%	$657.80	$125.53
25	ZL	1/28/2010	1/29/2010	$40,000.00	Colorado Cult &Edl	196458MN0	92.000	$36,800.00	88.711	No	3.71%	$1,315.60	$251.07
26	RRT	1/29/2010	1/29/2010	$100,000.00	Colorado Cult &Edl	196458MN0	92.000	$92,000.00	88.712	No	3.71%	$3,288.00	$626.84

Item	Customer Name	Purchase Date	Trade Date	Total Par Value	Description of Security	CUSIP	Sale Price	Customer's Total Cost	Purchase Price	Markup In Dispute	% Markup	$ Markup	$ Excessive Markup
27	LFT	1/29/2010	2/1/2010	$200,000.00	Colorado Cult &Edl	196458MN0	92.000	$184,000.00	88.712	No	3.71%	$6,576.00	$1,253.28
29	RL	2/17/2010	2/17/2010	$75,000.00	PR Inflation	74514LJU2	77.000	$57,750.00	74	Yes	4.05%	$2,250.00	$585.00
30	JC	2/17/2010	2/17/2010	$100,000.00	PR Inflation	74514LJU2	77.000	$77,000.00	74	Yes	4.05%	$3,000.00	$780.00
31	TG	2/17/2010	2/17/2010	$100,000.00	PR Inflation	74514LJU2	77.000	$77,000.00	74	Yes	4.05%	$3,000.00	$780.00
32	MS	2/17/2010	2/17/2010	$60,000.00	PR Inflation	74514LJU2	77.000	$46,200.00	74	Yes	4.05%	$1,800.00	$468.00
33	AN	2/17/2010	2/23/2010	$50,000.00	PR Inflation	74514LJU2	77.000	$38,500.00	74	Yes	4.05%	$1,500.00	$390.00
34	BTT	2/17/2010	2/23/2010	$30,000.00	PR Inflation	74514LJU2	76.880	$23,064.00	74	Yes	3.89%	$864.00	$198.00
35	ML	3/2/2010	3/3/2010	$100,000.00	Maryland Econ Dev Corp	574205FK1	89.990	$89,990.00	85	Yes	5.87%	$4,990.00	$2,440.00
36	TG	3/12/2010	3/17/2010	$60,000.00	Palm Beach Co Health	696507PF3	89.000	$53,400.00	83.32	Yes	6.82%	$3,408.00	$1,908.24
42	AN	4/22/2010	4/23/2010	$50,000.00	Palmdale Schools	69671TCE7	26.185	$13,092.50	25.143	Yes	4.14%	$521.00	$121.00
43	TG	5/5/2010	5/7/2010	$195,000.00	Cal Ed Fac Auth	130178FP6	84.500	$164,775.00	80	Yes	5.63%	$8,775.00	$4,095.00
44	LP	5/11/2010	5/12/2010	$75,000.00	Cal Ed Fac Auth	130178FP6	85.875	$64,406.25	83.124	Yes	3.31%	$2,063.25	$192.96
45	TG	7/19/2010	7/20/2010	$105,000.00	Meridian, MI Econ Dev	589664AU5	91.300	$95,865.00	88.125	No	3.60%	$3,333.75	$667.81
46	RP	7/19/2010	7/20/2010	$25,000.00	Meridian, MI Econ Dev	589664AU5	91.300	$22,825.00	88.125	No	3.60%	$793.75	$132.81
47	BCFT	7/19/2010	7/20/2010	$40,000.00	Meridian, MI Econ Dev	589664AU5	91.300	$36,520.00	88.125	No	3.60%	$1,270.00	$212.50
48	LP	7/19/2010	7/20/2010	$50,000.00	Meridian, MI Econ Dev	589664AU5	91.300	$45,650.00	88.125	No	3.60%	$1,587.50	$265.63
49	IKLT	7/19/2010	7/20/2010	$25,000.00	Meridian, MI Econ Dev	589664AU5	91.300	$22,825.00	88.125	No	3.60%	$793.75	$132.81
51	KRT	12/8/2011	12/9/2011	$100,000.00	E-470 Colorado Pub. Hwy	26822LGS7	20.955	$20,955.00	20.011	Yes	4.72%	$940.00	$339.67

