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SECURITIES AND EXCHANGE COMMISSION
Washington D.C.

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 60506 / August 14, 2009

Admin. Proc. File No. 3-13243

In the Matter of the Application of

ANDREW P. GONCHAR
and
POLYVIOS T. POLYVIOU

c/o Martin H. Kaplan, Esq.
Gusrae, Kaplan, Bruno & Nusbaum PLLC
120 Wall Street
New York, New York 10005

For Review of Disciplinary Action by

NASD

OPINION OF THE COMMISSION

REGISTERED SECURITIES ASSOCIATION – REVIEW OF DISCIPLINARY PROCEEDINGS

Violations of Securities Laws and Conduct Rules

Unfair and Fraudulent Markups

Interpositioning

Registered representatives of member firm of registered securities association fraudulently interposed a third party between their member firm and their customers and charged their customers undisclosed and fraudulently excessive markups. *Held*, association's findings of violations and sanctions are *sustained*.

APPEARANCES:

Martin T. Kaplan, *Melvyn J. Falis* and *Brian D. Graifman*, of Gusrae, Kaplan, Bruno & Nusbaum PLLC, for Andrew P. Gonchar and Polyvios T. Polyviou.

Marc Menchel, Alan Lawhead and *Carla Carloni*, for Financial Industry Regulatory Authority, Inc.

Appeal filed: September 26, 2008
Last brief received: June 16, 2009

I.

Andrew P. Gonchar and Polyvios T. Polyviou, formerly general securities representatives associated with CIBC World Markets Corp. ("CIBC"), an NASD member firm, appeal from NASD disciplinary action.[1] NASD found that Applicants, in 142 sales to seventy-one customers over one and one-half years, fraudulently interposed a third party between CIBC and their customers and charged their customers undisclosed and fraudulently excessive markups in violation of Section 10(b) of the Securities Exchange Act of 1934,[2] Rule 10b-5 thereunder,[3] and

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[1] On July 26, 2007, the Commission approved a proposed rule change filed by NASD to amend NASD's Restated Certificate of Incorporation to reflect its name change to Financial Industry Regulatory Authority, Inc., or FINRA, in connection with the consolidation of NASD and the member-regulation, enforcement, and arbitration functions of the New York Stock Exchange. *See* Securities Exchange Act Rel. No. 56146 (July 26, 2007), 91 SEC Docket 517 (Aug. 1, 2007). Because NASD instituted the disciplinary action before that date, it is appropriate to continue to use the designation NASD.

[2] 15 U.S.C. § 78j(b).

[3] 17 C.F.R. § 240.10b-5.

NASD Conduct Rules 2110, 2120, 2320, and 2440.[4] NASD barred Applicants in all capacities and fined each $114,022.[5] We base our findings on an independent review of the record.

II.

Background

This case revolves around convertible bond trades that Applicants made at CIBC between August 2000 and January 2002. Convertible bonds, as with most bonds, provide a fixed return of principal. Unlike straight bonds, however, convertible bonds include a right to exchange the bonds for the common stock of the issuer at a predetermined price. The price of a convertible bond is thus directly related to the price of the underlying stock. The convertible bond price therefore tends to rise as the underlying stock price rises, and fall when the underlying stock price falls.[6]

The majority of Applicants' business at CIBC involved the sale of convertible bonds to retail customers, and the trades at issue here all involved bonds from one of five issuers: Juniper Networks, Inc. ("JNI"), Redback Networks, Inc. ("RNI"), Protein Design Labs, Inc. ("PDLI"),

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[4] NASD Conduct Rule 2110 requires members to observe "high standards of commercial honor and just and equitable principles of trade," and a violation of any NASD rule constitutes a violation of Rule 2110. *Stephen H. Gluckman*, 54 S.E.C. 175, 185 (1999). NASD Conduct Rule 2120 prohibits members from effecting transactions, or inducing the purchase or sale of a security, by means of any manipulative, deceptive, or fraudulent device. NASD Conduct Rule 2320 generally prohibits members from interposing a third party between the member and the best available market. NASD Conduct Rule 2440 requires members to buy securities from and sell securities to customers at prices that are fair, taking into consideration all relevant circumstances.

[5] NASD also assessed $21,558 in costs, jointly and severally, and $1,412 in appeal costs as to each Applicant.

[6] *See United States. v. Regan*, 937 F.2d 823, 829 (2d Cir. 1991) ("[T]he higher the market value of the stock when the convertible bonds are offered for sale the more advantageous from the convertible standpoint the purchase of the bonds will appear to be."); *see also generally* William Bratton Jr., *The Economics and Jurisprudence of Convertible Bonds*, 1984 WIS. L. REV. 667, 673 ("[F]or investors, this [conversion feature] gives convertible bonds the advantage of combining desirable features of straight bonds, such as fixed income payments and principal repayment, with the upside potential of common stock.").

Enzon, Inc. ("EI") and Cell Therapeutics, Inc. ("CTI").[7] The prices of these bonds were not transparent, as none of these convertible bonds were listed on an exchange and transactions involving these bonds were not reported. The prices for these bonds were also very volatile. CIBC did not make a market in these bonds, and, like other participants in the convertible bond market, CIBC's traders used computerized models to determine their prices.

CIBC's Convertible Bond Trading Desk

Because Applicants were not traders, they had to contact CIBC's convertible bond trading desk whenever they wanted to obtain convertible bond prices. Applicants complained about this system, because they felt CIBC's traders were more responsive to CIBC's institutional clients. In an attempt to remedy the situation, CIBC created a retail liaison position in February 2000. Debora Frank, a former CIBC sales assistant, filled the newly created position.

Frank's primary role appears to have been providing Applicants and other retail salespeople with daily bond prices. Frank would first obtain prices from traders on CIBC's convertible bond desk. Frank would then update the prices during the trading day by either contacting a CIBC trader or using a computerized model available at Frank's desk. The computer system's ability to price convertible bonds, however, depended on the stock price that Frank entered into the system. If the price of the underlying stock put into the system was inaccurate, the resulting bond price would also be inaccurate.[8]

In addition to the computerized modeling system, CIBC also had an electronic trading and inventory system into which Frank would enter the name, price, and quantity of the security, the amount of markup or markdown, and the customer account number for each convertible bond trade. She was supposed to input this information at the time of the trade, but, at least with respect to the trades at issue here, did not. Frank instead maintained paper notes and generally

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[7] Applicants joined the securities industry in 1988 and, after moving to several different firms together, joined CIBC as a team in October 1996. Applicants left CIBC in February 2002, and neither is currently working in the securities industry.

[8] In 2004, NASD settled proceedings with Frank, alleging that she engaged in proprietary trades of convertible bonds, in violation of NASD rules, by purchasing bonds for CIBC from so-called "brokers' brokers" without being registered as a Series 55 equity trader. As part of that settlement, Frank consented to a censure and a $10,000 fine. That same year, NASD also settled proceedings with CIBC, alleging that CIBC (i) failed to register Frank as a Series 55 equity trader; (ii) failed to supervise Applicants' and the trading desk's trading of convertible bonds; and (iii) charged retail customers unfair and excessive markups on convertible bond sales as a result of Applicants' trading scheme. CIBC agreed, as part of that settlement, to a censure, a $75,000 fine and the payment of $154,700 in reimbursement, plus $50,600 in interest, to fifty-six retail customers affected by the interpositioning. Before settling with NASD, CIBC also paid $300,000 in partial restitution to the affected customers.

entered information into the electronic inventory system later in the day. Because of Frank's failure to enter information in "real time," it appears that no formal record exists of exactly when during the day Applicants' retail trades occurred.

The parties dispute whether Applicants also used paper tickets to record the time of their trades. Gonchar and Polyviou testified at their disciplinary hearing that, before the terrorist attacks of September 11, 2001, they used an older paper ticket system. Applicants claimed they sent these paper tickets to Frank by runner to enable her to enter the trades into CIBC's electronic system. According to Applicants, however, any paper tickets that Applicants used before September 11 were destroyed in the World Trade Center attacks. Applicants claim they continued to use paper tickets for a time after September 11, but it is unclear what happened to those subsequently created tickets.[9] As discussed below, however, the record does contain other evidence – primarily, transcripts from recorded telephone conversations – from which we can deduce the approximate time of certain trades.

