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SECURITIES EXCHANGE ACT OF 1934
Rel. No. 61135 / December 10, 2009

Admin. Proc. File No. 3-13422

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In the Matter of the Application of

KIRLIN SECURITIES, INC.
ANTHONY KIRINCIC
and
ANDREW ISRAEL

21210

1499511

c/o Isaac M. Zucker
Law Offices of Isaac M. Zucker, PLLC
600 Old Country Road, Suite 321
Garden City, NY 11530

For Review of Disciplinary Action Taken by
FINRA

OPINION OF THE COMMISSION

REGISTERED SECURITIES ASSOCIATION – REVIEW OF DISCIPLINARY PROCEEDING

Violations of Securities Laws and Conduct Rules

Manipulation

Failure to Provide Best Execution

Improperly Signing Customer Names to Transactional Documents

Registered broker-dealer, its co-chief executive officer, and its head trader manipulated price of security sold to public investors. Broker-dealer's co-chief executive officer also improperly signed customers' names to transactional documents. Broker-dealer and head trader breached obligation of best execution. *Held*, association's findings of violation are *sustained*, and the sanctions imposed are *modified*.

0000056358 2009

APPEARANCES:

Isaac M. Zucker, for Kirlin Securities, Inc., Anthony Kirincic, and Andrew Israel.

Marc Menchel, Alan Lawhead, Carla Carloni, and *Andrew J. Love*, for FINRA.

Appeal filed: March 26, 2009
Last brief received: July 13, 2009

I.

Kirlin Securities, Inc., formerly a broker-dealer registered with FINRA ("Kirlin" or the "Firm"); Anthony Kirincic, Kirlin's co-chief executive officer; and Andrew Israel, Kirlin's head equity trader, appeal from FINRA disciplinary action.[1] FINRA found that Kirlin, Kirincic, and Israel (together, "Applicants") manipulated the stock price of Kirlin's publicly-traded parent company, Kirlin Holding Corporation ("KILN"), and thereby violated Section 10(b) of the Securities Exchange Act of 1934,[2] Rule 10b-5 thereunder,[3] and NASD Conduct Rules 2120 and 2110.[4] FINRA expelled Kirlin from FINRA membership and barred Kirincic and Israel in all

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[1] Kirlin filed a request to withdraw its registration as a broker-dealer in November 2006 and is no longer a FINRA member.

[2] 15 U.S.C. § 78j(b).

[3] 17 C.F.R. § 240.10b-5.

[4] On July 26, 2007, the Commission approved a proposed rule change filed by National Association of Securities Dealers, Inc. ("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 ("NYSE"). *See* Securities Exchange Act Rel. No. 56146 (July 26, 2007), 91 SEC Docket 517. NASD filed its complaint against Applicants before the consolidation for conduct that allegedly violated NASD Rules 2120 and 2110. As part of the effort to consolidate and reorganize NASD's and NYSE's rules into one FINRA rulebook, NASD Rules 2110 and 2120 (which are otherwise unchanged) are now codified as FINRA Rules 2010 and 2020, respectively. FINRA now litigates the case against Applicants, and references in this opinion to FINRA include, where appropriate, references to NASD.

NASD Rule 2120 (now FINRA Rule 2020) prohibits inducing the purchase or sale of a security by means of "any manipulative, deceptive or other fraudulent device or contrivance." NASD Rule 2110 (now FINRA Rule 2010) requires that members "observe high standards of

(continued...)

capacities for these violations. FINRA also found that Kirincic violated NASD Rule 2110 by falsifying the signatures of his parents on several stock certificates and letters of authorization to facilitate the manipulative scheme, for which FINRA imposed another bar in all capacities. Finally, FINRA found that Kirlin and Israel failed to provide best execution to a customer who sought to sell KILN stock during the manipulation, in violation of NASD Rule 2110, and ordered them to pay, jointly and severally, restitution to the injured customer.[5] We base our findings on an independent review of the record.

II.

This appeal involves findings by FINRA that, during a five-week period in early 2002, after learning that KILN's declining bid price threatened to cause the company to be delisted by Nasdaq, Kirincic, with Israel's assistance, placed more than 100 orders to buy shares of KILN to artificially increase its stock price. FINRA found that Kirincic, whose trades accounted for the vast majority of volume in the thinly-traded KILN, raised KILN's closing bid price over $1.00 for a sustained period and successfully prevented the company from being delisted. In addition, Kirincic admittedly signed his parents' names to certain documents that, among other things, facilitated the transfer of cash to his sister's account to help fund the manipulative purchase orders Kirincic was placing. FINRA further found that Israel, who was involved in Kirincic's scheme to inflate KILN's price, failed to provide best execution to a Kirlin customer who placed an unexpected and substantial order to liquidate his KILN shares that threatened to depress the inflated price of KILN. We turn first to a discussion of the facts surrounding the market manipulation and forgery allegations, and then to the facts regarding the best execution allegation.