$25,812.44

Corporate and CMO Securities Transactions
2009-2011
(Amended Schedule B)

Item	Customer Name	Purchase Date	Trade Date	Inventory Time	Total Par Value	Description of Security	CUSIP	Sale Price	Settlement Factor	Customer's Total Cost/ Proceeds	Purchase Price	Markup/ Markdown In Dispute	% Markup/ Markdown	$ Markup/ Markdown	$ Excessive Markup/ Markdown
1	AP	04/08/2009	04/08/2009	2:05	$35,000	HBC.OJ	40429CCW0	89.500		$24,325.00	68.000	Yes	5.30%	$1,225.00	$832.00
2	DB	04/08/2009	04/08/2009	2:05	$20,000	HBC.OJ	40429CCW0	89.500		$13,900.00	68.000	Yes	5.30%	$700.00	$300.00
3	CBTBFT	04/08/2009	04/08/2009	2:05	$85,000	HBC.OJ	40429CCW0	89.500		$59,075.00	68.000	N/A	5.30%	$2,975.00	$1,292.00
4	NM	04/08/2009	04/08/2009	2:05	$100,000	HBC.OJ	40429CCW0	89.500		$69,500.00	68.000	Yes	5.30%	$3,500.00	$1,520.00
5	BF	4/21/2009	4/21/2009	0:13	$38,000	CHRCY.GC	12626PAE3	84.750		$30,610.00	81.900	No	3.46%	$1,026.00	$141.48
6	JC	04/24/2009	04/24/2009	0:28	$400,000	ALD.GA	01903QAA8	38.000		$152,000.00	38.000	N/A	5.56%	$8,000.00	$3,680.00
7	AET	5/15/2009	5/15/2009	0:03	$25,000	ALL.HQ	02003MAF1	75.85		$18,962.50	73	No	3.90%	$712.50	$188.00
8	MS	06/24/2009	06/24/2009	0:01	$25,000	SUM.GJG	78442FEH7	89.500		$22,375.00	88.500	No	3.47%	$750.00	$101.25
9*	TG	01/22/2010	01/22/2010	Simultaneous	$50,000	SLM.KZ	78442FAX8	80		$38,500.00	77	No	3.78%	$1,500.00	$300.00
10*	BG	03/01/2010	03/01/2010	Simultaneous	$65,000	F.GL	3453708M1	82.25		$51,612.50	79.25	No	3.68%	$1,950.00	$346.13
11*	TG	03/12/2010	03/12/2010	Simultaneous	$50,000	AIG.HLA	02687QBW7	88.15		$42,500.00	85	No	3.57%	$1,575.00	$252.75
12*	BG	03/18/2010	03/18/2010	0:03	$75,000	F.GL	3453708M1	83.25		$60,093.75	80.125	No	3.78%	$2,343.75	$470.63
13	JAIRA	10/14/2010	10/14/2010	0:01	$20,000	HBAC.GD	420122AB9	83		$16,600.00	80	No	3.75%	$600.00	$120.00
14	JAIRA	10/14/2010	10/14/2010	0:01	$20,000	HBAC.GD	420122AB9	83		$16,600.00	80	No	3.75%	$600.00	$120.00
15	AET	12/2/2011	12/2/2011	Simultaneous	$5,000,000	GNMA CMO 2009-062	38373AAV9	13.3	0.371804	$347,249.66	12.875	No	3.30%	$7,900.83	$720.37
16	JKCRT	12/6/2011	12/6/2011	3:29	$100,000	GNMA CMO 2010-166	38377R2F1	94.75	0.627484423	$59,454.16	91.750	No	3.27%	$1,882.45	$188.30
17	KH	12/6/2011	12/6/2011	3:29	$100,000	GNMA CMO 2010-166	38377R2F1	94.75	0.627484423	$59,454.16	91.750	No	3.27%	$1,882.45	$188.30
18	MFT	12/7/2011	12/7/2011	0:51	$50,000	UltraPetrol Bahamas LTD	90400XAC8	88.5		$47,750.00	92.500	No	3.24%	$1,500.00	$112.50
													Total		$10,484.71

* = markdown

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