Applicants' Cross Trades

The trades that led to this case involved a similar pattern. In the morning, Applicants would inform Frank that they intended to use a so-called "128 Account" to purchase bonds, but would not identify a purchaser until later in the day.[10] The 128 Account, which was owned by CIBC, was an account that did not maintain inventory, hold positions overnight, or take risk positions. The account's sole purpose was to facilitate order flow between CIBC and its retail customers in "riskless principal" transactions and to capture customers' fees from markups and markdowns.[11] The head of compliance for CIBC's convertible bond trading desk reviewed the

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[9] Polyviou testified that he had some of the relevant tickets in his possession after NASD launched its investigation, but he was unable to recall what had happened to those tickets. While Applicants produced some paper order tickets at the hearing, none was from the trades at issue.

[10] To acquire the bonds for the 128 Account, Frank appears to have either gone through CIBC's trading desk or purchased them herself from a non-CIBC broker. Although CIBC was not a market maker in the bonds at issue, CIBC apparently did hold some bonds in inventory in anticipation of customer demand. Therefore, if CIBC's trading desk had the bonds Frank was seeking in inventory, Frank would obtain the bonds from this inventory. If the bonds were not in inventory, however, CIBC's trading desk would obtain them from the market or, it appears, Frank would obtain the bonds herself from other dealers without going through CIBC's trading desk.

[11] *See P'ship Sec. Exch. Co.*, 51 S.E.C. 1198, 1204 (1994) ("[I]f the dealer is not a market maker, its markups have generally been computed based on the difference between a

(continued...)

128 Account at the end of each day to ensure that the account held no positions overnight, but he did not monitor the account's trading activity during the trading day.

In fact, CIBC's trading desk appeared to play little, if any, role in overseeing Applicants' cross trades. Frank testified at the hearing that, although the trading desk was not involved in setting prices for cross trades, CIBC's traders "instantly saw on their screen" any cross trade that she executed and, "if there had been a problem, they would have said something." The record, however, contains little evidence to corroborate that the trading desk played such an active role in monitoring cross trades.[12] Instead, one CIBC trader testified that, although he thought cross trades showed up on his computer screen and that he may have had to "accept" them, he would not have examined those trades closely enough to ensure that they were being executed at an appropriate price level. Two other CIBC traders testified more flatly that they played no role in approving cross trades between retail customers.

Regardless, once Applicants had identified a retail customer who would buy the bonds, Applicants would inform Frank they intended to execute a cross trade between a trading vehicle called Avalon Asset Management, Inc. ("Avalon") and the retail customer. Avalon was operated by a former colleague of Gonchar and Polyviou at CIBC, Anthony Coscio, and was one of Applicants' most active convertible bond customers. In each of the transactions at issue, Avalon

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[11] (...continued)
dealer's net contemporaneous cost of acquisition and the net amount it receives for a complained-of sales transaction.").

As we have explained,

> a riskless principal transaction is the economic equivalent of an agency trade. Like an agent, a firm engaging in such trades has no market making function, buys only to fill orders already in hand, and immediately 'books' the shares it buys to its customers. Essentially, the firm serves as an intermediary for others who have assumed the market risk. The firm in these circumstances provides no liquidity to the interdealer market.

Kevin B. Waide, 50 S.E.C. 932, 935-36 (1992) (footnotes omitted).

[12] In fact, the Hearing Panel expressly rejected Frank's testimony that traders had to approve her cross trades because, as discussed *infra*, CIBC traders testified that they played no such role. The Hearing Panel also "discount[ed] much of Frank's testimony due to her demeanor during the hearing, which was argumentative and overtly hostile . . . ." The panel noted further that Applicants helped Frank obtain another position after she left CIBC, and Applicants were apparently responsible for more than half her business at firms at which she worked after CIBC. "For all these reasons," the Hearing Panel found "that Frank's testimony was slanted in [Applicants'] favor and not entirely credible."

was the entity that Applicants interposed between CIBC and the retail customers. To execute the cross sale, Applicants would sell the bonds from the 128 Account to Avalon, which would, in turn, sell the bonds back to the 128 Account. On each leg of this round-trip transaction, Avalon would pay either a markup or markdown. Applicants would then sell the bonds out of the 128 Account to the retail customer, who would pay a markup. Applicants did not disclose to their retail customers, however, that these cross trades had occurred (as opposed to obtaining the bonds for the customers directly from the market or selling the bonds from CIBC's inventory) or the price at which Applicants had first acquired the bonds for Avalon. A more detailed look at some of Applicants' cross trades illustrates the pattern.

A. January 7, 2002 Trades

On January 7, 2002, PDLI's stock price opened the day's trading at $31.75 per share. According to transcripts of telephone conversations from that day between Applicants and Frank,[13] Gonchar directed Frank to buy 100 PDLI bonds through the 128 Account approximately forty minutes after trading opened, at 10:11 a.m., by which time the stock price had fallen to $30.50. Frank quoted Gonchar a price level of 107 $^{7}/_{16}$, 108 $^{7}/_{16}$ (traders would sometimes describe this as "a price level of 107 $^{7}/_{16}$, 108 $^{7}/_{16}$ versus 30.50") and, at 10:41 a.m., advised Gonchar that his order for PDLI bonds had been filled at 108 $^{5}/_{8}$ (*i.e.*, $108.625 per bond). Although Gonchar had not yet provided a customer account number for this bond purchase (nor had Frank asked for one), the purchase was later attributed to Avalon.

At 11:22 a.m., Gonchar advised Frank that he wanted to cross-sell the PDLI bonds. Frank asked Gonchar what stock price he wanted to use to calculate the bond price for the trade. Although the price of PDLI's stock had fallen to $29.75, Gonchar responded that a stock price of $31.75 was the "preference point," which was, as indicated above, the price that had occurred nearly two hours earlier, at 9:30 a.m., and, in fact, was the highest stock price PDLI achieved all day. Frank used this high stock price to calculate the bond level as 110, 111 versus $31.75 per share.

At 3:06 p.m., when PDLI's stock price was trading below the price upon which Applicants' purchase price for the bonds was based, Polyviou contacted Frank and gave her the customer account numbers, along with the following prices and markups for the PDLI bond trades:

- Avalon purchased 100 PDLI bonds from the 128 Account at 108 $^{5}/_{8}$ plus a three-point markup (for a total of $111 $^{5}/_{8}$ per bond).

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[13] CIBC recorded Frank's telephone conversations in the normal course of business, but recycled those tapes every fifteen days. As a result, the record contains transcripts of only the following dates: January 4, 7, 8, 14, 15, 16, 17 and 29, 2002.

- Avalon then sold 100 bonds to the 128 Account at $112 per bond (which included a $^3/_8$ of a point markdown).

- Applicants resold the bonds from the 128 Account to two retail customers (50 bonds each) for $112 per bond plus a 3-point markup (for a total of $115 per bond).

Applicants thus charged their retail customers a total purchase price of $115,000 for convertible bonds that Avalon purchased earlier in the day for only $108,625. As a result, the retail customers paid $6,375 more for the bonds than Applicants had paid to acquire the bonds. Of that difference, Avalon earned a net profit of $250 on the transaction, while Applicants earned nearly ten times as much – $2,311.26 – in charges to their customers.

B. January 8, 2002 Trades

A similar transaction occurred the following day. On the morning of January 8, 2002, Gonchar purchased 100 PDLI bonds at $104.75 versus a stock price of $28.628. Then, at 11:27 a.m., Gonchar asked Frank for a price quote versus a stock price of $30.50, which represented a stock price slightly above the highest price PDLI's stock achieved all day. (Moreover, the high price of the day, which was $30.45, occurred almost two hours earlier, at 9:32 a.m.). Frank calculated that a stock price of $30.50 would "equal like 107 ½ 108 ½." Approximately three hours later, at 2:28 p.m., Gonchar asked Frank to cross-sell the PDLI bonds at 109 ½, and, at 3:47 p.m., Polyviou called Frank to provide account numbers and prices for the transactions.