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[4] (...continued)
commercial honor and just and equitable principles of trade." NASD General Rule 115 (now FINRA Rule 140) provides that persons associated with a member have the same duties and obligations as a member.

[5] FINRA found that David Lindner, the other co-CEO of Kirlin Securities, was also liable for failing to give a customer best execution on this trade. FINRA imposed a one-year suspension on Lindner, ordered him to requalify, and found him liable, jointly and severally with Kirlin and Israel, for the restitution owed to the affected customer. FINRA found that Israel's and Kirlin's failure to provide the customer with best execution on his trade also justified one-year suspensions, but it declined to impose them because, "in light of Israel's bar and Kirlin's expulsion for their manipulation, we consider the one-year suspensions . . . redundant."

Lindner initially joined the other applicants in petitioning the Commission for review of FINRA's decision but moved to withdraw his petition on May 20, 2009. Lindner's motion was granted on May 26, 2009. *See Kirlin Sec.*, Order Granting Request to Withdraw Application and Dismissing Review Proceeding Against Applicant Lindner, Admin. Proc. File No. 13422 (May 26, 2009). Accordingly, findings in this opinion with respect to Lindner are made only for the purpose of determining liability as to the remaining applicants.

A. Background

With David Lindner,[6] Kirincic was co-CEO and co-founder of Kirlin. At the Firm, Kirincic's primary role "was to evaluate the [company's] financial matters, to deal with liquidity and to deal with the overall structure of our company . . . ."[7] Israel, who had joined the Firm in 1989, became Kirlin's head equity trader in January 2002. Only one other trader in the office traded in equity securities at the time; he served as Israel's assistant. When Kirincic wanted to place an order to buy or sell securities for his customers' accounts, he would generally call the trading desk and instruct Israel (or Israel's assistant) to enter the order.[8] Israel testified that, when Kirincic called to place an order for his customer, Kirincic specified the price, number of shares, and how to route the order. Israel or his assistant would then write the order ticket and enter it as instructed. Israel testified that, although he was not always the one who received Kirincic's calls, he would nevertheless review all of the trading department's order tickets (including, presumably, Kirincic's) "to make sure there was nothing inappropriate" about them.

Kirlin was at all times relevant to this proceeding a wholly-owned subsidiary of KILN. KILN was incorporated in 1994 by Kirincic and Lindner, who both served as co-chief executive officers and members of the five-person board of directors. KILN has been publicly traded since its listing on the Nasdaq Small Cap Market in 1995. In 1999, the company achieved compliance with the standards set by Nasdaq's National Market ("NNM") and transferred its listing there.[9] Kirincic testified that, "given the choice" between the two market levels, he "would prefer to be on the one that was more highly recognized by the market," and that KILN's move to NNM was "a positive development in the evolution of the company moving forward." A press release issued by the company in 1999 noted that "[t]he prestige and viability of the listing [on] the Nasdaq National Market would enhance the company's accessibility with both the institutional investment community and the financial media."

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[6] *See supra* note 5.

[7] The Firm employed about 150 registered representatives in its Syosset, New York headquarters and seven branch offices. In 2002, Kirlin maintained more than 26,000 customer accounts, which held over $800 million in assets. Kirincic did not generally manage day-to-day operations of Kirlin, and he handled only about fifty customer accounts, many of which were owned by members of his family.

[8] Kirincic testified that he gave orders to "[w]hatever qualified individual in our trading department answered the phone." Israel was that person "some of the times."

[9] In 2005, Nasdaq changed the name of its Small Cap Market to the Nasdaq Capital Market. *See* Exchange Act Rel. No. 52489 (Sept. 21, 2005), 86 SEC Docket 906. In 2006, Nasdaq changed the name of its National Market to the Nasdaq Global Market. *See* Exchange Act Rel. No. 53799 (May 12, 2006), 88 SEC Docket 25. We continue to use the designations "Small Cap Market" and "National Market" for purposes of this opinion.