In other words, Applicants cross-sold the bonds at a price $1.00 more per bond than Frank's previous quote (which was based on a price above what the underlying stock had actually achieved) and $4.75 more per bond than Applicants had paid to acquire the bonds for Avalon. On top of this already inflated price, Applicants added an additional 2.7% markup, for a final cost to the customer of $112.50 per bond. The underlying PDLI stock, meanwhile, was headed in the other direction, having fallen below $28.50 per share by the time Gonchar asked to cross-sell the bonds. The retail customers thus paid $7,750 more for the bonds than Applicants had paid to acquire them. Of that amount, Avalon earned $500 in profit, while Applicants earned $2,755 in charges to their customers.

C. January 29, 2002 Trades

Another example of Applicants' cross-selling occurred later that month. On January 29, 2002, PDLI's stock price opened the day's trading at $22.93 per share, which turned out to be the high price of the day. Sometime that morning, Applicants purchased 100 PDLI bonds for $93.50 (which was based on a stock price of $22 ½). Then, at 1:56 p.m., when the underlying PDLI stock had fallen below $22 per share, the following conversation took place:

GONCHAR: How about PDLI? Can I do this cross, or do you want to do it later . . . . I think we got 93 ½ before . . .

FRANK: . . . we did, we bought 100 versus 22 ½ at 93 ½. I'll go back on my bond model. What price should I use here . . .

GONCHAR: 22.93 is the high, so . . .
FRANK: 22.93 would be ah 99, 93 $^{3}/_{8}$94 $^{3}/_{8}$
GONCHAR: So I can use 95 ½, is that cool?

Thus, instead of using the actual stock price (which at the time was less than $22), Gonchar asked for a bond quote using the high stock price of the day ($22.93), which had occurred more than four hours earlier. After receiving a price range of 93 $^{3}/_{8}$, 94 $^{3}/_{8}$, which was based on a no-longer accurate stock price, Gonchar tacked on an additional dollar plus a 2.5 point markup (along with charging Avalon a 0.25 point markdown), for a final price of $98.00. The retail customer thus paid $4.50 (or 4.8%) more per bond than Applicants had paid to acquire the bonds. Avalon made $250 in profit, while Applicants earned seventeen times that much – $4,250 – in charges to their customers.

The above trading pattern was not unique to these three days. The same pattern took place on every day for which there is a recorded conversation between Applicants and Frank. Applicants would tell Frank they wanted to cross-sell the bonds and would ask her for a bond price based on the highest price of the day. By the time Applicants asked to price the bonds, however, that price would no longer be accurate because the market had moved lower. Applicants would also generally add at least one dollar to the price Frank quoted before executing the cross sale, in addition to which Applicants would also charge a markdown to Avalon and a markup to their customers.

D. January 3, 2001 Trades

Although most of Applicants' cross sales followed the pattern described above, a slight variation occurred on sixteen of the seventy-two days at issue. This variation involved Avalon trading the convertible bonds back and forth with itself through the 128 Account before Applicants cross-sold the bonds to their retail customers. In each of these round trip transactions, the bonds Avalon was buying and selling would go into the 128 Account, rather than back to CIBC's general inventory. For example, on January 3, 2001, Avalon made the following purchases and sales of 50 JNI bonds, in each case with the 128 Account:

- Purchased 50 JNI bonds at $89 per bond ($88.125 plus a $0.875 markup);
- Resold the bonds for $89.50 per bond ($92.25 minus a $2.75 markdown);
- Repurchased them at $95 per bond ($92.25 plus a $2.75 markup);
- Resold them for $95.25 per bond ($95.50 minus a $0.25 markdown);

- Repurchased them at $98.25 per bond ($95.50 plus a $2.75 markup);
- Resold them at $98.375 ($98.50 minus a $0.125 markdown);
- Repurchased them at $101.375 per bond ($98.50 plus a $2.875 markup);
- Resold them at $101.50 per bond ($102.50 minus a $1 markdown); and
- Repurchased them at $105.50 per bond ($102.50 plus a $3 markup).

After Avalon bought and sold the same bonds five times, Gonchar and Polyviou finally sold the bonds in a cross trade through the 128 Account to one of Polyviou's clients for $109.25. The total sale price to the retail customer of $5,462.50 represented $1,056.25 (nearly 25%) more than Applicants paid to acquire the bonds earlier in the day.[14] On this series of transactions, Avalon made a net profit of $750, while Applicants earned nearly six times that much – $3,728.78 – in charges to their customers.[15]

All told, Applicants interpositioned Avalon in 142 transactions between August 2000 and January 2002. Of these transactions, Avalon's total profit was approximately $30,000, while Applicants earned more than $228,000 in markups and markdowns charged to their customers. The retail customers, meanwhile, unknowingly paid between 3.5% and 23.97% more for the bonds at issue than what Applicants paid earlier in the day to acquire them for Avalon.

While most of the above examples involve conversations between Gonchar and Frank, Polyviou was also an active and knowing participant in the trading scheme. Telephone transcripts reveal that Polyviou and Gonchar interacted interchangeably with Frank. Polyviou obtained price levels from Frank, directed Frank to execute cross trades, set the price of those cross trades, and provided Frank with account information for both the buy side and sell side of the cross trades. In fact, Frank testified at the hearing that, when Polyviou called to provide markups and account numbers, he did not always have to identify the bond purchased or sold, because both he and Frank were already familiar with all of the trades that Gonchar had executed earlier in the day. Frank also testified that both Gonchar and Polyviou wanted to use the high stock price of the day to calculate bond prices for their trades, and a recorded conversation

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[14] To calculate Applicants' cost of acquiring bonds, NASD used the lowest purchase price Avalon paid for a given convertible bond, not including any markup charged. As noted above, Avalon initially paid $88.125 per bond (not including markups) on January 3, 2001 to acquire the JNI bonds. Trading records from the 128 Account, however, suggest that Applicants may have only paid $85.63 per bond to first acquire the bonds for the 128 Account, which suggests that the retail customer on this trade may have paid an even larger 27.5% markup.

[15] The record does not appear to contain any evidence, such as transcripts of conversations between Applicants and Frank, reflecting the times at which these trades occurred.

between Frank, Gonchar, and Polyviou indicates that the three discussed using the high stock price of the day as a basis for pricing Applicants' cross trades.

III.

NASD found that Applicants violated NASD rules and the federal securities laws by interpositioning Avalon between CIBC and their customers, charging excessive markups on the sales to Applicants' customers, and failing to disclose either the interpositioning or the excessive markups. Specifically, NASD found that Applicants violated Rule 2420, which requires members to sell securities to customers at a fair price, and NASD Rule 2320, which prohibits member firms and their associated persons from interpositioning a third party between the member and the best available market, except where the member can demonstrate the interpositioning resulted in the customer being charged a price lower than the prevailing market price.[16] NASD further found that Applicants violated Section 10(b) of the Exchange Act, Exchange Act Rule 10b-5, and NASD Rule 2120, which prohibit the use of any manipulative or fraudulent device in connection with the purchase or sale of a security.[17] NASD finally found that Applicants' violations of the above rules also constituted a violation of NASD Rule 2110, which requires adherence to just and equitable principles of trade.

In their appeal to the Commission, Applicants do not deny that they placed Avalon between their original purchases of the convertible bonds and their sales to their retail customers or that they failed to disclose that fact to their customers. They instead argue that "[i]nterpositioning by itself is not fraudulent" and that NASD failed to establish that the prices at

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[16] As NASD Rule 2320(b) states, "[a] member's obligations to his customer are generally not fulfilled when he channels transactions through another broker/dealer or some person in a similar position, unless he can show that by so doing he reduced the costs of the transactions to the customer."

[17] Rule 10b-5(c), 17 CFR § 240.10b-5(c). One can establish violations of the antifraud provisions by showing that persons acting with scienter misrepresented material facts or engaged in deceit in connection with securities transactions. *Alvin W. Gebhart, Jr.*, Exchange Act Rel. No. 58951 (Nov. 14, 2008), 94 SEC Docket 11637, 11646 (citing *Basic Inc. v. Levinson*, 485 U.S. 224, 239 n.17 (1988) and *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12 (1976)).

which they sold the convertible bonds to their customers were excessive.[18] Applicants assert that NASD's decision should therefore be "vacated, remanded and/or modified." We disagree.

We have long held that interpositioning can result in fraud where, as here, it is done with scienter and results in the charging of excessive and undisclosed markups.[19] As the Second Circuit, among others, has stated, broker-dealers possess "an implied duty to disclose excessive markups."[20] Therefore, "[u]ndisclosed markups on sales of securities to retail customers can violate the antifraud provisions of the securities laws if they are not reasonably related to the baseline against which they are measured and if the responsible parties acted with scienter."[21]

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[18] In support of their assertion that interpositioning does not amount to fraud, Applicants cite *United States v. Finnerty*, 533 F.3d 143 (2d Cir. 2008), in which the Second Circuit concluded that interpositioning by an NYSE specialist did not constitute securities fraud, because there was "no evidence that Finnerty conveyed an impression that was misleading." *Id.* at 149. In contrast, Applicants here failed to disclose the resulting excessive markups to their customers, and we and the Second Circuit have consistently held that, "[u]nder § 10(b) of the Exchange Act, a seller has a duty to disclose the details of a markup if the markup is 'excessive.'" *Ganino v. Citizens Utils. Co.*, 228 F.3d 154, 163 (2d Cir. 2000) (quoting *Press v. Chem. Inv. Servs. Corp.*, 166 F.3d 529, 534 (2d Cir. 1999)); *see also infra* notes 19 & 20 and accompanying text.

[19] *See Donald T. Sheldon*, 51 S.E.C. 59, 78 (1992) (concluding that applicant's interpositioning resulted in fraudulent markups, "demonstrate[d] clear scienter and, in our view, was particularly egregious"), *aff'd*, 45 F.3d 1515 (11th Cir. 1995); *Del. Mgmt. Co.*, 43 S.E.C. 392, 396-98 (1967) (concluding that applicant's interpositioning violated the anti-fraud provisions of Section 10(b) of the Exchange Act).

[20] *Starr ex rel. Estate of Sampson v. Georgeson S'holders, Inc.*, 412 F.3d 103, 111 (2d Cir. 2005) (quoting *Grandon v. Merrill Lynch & Co., Inc.*, 147 F.3d 184, 192 (2d Cir. 1998)); *see also SEC v. First Jersey Sec., Inc.*, 101 F.3d 1450, 1469 (2d Cir. 1996) (concluding that a failure to disclose excessive markups violated Rule 10b-5); *Ettinger v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 835 F.2d 1031, 1033 (3d Cir. 1987) ("The SEC has established through its enforcement actions the principle that charging undisclosed excessive commissions constitutes fraud.").

[21] *Dennis Todd Lloyd Gordon*, Exchange Act Rel. No. 57655 (April 11, 2008), 93 SEC Docket 5055, 5111; *see also First Jersey*, 101 F.3d at 1469 (holding that "a broker-dealer who charges customers retail prices that include an undisclosed, excessive markup violates § 17(a) and § 10(b) of the securities laws").

We have also long held that a dealer that is not a market maker must base its prices on its own contemporaneous cost.[22] Moreover, where an applicant has interpositioned, "he has the burden of showing that the customer's total cost or proceeds of the transaction is the most favorable obtainable under the circumstances."[23]

Here, NASD used Applicants' contemporaneous cost of acquiring the bonds for the 128 Account as the basis for determining prevailing market price and, on that basis, found that Applicants' charged their customers markups ranging between 3.5% and 23.97%. Applicants do not dispute that NASD's calculations accurately reflect the spread between what the ultimate retail customers paid and what Applicants paid earlier in the day to acquire the bonds. Applicants instead argue that the spread between those two prices was not a "comparison of true contemporaneous price with any price the customer paid." As a result, Applicants contend that NASD failed to make a "showing or finding that the prices at which the customers purchased [the bonds] were unfair at the time purchased." Applicants add that NASD improperly shifted the burden of proof onto Applicants to show that the prices they charged were fair. We disagree and find NASD's methodology appropriate to the circumstances.

As noted above, firms that do not make a market in a security (such as CIBC with respect to the bonds at issue here) must calculate their markups based on the firm's contemporaneous cost of acquiring the security.[24] Therefore, once NASD presents evidence of contemporaneous cost, the burden shifts to Applicants to refute that evidence.[25] This is true even in cases involving

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[22] *See Daniel R. Lehl*, 51 S.E.C. 1156, 1159 (1994) (holding that a firm that is not a market maker must base its prices on its own contemporaneous cost), *aff'd*, 90 F.3d 1483 (10th Cir. 1996); *see also F.B. Horner & Assocs., Inc. v. SEC*, 994 F.2d 61, 63 (2d Cir. 1993) (affirming contemporaneous cost of acquiring the bonds as an appropriate gauge of the market price for purposes of determining markups); *David Disner*, 52 S.E.C.1217, 1220 (1997) (using contemporaneous cost to conclude that applicant had charge fraudulently excessive markups) (citing *Alstead, Dempsey & Co.*, 47 S.E.C. 1034, 1035 (1984)); *George Salloum*, 52 S.E.C. 208, 215 (1995) (using contemporaneous cost to conclude that applicant had charged customers fraudulently excessive markups).

[23] *Thomson & McKinnon*, 43 S.E.C. 785, 789 (1968) (concluding broker-dealers' interpositioning "constituted a fraud upon their customers" in violation of the antifraud provisions of the Exchange Act); *see also Milton M. Star*, 47 S.E.C. 58, 59 (1979) ("[W]here interpositioning has occurred, the burden is on the member to demonstrate that his action resulted in the customer being charged a lower price than that prevailing in the inter-dealer market.").

[24] *See supra* note 22 and accompanying text.

[25] *See Mark David Anderson*, 56 S.E.C. 840, 855 n.41 (2003) (noting that the applicant "had the burden of producing evidence to support his claim that his pricing was not

(continued...)

allegations of fraud.[26] Notably, however, the ultimate burden of proof for the violations does not, as Applicants assert, shift onto Applicants. NASD still retains the ultimate burden of persuasion.[27]

NASD's determination that Applicants' charged excessive markups is consistent with this precedent. While NASD has typically used a firm's contemporaneous cost as the basis for calculating markups, NASD here looked to Applicants' contemporaneous cost of acquiring the bonds into the 128 Account. Given the way Applicants used the 128 Account as an internal trading account for their transactions, we see no basis for rejecting that approach here.[28]

In those instances where Frank or the Firm's traders had to obtain bonds from the market because CIBC did not hold them in inventory, the 128 Accounts' costs were presumably the same as the Firm's costs. Furthermore, we have previously concluded that retail trades are an appropriate means for determining the prevailing market price, which is the approach NASD used here when looking to the cost Avalon paid to acquire the bonds from the 128 Account (not

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[25] (...continued)
excessive"); *Steven P. Sanders*, 53 S.E.C. 889, 895 (1998) ("Once the NASD presented evidence that the Firm's markups exceeded 5% over its contemporaneous cost, the burden properly shifted to the applicants to show that the facts surrounding these transactions justified higher markups."); *First Honolulu Sec., Inc.*, 51 S.E.C. 695, 701 n.23 (1993) ("Once the NASD presented evidence of the markups, the burden shifted to Applicants to refute this evidence"); *Richard R. Perkins*, 51 S.E.C. 380, 383 n.16 (1993) ("Once the NASD presented its *prima facie* case, it was incumbent on Applicants to explain why, notwithstanding the evidence to the contrary, their pricing was fair.").