As Applicants acknowledged at the hearing, KILN was a thinly-traded stock: the average daily volume of KILN trading prior to the events at issue was generally less than 10,000 shares. Israel testified that there was "really no outside interest" in KILN shares beyond the interest Kirlin and its customers may have had. KILN's public float in the spring of 2002 was approximately 8.5 million shares held by 193 owners of record;[10] Israel estimated that about eighty percent of the stock was held in accounts serviced by Kirlin. Kirincic himself owned twenty percent of KILN's stock.[11]

B. Nasdaq notifies KILN of possible delisting based on low stock price

Although KILN's stock had once traded at prices as high as $57 or $58 per share, the company reported substantial net losses in 2000 and 2001,[12] and the price of KILN shares declined. By early 2002, KILN's closing bid price dropped below $1.00, the minimum price required to maintain listing on Nasdaq, and remained below that level for thirty consecutive trading days.[13]

As a result, on February 20, 2002, Nasdaq notified KILN that its stock would be delisted from the exchange in accordance with Nasdaq Marketplace Rule 4450(e)(2) unless, within the next ninety calendar days, KILN's bid price closed at or above $1.00 for at least ten consecutive trading days.[14] In its letter, Nasdaq noted that "[u]nder certain circumstances, to ensure the Company can sustain long-term compliance, Staff may require that the closing bid price equals

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[10] In its Form 10-K filing for the year ended December 31, 2001, KILN reported that it believed there were "over 1,500 beneficial owners" of KILN stock.

[11] Lindner also owned 20% of KILN's stock. In 2006, Kirincic came to hold approximately 35% of the company's shares when he agreed to a reduction in salary in exchange for KILN shares. Israel testified that in 2002 his only KILN holdings were options on 10,000 shares that had not yet vested.

[12] Kirincic testified that these losses were due largely to expenses related to the acquisition of other broker-dealers.

[13] Nasdaq Marketplace Rule 4450(a)(5) required that securities maintain a minimum bid price of at least $1.00 for continued inclusion on the Nasdaq market. The closing inside bid of a stock is set by the inside, or highest, bid reflected by a market maker at the close of the market.

[14] Nasdaq Marketplace Rule 4450(e)(2) provided that "[a] failure to meet the continued inclusion requirement for minimum bid price shall be determined to exist only if the deficiency continues for a period of 30 consecutive business days," and that, "[u]pon such failure, the issuer shall be notified promptly and shall have a period of 90 calendar days from such notification to achieve compliance."

$1.00 per share or greater for more than 10 consecutive trading days before determining that the Company complies." The letter also suggested that KILN consider transferring its securities to the Nasdaq Small Cap Market. The Small Cap Market also required listed companies to maintain a $1.00 minimum bid price but offered an extended period within which to regain compliance with that requirement.

C. Kirincic places trades in parents' accounts following delisting notice

Shortly after Nasdaq notified KILN that its low bid price threatened its listing status, Kirincic placed several trades in accounts held at Kirlin by his parents. Although Kirincic did not have formal discretionary authority over these accounts, he testified that he exercised time and price discretion in placing orders to effect his customers' trades "to get the best execution for my customer without impacting the market." On March 5, 2002, Kirincic placed an order with Israel to cross four sell orders (two from his parents' retirement accounts and two from the accounts of his parents-in-law) with a buy order for his parents' joint (non-retirement) account for 140,000 KILN shares at $.85 per share. During the hearing, Kirincic could not recall any details about these transactions or discussions with his parents regarding their reasons for these trades, other than that they served certain unspecified "tax planning" purposes. Despite these trades, KILN's bid price closed at $.80.

From March 7 through March 15, 2002, Kirincic placed several more orders to purchase KILN shares for his parents' joint account, purchasing a total of 10,981 shares in twelve transactions.[15] Kirincic testified that he had no understanding of his parents' strategy in KILN at the time and no recollection of how these orders were executed. Kirincic directed the trading desk to place these orders through the Firm's clearing broker, Bank of New York, which automatically routed the orders to Herzog Heine Geduld ("Herzog"), a market maker in KILN stock.[16] Despite this increase in activity, the price of KILN generally declined through these first two weeks of March, and after the Kirincics' purchases on Friday, March 15, KILN's inside bid price closed at $.64, the lowest closing price since KILN began trading on the NNM in 1999.

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[15] Kirincic's parents purchased 2,800 shares at $.75 on March 7; 500 shares at $.73 on March 8; 100 shares at $.73 on March 11; 581 shares at $.73 and 622 shares at $.71 on March 13; 1,378 shares at $.76 in two transactions on March 14; 2,000 shares at $.6499, 1,000 shares at $.65, and 2,000 shares in three transactions at $.64 on March 15. Kirincic's parents purchased no more KILN shares for this account at least through June 2002, but, as discussed later in this opinion, they sold a total of 385,498 KILN shares back to the company in April 2002.

[16] In addition to Herzog, five other firms made a market in KILN stock. Kirlin, however, was not a KILN market maker.