[26] *See Anderson*, 56 S.E.C. at 855 n.41 (noting that respondent has the burden of refuting evidence of markups presented by the Division of Enforcement even where the respondent is charged with "federal securities fraud" (citing *Sheldon*, 51 S.E.C. at 77 (noting that burden shifted to respondent to refute evidence of markups in case involving allegations of fraud))).

[27] *Id.* (stating that, even after burden to refute Division of Enforcement's evidence of excessive markups shifts to respondent, "the ultimate burden of persuasion remains with the Division").

[28] *Cf. Bison Sec., Inc.*, 51 S.E.C. 327, 329, 333 (1993) (deeming retail account controlled by firm's holding company as *de facto* trading account and using its costs in determining fairness of markups).

including any markup that Avalon paid) to determine Applicants' contemporaneous cost.[29] Applicants assert that their trades with Avalon were legitimate, arm's-length transactions. Thus, those trades should provide a good indication of the prevailing market price at the time the transactions took place.

Perhaps the key fact, however, is that Applicants were aware of the prices Avalon paid to acquire the bonds, which Applicants failed to consider when later determining the retail prices at which they would sell the bonds to their retail customers. Applicants instead based the prices of the retail sales, in at least those instances where we have telephone transcripts, on the no-longer-accurate high stock price of the day and did so through entirely unnecessary cross sales between the 128 Account and Avalon, charging markups and markdowns on each leg of the transaction. We conclude, given these circumstances, that it was appropriate for NASD to limit Applicants' markups to a reasonable amount above Avalon's initial cost to acquire them.[30]

Moreover, Applicants still had the opportunity to show that their contemporaneous cost of acquiring the bonds did not accurately represent the prevailing market price at the time of the ultimate sale to the retail customers. Applicants, for example, could have provided countervailing evidence that showed a change in the market between when Applicants acquired the bonds and when they later sold the bonds to their customers (such as evidence of market trades occurring at the time of the ultimate retail trade). Applicants, however, wholly failed to do this. They instead offer a variety of reasons why they were unable to produce such evidence.[31] For example, Applicants argue that the September 11 terrorist attacks destroyed the paper tickets that allegedly would have established the time of Applicants' cross trades. Those tickets, in turn, allegedly would have established the prevailing market price at the time Applicants cross-sold the bonds at issue. That assertion, however, is undercut by the telephone conversations between Applicants and Frank indicating when several of Applicants' cross sales took place. Transcripts

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[29] *See G.K. Scott*, 51 S.E.C. at 965 (using applicant's purchases from retail customers to determine the prevailing market price for purposes of calculating markups).

[30] *Cf. Waide*, 50 S.E.C. at 936 (noting that the inquiry into whether prices are fair goes "beyond whether a broker-dealer charged prices that were reasonably related to the market price," that using a firm's contemporaneous cost to calculate markups appropriately addresses the other inquiry of "whether a firm employed a price-setting *process* that treated customers fairly," and that where "the firm serves as an intermediary for others who have assumed the market risk. . . . a firm is adequately compensated by a markup over its cost").

[31] In fact, on appeal, Applicants point to no evidence that conflicts with NASD's calculations. Applicants suggest that their pricing was fair by asserting that CIBC's trading desk would not have approved Applicants' trades if they could have been done at a more favorable price for the customer. This assertion, however, is undercut by testimony that CICB's traders played virtually no role in overseeing Applicants' cross trades. *See infra* note 35 and accompanying text.

of those conversation show that, instead of accurately pricing those sales, Applicants were basing the bond prices on the high stock price of the day, regardless of when that price occurred, underscoring the conclusion that Applicants' bond prices did not reflect the prevailing market.[32]

Applicants' contemporaneous cost therefore remains the best – and essentially only – evidence of the prevailing market price. This evidence shows that Applicants' markups ranged between 3.5% and 23.97%, with the majority of Applicants' markups at issue exceeding 5% – an amount we have consistently held, with respect to the sale of bonds, as "acceptable in only the most exceptional cases."[33] Applicants do not challenge that such markups are excessive nor do Applicants identify any special circumstances or otherwise try to justify the size of these markups.[34]

Applicants suggest only that, regardless of their actions, the prices they charged must have been consistent with the prevailing market prices because CIBC's trading desk would not have permitted such trades to be executed if Applicants could have done them at a more favorable price for the customer. As noted previously, however, testimony from CIBC's bond traders contradicts Applicants' assertion that CIBC was monitoring their trades, let alone that

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[32] Applicants similarly contend that NASD's refusal to allow them to subpoena certain witnesses prevented them from introducing certain exculpatory evidence. As discussed in the following section, however, none of that potential testimony would provide Applicants with evidence that they were pricing their cross sales fairly.

[33] *Inv. Planning, Inc.*, 51 S.E.C. 592, 594 (1993) (finding markups ranging from 4% to 7.26% on the sale of corporate bonds to be improper and noting "it has long been recognized that debt securities markups normally are lower than those for equities, and that, in appropriate circumstances, markups under [five percent] may be subject to sanction").

In fact, NASD's method of calculating markups may have underestimated some markups. In the example from January 29, 2002, the contemporaneous bond price NASD used for its calculations was $93.50, which was based on a stock price of $22.50. However, a transcript of Gonchar's telephone conversation with Frank reveals the exact time when Gonchar asked to price the cross sale. At that time, the underlying PDLI stock was trading at less than $22.00. This suggests that the fair market value of the bond was not only less than the price at which Applicants cross-sold the bonds ($98.00), but also less than the contemporaneous cost that NASD used to calculate the effective markup ($93.50).

[34] *See generally Press*, 166 F.3d at 535 (enumerating factors for determining excessiveness).

CIBC was ensuring Applicants were executing their cross trades at fair prices.[35] In fact, the above-mentioned transcripts indicate that Applicants made no effort to ensure that their customers were receiving the then-fair market price of the securities. Instead, Applicants' interpositioning essentially guaranteed that Applicants (and Avalon) would be buying low and selling high, as demonstrated by Avalon profiting on sixty-nine of the seventy-two days at issue, suffering a net loss of $125, on just one trade.

Moreover, the opaque and volatile nature of the convertible bond prices meant that Applicants' retail customers had no ready way to verify whether the price they were paying was fair. As a result, their customers were almost entirely reliant on Applicants to obtain a fair price. Instead of assisting their clients, however, Applicants exacerbated the lack of transparency by not disclosing to their customers that the bonds were coming from Avalon in a cross trade or that their clients were paying more than Avalon had paid earlier in the day.

As we have stated, "[p]ersons engaged in the securities business cannot be unaware of their obligation to serve the best interests of their customers, and that interpositioning is bound to result in increased prices or costs."[36] Here, instead of serving their customers' interests, Applicants showed a "reckless disregard for determining the actual prevailing market price," and, by using the highest stock price of the day to price the bonds and then adding a commission on top of that inflated price, Applicants displayed "not merely an insensitivity to the obligation of fair pricing, but an intent by Applicants to gouge their customers."[37]

We thus conclude that Applicants violated Section 10(b) of the Exchange Act, Exchange Act Rule 10b-5, and NASD Conduct Rule 2120. By charging excessively high markups, Applicants also violated NASD Conduct Rule 2440, and, by interpositioning a third party between CIBC and their customers without demonstrating a benefit to those customers,

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[35] An applicant also "cannot shift his responsibility to comply with NASD rules to his firm," and efforts to do so raises questions about the applicant's fitness to remain in the securities industry. *Jason A. Craig*, Exchange Act Rel. No. 59137 (Dec. 22, 2008), 94 SEC Docket 12694, 12700 (noting that an applicant cannot shift responsibility to his firm for complying with NASD rules); *see also Steven M. Muth*, Exchange Act Rel. No. 8622 (Oct. 5, 2005), 86 SEC Docket 1217, 1247 (concluding that applicant's attempt to shift responsibility to his supervisors for failing to object to certain of his transactions was a factor establishing that applicant "pose[d] a substantial, continuing risk of harm to investors").

[36] *Del. Mgmt. Co.*, 43 S.E.C. at 400 (finding that applicant's interpositioning violated the antifraud provisions of the securities laws).

[37] *Bison Sec.*, 51 S.E.C. at 332 ("Scienter is clearly evident here, as demonstrated by Applicants' reckless disregard for determining the actual prevailing market price.").

Applicants violated NASD Rule 2320.[38] Finally, Applicants' violation of the above rules constitutes a violation of NASD Rule 2110.[39]

IV.

Applicants contend that NASD's findings are flawed because of certain procedural defects related to (i) Applicants' efforts to use state law procedures to subpoena witnesses and (ii) the standard of proof NASD applied to the evidence. We discuss each in turn.

Subpoenas

Applicants' first procedural argument relates to their unsuccessful effort to subpoena certain witness not subject to NASD's jurisdiction, including Anthony Coscio, Avalon's owner, and Vincent Rusciano, a runner who Applicants claimed had delivered their handwritten trade tickets to Frank. The NASD Hearing Officer quashed Applicants' attempt to issue these

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[38] *See supra* note 23 and accompanying text. We also note that, on April 17, 2009, we solicited comments on a FINRA proposal to amend NASD Conduct Rule 2320 (the "Proposed Rule Change"), which would "replace the current [Rule 2320(b) (the "Interpositioning Rule")] with a more general statement that the factors enumerated in Rule 2320(a) apply to those situations contemplated by the Interpositioning Rule." Exchange Act Rel. No. 59788 (Apr. 17, 2009), 95 SEC Docket ____. The Proposed Rule Change would therefore require a broker-dealer to "use reasonable diligence to ascertain the best market for the subject security," as outlined in the present NASD Rule 2320(a), which lists the factors to be considered in determining "reasonable diligence" as "(1) the character of the market for the security, *e.g.*, price, volatility, relative liquidity, and pressure on available communications; (2) the size and type of transaction; (3) the number of markets checked; (4) accessability of the quotation; and (5) the terms and conditions of the order which result in the transaction, as communicated to the member and persons associated with the member." We asked the parties to provide supplemental briefing regarding the question of whether the Proposed Rule Change has any impact on the merits of this proceeding.

After considering the parties' supplemental briefs, we conclude that the Proposed Rule Change has no impact on the merits of this proceeding. Because the Proposed Rule Change has not taken effect as of the date of this opinion, we see no basis for applying it here. Moreover, even if the Proposed Rule Change were to take effect, Applicants, as discussed herein, failed to "use reasonable diligence" in determining the best market for the subject bonds by purposefully using their interpositioning scheme and artificially high bond quotations to charge retail customers excessively high markups.

[39] *Gluckman*, 54 S.E.C. at 185 (noting "our long-standing and judicially-recognized policy that a violation of another Commission or NASD rule or regulation . . . constitutes a violation of [NASD] Rule 2110").

subpoenas prior to the NASD disciplinary hearing, and Applicants now argue that this prevented them from bringing crucial evidence before the NASD Hearing Panel.

Because NASD rules do not provide for the use of subpoenas, Applicants relied on § 2302(a) of New York's Civil Practice Law and Rules ("C.P.L.R."), which allows subpoenas "to be issued without a court order by . . . an attorney of record for a party to . . . an administrative proceeding or an arbitration . . . in relation to which proof may be taken or the attendance of a person as a witness may be required."[40] In quashing Applicants' subpoenas, the Hearing Officer concluded that C.P.L.R. § 2302(a) did not apply because Applicants' disciplinary hearing was not an "administrative proceeding" for purposes of the New York rule. Applicants subsequently sought to enforce the subpoenas in state court, but the New York court agreed with the Hearing Officer's conclusion that C.P.L.R. § 2302 did not apply to NASD disciplinary proceedings.[41] This conclusion is consistent with prior New York precedent, which similarly held that NASD disciplinary proceedings are not administrative proceedings within the meaning of C.P.L.R. § 2302 and thus not subject to the New York rule.[42]

Under the law-of-the-case doctrine, "courts are understandably reluctant to reopen a ruling once made, especially when one judge or court is asked to consider the ruling of a different judge or court."[43] Applicants nevertheless ask us to discount the two above-mentioned New York decisions and instead rely on two other decisions: *Crimmins v. American Stock Exchange,*

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[40] N.Y. C.P.L.R. § 2302 (McKinney 2005).

[41] *Gonchar v. NASD*, Index No. 101445-2006, slip op. at 7 (N.Y. Sup. Ct. Feb. 7, 2006) ("Contrary to petitioners' contention, CPLR 2302 does not apply to the Disciplinary Proceeding herein brought by the NASD." (citation omitted)), *dismissed as moot*, 829 N.Y.S. 2d 900 (N.Y. App. Div. Feb. 27, 2007). Applicants characterize the New York court's holding regarding C.P.L.R. § 2302 as dictum because the court first held that it lacked jurisdiction to entertain Applicants' claims. Although the New York court did conclude that Applicants had "failed to exhaust the administrative remedies available under NASD rules," the court also went on to hold that, "[i]n any event, the Court rejects petitioners' alleged right to issue a subpoena in the Disciplinary Proceeding pursuant to CPLR § 2302(a)." *Id.* As the Supreme Court has stated, "where a decision rests on two or more grounds, none can be relegated to the category of obiter dictum." *Woods v. Interstate Realty Co.*, 337 U.S. 535, 537 (1949).

[42] *Application of NASD Regulation, Inc., Dep't of Enforcement v. Rosato*, Index No. 119971-1998, at 2 (N.Y. Sup. Ct. Nov. 5, 1998) (stating that an "NASD Regulation, Inc. hearing is not an administrative proceeding under [C.P.L.R. §]2302(a)").

[43] *Ali v. Mukasey*, 529 F.3d 478, 490 (2d Cir. 2008) (quoting *Lillbask ex rel. Mauclaire v. Conn. Dept. of Educ.*, 397 F.3d 77, 94 (2d Cir. 2005) (citation and internal quotation marks omitted)).

Inc.[44] and *Hessel v. Merrill Lynch, Pierce Fenner & Smith.*[45] Neither *Crimmins* nor *Hessel*, however, is on point. While both *Crimmins* and *Hessel* theorized that C.P.L.R. § 2302 may empower parties to subpoena witnesses in administrative proceedings, neither case involved NASD or its rules.[46] Moreover, neither case actually allowed the parties seeking the subpoenas to obtain them, and neither case addressed the question of enforcing subpoenas under C.P.L.R. § 2302 directly, instead addressing the New York statute only in dicta.[47]

Regardless, we need not decide whether a party is entitled to pursue subpoenas in NASD disciplinary proceedings.[48] As the *Crimmins* decision suggested, an applicant's inability to subpoena witnesses is not grounds for overturning a disciplinary action unless the applicant can show prejudice.[49] This is consistent with a myriad of other courts that have held that a party has

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[44] 368 F. Supp. 270, 277 (S.D.N.Y. 1973).

[45] Index No. 106285-2000 (N.Y. Sup. Ct. Aug. 9, 2000).

[46] *Crimmins*, 368 F. Supp. at 274 (involving disciplinary action by the American Stock Exchange ("AMEX")); *Hessel*, Index No. 106285-2000 (involving disciplinary action brought by the New York Stock Exchange).

[47] *Crimmins*, 368 F. Supp. at 277 (noting that C.P.L.R. § 2302 "seemed" to empower both administrative panels and attorneys of record with the ability to issue subpoenas without a court order, but concluding that applicant was not prejudiced by AMEX's refusal to subpoena certain witnesses); *Hessel*, Index No. 106285-2000, at 27 (concluding that applicant had waived his right to pursue a subpoena in state court, but stating that it "believe[d]" that C.P.L.R. § 2302 may have allowed applicant to pursue the subpoena in state court had he not waived that right).

[48] We also need not address NASD's contention that FINRA rules preempt C.P.L.R. § 2302.

[49] *See Crimmins*, 368 F. Supp. at 277 (rejecting plaintiff's attempt to vacate disciplinary action on grounds that plaintiff was not prejudiced by lack of subpoenas); *see also Thomas E. Warren, III*, 51 S.E.C. 1015, 1020 n.22 (1994) (dismissing allegation that applicant was disadvantages by inability to subpoena witnesses), *aff'd*, 69 F.3d 549 (10th Cir. 1995); *Gateway Stock & Bond, Inc.*, 43 S.E.C. 191, 195 (1966) (refusing to disturb NASD disciplinary sanctions where lack of subpoena did not cause prejudice).

no absolute right to subpoena witnesses in administrative hearings.[50] As one court relevantly explained,

> it makes perfect sense . . . to control the issuance of subpoenas . . . . For if it were otherwise, one can easily imagine the process becoming cumbersome and potentially unmanageable. For example, if the [applicants] were to have their own, absolute or independent subpoena power, they effectively could stop, or at the very least delay significantly, the entire . . . process by issuing subpoenas to potentially hundreds of individuals.[51]

Here, Applicants cannot point to any excluded testimony that would have been material. For example, Applicants contend Coscio was "the one witness who could have explained the rationale for his transactions underlying this matter," thus bolstering Applicants' argument that "they legitimately carried out Avalon's upright trading intentions." Avalon's trading intentions, however, are not the issue here. The issue is whether Applicants were interpositioning Avalon between their customers and the market – an issue Applicants do not dispute – and whether that interpositioning, along with the prices Applicants charged to their customers, constituted fraud. Avalon's reasons for trading bonds would not address these questions.[52]

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[50] *See, e.g.*, *Foxy Lady, Inc. v. City of Atlanta, Ga.*, 347 F.3d 1232, 1237 (11th Cir. 2003) ("[N]o absolute or independent right to subpoena witnesses exists during administrative proceedings, and [we] now hold expressly that procedural due process also does not require an absolute or independent right to subpoena witnesses in administrative hearings."); *Travers v. Jones*, 323 F.3d 1294, 1297 (11th Cir. 2003) ("[A] party has no right to subpoena witnesses to state administrative hearings." (citations omitted)); *Amundsen v. Chicago Park Dist.*, 218 F.3d 712, 717 (7th Cir. 2000) ("Nonetheless, this court has held that in the administrative hearing context, the ability to subpoena witnesses is not an absolute right. . . . Indeed, in administrative matters, due process is satisfied when the party concerned is provided an opportunity to be heard in an orderly proceeding which is adapted to the nature and circumstances of the dispute." (quotation marks and citations omitted)).

[51] *Foxy Lady*, 347 F.3d at 1238.

[52] In fact, Avalon may well have had a legitimate reason for its pattern of buying and selling convertible bonds given Avalon's record of profiting on 69 out of the 72 trading days at issue and suffering a net loss only once. Regardless, Avalon's trading strategy – whatever it was – would provide no justification for Applicants' interpositioning scheme at issue here. At most, Coscio's testimony could have explained why Avalon occasionally bought and sold bonds with itself before Applicants' cross-sold the bonds to retail customers – a trading pattern that the NAC noted neither respondent was able to explain. Avalon's trades with itself, however, are not relevant with respect to Applicants' fraudulent conduct toward their customers.

Rusciano's testimony would have been similarly unhelpful. According to Applicants, Rusciano would have testified "that [Applicants] prepared time-stamped order tickets which reflected the exact time of each trade." Applicants contend that such testimony would have shown that NASD's method of calculating Applicants' markups was flawed. Because, by "[n]ot having the exact timing of the trades at issue, the [Hearing] Panel fell back on concluding that 'a dealer's 'contemporaneous cost' is the best evidence of the current market,' rather than the value of the convertible bonds on a myriad of factors including the then-current price of the underlying stock."

Contemporaneous costs, as discussed above, is not a "fall back" position. Rather, it is the primary method of calculating markups where a firm does not make a market in a security (such as CIBC with respect to the bonds at issue).[53] Applicants may challenge the resulting markups by introducing countervailing evidence, but they bear the burden of doing so.[54] Here, Rusciano's potential testimony would not have undermined the validity of NASD's calculations. Rusciano, at most, may have testified that time-stamped tickets existed, but there is no suggestion he would have produced the actual tickets. Moreover, the record does contain evidence of when several of Applicants' cross trades likely occurred (namely, from the transcripts of Applicants' conversations with Frank). As explained earlier, that evidence directly undercuts Applicants' assertion that they were pricing the bonds consistently with the then-current market price.

Standard of Proof

Applicants next contend NASD incorrectly applied the "preponderance of the evidence" standard of proof in reaching its decision, rather than the more demanding "clear and convincing" standard. Applicants argue that, because the evidence against them is only circumstantial and because their livelihood is at stake, the "clear and convincing" standard should apply.
We have consistently rejected this argument when raised by other parties. For example, in *Sandra K. Simpson*, the respondent appealed an administrative law judge's use of the preponderance of the evidence standard in barring the applicant from the securities industry.[55] The *Simpson* applicant argued that, "because a decision against [her] would in all likelihood deprive her of her ability to make a living in the securities industry, a higher standard of proof should apply."[56] In rejecting this argument, we explained:

> To mandate that any misconduct for which the Division seeks a permanent bar must be proved by clear and convincing evidence would compromise the

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53 *See supra* note 22 and accompanying text.

54 *See supra* note 23 and accompanying text.

55 55 S.E.C. 766, 798 (2002).

56 *Id.* at 798.

> Commission's ability to protect public investors by, among other things, putting those respondents whose misconduct has been proven by a simple preponderance of the evidence beyond the reach of a permanent bar, however egregious the misconduct. This result would be inconsistent with our duty to protect the public.[57]

Despite our prior decisions, Applicants nevertheless argue that the "clear and convincing" standard should apply by pointing to *Collins Securities Corp. v. SEC*, in which the United States Court of Appeals for the District of Columbia held that the "clear and convincing" standard should govern cases involving a deprivation of livelihood.[58] As Applicants concede, however, the Supreme Court overruled *Collins* in *Steadman v. SEC*,[59] in which the Supreme Court rejected a petitioner's argument that the "clear and convincing" standard should apply "because of the potentially severe sanctions that the Commission was empowered to impose and because of the circumstantial and inferential nature of the evidence that might be used to prove intent to defraud, the Commission was required to weigh the evidence against a clear-and-convincing standard of proof."[60]

Applicants seek to get around *Steadman* by pointing to a district court decision from the Southern District of New York, *SEC v. Moran*.[61] Applicants quote *Moran*, which was decided after *Steadman*, for the proposition that "*Collins* remain[s] compelling post-*Steadman* because a member of the securities industry who is found liable of violations of § 10b or Rule 10b-5 will effectively be deprived of his livelihood."[62] In that quotation, however, the *Moran* court was not stating its own opinion, but rather reciting the *defendants'* position, which the court rejected as

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[57] *Id.* at 799. Although *Simpson* involved a bar imposed by the Commission, we have consistently applied the same preponderance of the evidence standard to bars imposed under NASD rules. *See, e.g.*, *John D. Audifferen*, Exchange Act Rel. No. 58230 (July 25, 2008), 93 SEC Docket 8129, 8134 n.9 (applying preponderance of the evidence standard when reviewing FINRA's decision to bar applicant in all capacities); *Kirk A. Knapp*, 51 S.E.C. 115, 116, 130 n.65 (1992) (stating that "[t]he correct standard is preponderance of the evidence" where NASD "barred [applicant] from association with any member in any capacity").

[58] 562 F.2d 820, 824 (D.C. Cir. 1977).

[59] 450 U.S. 91 (1981) (involving permanent bar against the petitioner for violating the antifraud provisions of the securities laws).

[60] *Id.* at 95 (overruling *Collins* and concluding that the proper standard of proof was preponderance of the evidence).

[61] 922 F. Supp. 867 (S.D.N.Y. 1996).

[62] Quoting *Moran*, 922 F. Supp. at 889.

inapplicable to the case before it.[63] Moreover, and contrary to Applicants' reading of the case, the court expressly rejected any contention that circumstantial evidence requires a "clear and convincing" standard, stating that "the fact that this is an action based on circumstantial evidence does not in any way necessitate a higher standard of proof [than preponderance of the evidence]."[64] Finally, because NASD introduced transcripts of Applicants' telephone conversations with Frank, NASD's case against Applicants was based on more than just circumstantial evidence.

For these reasons, we see no basis to reverse well-established precedent, regardless of whether both a deprivation of livelihood and circumstantial evidence are involved. We thus conclude that NASD correctly applied a preponderance of the evidence standard.

V.

Exchange Act Section 19(e)(2) directs us to sustain NASD's sanctions unless we find, having due regard for the public interest and the protection of investors, that the sanctions are excessive, oppressive, or impose an unnecessary or inappropriate burden on competition.[65] Here, Applicants contend NASD's sanctions were excessive because NASD failed to establish whether the alleged misconduct resulted in injury to others and, if so, "the nature and extent of that injury."[66] In making this argument, Applicants recycle their contention that, because the exact times of the trades are unknown, one cannot establish that the trades were unfairly priced. As we discussed above, however, NASD appropriately used Applicants' contemporaneous cost to establish that Applicants priced their trades unfairly. It was Applicants' burden to come forward with alternative evidence, and they failed to do so.

Applicants similarly argue that NASD failed to introduce any evidence "as to the ultimate impact to the customers on the liquidation of any of the transactions," which Applicants argue "could have been negligible in light of the ultimate price obtained by the customer." NASD did, however, establish that Applicants' interpositioning scheme deprived the customers of the best available market prices. Moreover, even assuming, *arguendo*, that some of Applicants'

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[63] *Moran*, 922 F. Supp. at 889 (concluding that the penalties at issue would not, in fact, deprive defendants of their livelihood).

[64] *Id.* at 890; *see also SEC v. Credit Bancorp, Ltd.*, 195 F. Supp. 2d 475, 491 (S.D.N.Y. 2002) ("[A]n action based upon circumstantial evidence is not any less sufficient than one based on direct evidence, and does not necessitate a higher standard of proof." (citations omitted)).

[65] 15 U.S.C. § 78s(e)(2). Applicants do not allege, and the record does not show, that NASD's sanctions imposed an undue burden on competition.

[66] NASD Sanction Guidelines 6 ("Sanction Guidelines").

customers may have suffered only negligible losses when they ultimately sold their bonds,[67] that would not weigh in favor of reducing the sanctions.[68]

We also give no weight to Applicants' argument that the 142 trades at issue were out of 10,000-15,000 transactions Applicants executed while at CIBC. Because Applicants were registered with NASD, they were expected to follow its rules. That Applicants may have complied with those rules when executing other trades is not a mitigating factor.[69]

Applicants finally contend that Polyviou should not face the same sanctions as Gonchar, because, they assert, Polyviou performed principally administrative functions and is therefore not as culpable. We disagree. As noted earlier, Polyviou was more than a passive participant in Applicants' cross trading scheme. Among other things, he and Gonchar interacted with Frank interchangeably, he and Gonchar shared the commissions from the fraudulent cross trades equally, and many of the victims were Polyviou's customers. We thus see no basis for holding Polyviou less culpable than Gonchar.

We agree with NASD's characterization of Applicants' misconduct as egregious and, therefore, find the sanctions neither excessive nor oppressive. As we have stated, "[t]he charging of excessive markups [i]s a serious breach of [an applicant's] obligation to deal fairly with its customers."[70] Applicants' interpositioning of a favored account between the market and their retail customers, which resulted in excessive markups, showed a complete disregard for this obligation.[71] As such, Applicants' actions pose too great a risk to the markets and investors to

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[67] The record does not contain evidence regarding this question. We note, however, that CIBC paid $300,000 in partial restitution. *See supra* note 8.

[68] *Coastal Fin., Inc.*, 54 S.E.C. 388, 396 (1999) (affirming bar despite NASD presenting no evidence of customer harm); *cf. Chris Dinh Hartley*, 57 S.E.C. 767, 775 (2004) (concluding that applicant was not entitled to a reduction in his sanctions, which included a suspension, simply "because his clients may be able to recover some of their losses").

[69] *Michael F. Siegel*, Exchange Act Rel. No. 58737 (Oct. 6, 2008), 94 SEC Docket 10501, 10519 ("[W]hen [applicant] registered with NASD, he agreed to abide by its rules, and compliance with this obligation is not a mitigating factor.").

[70] *Nicholas A. Codispoti*, 48 S.E.C. 842, 845 (1987).

[71] *See Sheldon*, 51 S.E.C. at 78 (finding applicant's conduct to be "particularly egregious" where "interpositioning of favored accounts between the dealer market and non-favored accounts resulted in fraudulent, effective markups of as much as 10 percent" and sustaining imposition of a bar); *see also Frank L. Palumbo*, 52 S.E.C. 467, 480 (1995) (stating that recklessly overcharging customers without justification demonstrates "a marked insensitivity

(continued...)

allow Applicants to remain in the securities industry. The sanctions are also consistent with NASD's Sanction Guidelines, which recommend fines of up to $100,000 plus the gross amount of any markups, along with a bar in egregious cases.[72] In addition, the sanctions will "have the salutary effect of deterring others from engaging in the same serious misconduct."[73]

For these reasons, we sustain NASD's findings of violation and imposition of sanctions. An appropriate order will issue.[74]

By the Commission (Commissioners CASEY, PAREDES, and WALTER); Chairman SHAPIRO and Commissioner AGUILAR not participating.

Elizabeth M. Murphy
Secretary

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[71] (...continued)
to [the] obligation to deal fairly with customers"). As discussed above, however, we believe Applicants' actions went beyond recklessness and were done with an intent to defraud.

[72] Sanction Guidelines at 95. Although the Commission is not bound by the Sanction Guidelines, it uses them as a benchmark in conducting its review under Exchange Act Section 19(e)(2). *Wanda P. Sears*, Exchange Act Rel. No. 58075 (July 1, 2008), 93 SEC Docket 7395, 7403.

[73] *Gordon*, 93 SEC Docket at 5113 & n.75 ("[W]e are mindful that although 'general deterrence is not, by itself, sufficient justification for expulsion or suspension . . . it may be considered as part of the overall remedial inquiry.'" (quoting *PAZ Sec., Inc.*, 494 F.3d 1059, 1066 (D.C. Cir. 2007))); *see also Boruski v. SEC*, 289 F.2d 738, 740 (2d Cir. 1961) ("The public interest requires that appropriate sanctions be imposed to secure compliance with the rules, regulations and policies of both NASD and SEC . . . .").

[74] We have considered all of the parties' contentions. We have rejected or sustained them to the extent that they are inconsistent or in accord with the views expressed in this opinion.

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 60506 / August 14, 2009

Admin. Proc. File No. 3-13243

In the Matter of the Application of

ANDREW P. GONCHAR
and
POLYVIOS T. POLYVIOU

c/o Martin H. Kaplan, Esq.
Gusrae, Kaplan, Bruno & Nusbaum PLLC
120 Wall Street
New York, New York 10005

For Review of Disciplinary Action by
NASD

ORDER SUSTAINING DISCIPLINARY ACTION

On the basis of the Commission's opinion issued this day, it is

ORDERED that the disciplinary action taken by NASD against Andrew P. Gonchar and Polyvios T. Polyviou, and NASD's imposition of costs, be, and they hereby are, sustained.

By the Commission.

Elizabeth M. Murphy
Secretary