D. Kirincic changes his trading strategy, and KILN's price increases

The next trading day, Monday, March 18, Kirincic began placing orders to purchase substantial amounts of KILN stock for his sister, Susan Paduano, and would continue to do so through April 22 (the "Trading Period"). Kirincic, who testified that he exercised time and price discretion over Paduano's orders and also determined how to route them in the market, placed most of these orders not through Herzog but through BRUT, an electronic communications network ("ECN"), for execution. A significant feature of trading on ECNs, as Applicants' expert explained, is that, when a broker places an order with an ECN at a price above the highest, or "inside" bid, the ECN automatically displays that bid as its own, creating a new inside bid price that is displayed to the market. According to Applicants' expert, of the 65 orders Kirincic placed for Paduano on the BRUT ECN during the Trading Period, 41 of them were priced at or above the inside bid, and an additional 20 of them were priced at or above the inside ask; more than 93% of Kirincic's orders were therefore responsible for setting a new inside bid. Paduano's KILN purchases would total over $200,000 in a five-week period, account for 43% of the total trading volume in KILN, and increase the price of KILN over 57%.

In March 2002, Paduano was divorced, unemployed, caring for three children, and receiving as income only $3,600 per month in alimony. She nevertheless testified that she gave instructions to Kirincic to purchase shares in large dollar amounts, such as $25,000 or $50,000, depending on what she was "comfortable with" at the time.[17] During the hearing, neither Paduano nor Kirincic could recall specific details about any of the orders she gave Kirincic.[18] Although Paduano had not been an active purchaser of KILN shares in the four years preceding 2002 and had purchased none in January or February 2002,[19] she testified that she wanted to acquire KILN stock because "it was [her] desire to always hold a large position in the company" that her ex-husband (formerly a partner of Kirincic and Lindner) and brother had built. The KILN shares were intended, she said, to be a "legacy for my children." Although each of Paduano's children had a custodial account at another financial institution, all the KILN purchases Paduano made in 2002 were bought through her own account at Kirlin. There is no evidence that Paduano transferred any of the acquired KILN shares to her children's accounts; in

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[17] Paduano testified that her liquid net worth was approximately $500,000, though Kirlin's account documentation reflected a lower figure of $150,000 - $250,000.

[18] There is no written evidence in the record of any of the instructions Paduano gave Kirincic.

[19] She purchased 9,100 shares in 1998, none in 1999 or 2000, and 31,925 in 2001 (which includes a purchase of 10,000 shares that Paduano testified she acquired in a private placement in September 2001). Over the same period, she sold 45,400 shares, making her a net seller of KILN. By the beginning of 2002, Paduano held approximately 167,000 shares of KILN in her account at Kirlin.

fact, as discussed later in this opinion, Paduano sold all the shares she acquired at the end of 2002.

Kirincic did not recall discussing with his sister the wisdom of acquiring substantial amounts of KILN, and Paduano testified that she did not consider news regarding KILN, or the delisting notice it received, when she decided to purchase shares of KILN. Paduano testified that she considered March 2002 to be a good time to acquire KILN because she "had a better cash flow" than in the past. Despite her professed improved cash flow, however, Paduano borrowed substantial amounts from her parents to help finance at least some of these purchases.[20] For example, on April 16, Kirincic effected a transfer of $75,000 from one of his parents' accounts at Kirlin to Paduano's account by means of a letter of authorization to which Kirincic admittedly signed his parents' names.[21] Although Kirincic claims he signed this document, and others discussed later, with his parents' authorization, nothing in the record evidences that authorization.[22]

Kirincic placed his first order for Paduano's account at 9:33 a.m. on March 18, for 7,000 shares (with 500 shares displayed to the market and 6,500 kept "in reserve," *i.e.*, hidden from the market until the displayed portion of the order was filled) at a limit price of $.68 via the BRUT ECN. Because this price was $.01 above the inside ask, Kirincic quickly received a partial fill of about 2,500 shares. An hour later, Kirincic directed that the order for the remaining shares be cancelled and replaced with an order for 4,400 shares (showing 500 with 3,900 in reserve) at $.74 (again, $.01 above the inside ask). Kirincic quickly received a partial fill on 1,500 shares, and the inside market for KILN moved to $.74 - $.76. Less than an hour later, Kirincic directed the remaining order be cancelled. At 1:00 p.m., with the inside market at $.66 - $.76, Kirincic placed another order for 10,000 shares (showing 1,000 with 9,000 in reserve) at $.76. He immediately received a partial fill of 3,000 shares, and the inside market moved to $.76 - $.79. The remainder of this order was filled in increments throughout the afternoon and was completed just before 4:00 p.m. KILN's inside bid price closed at $.68, $.04 higher than the previous day's close.

This pattern of trading activity by Kirincic – *i.e.*, placing an order for several thousand shares (most held in reserve) on the BRUT ECN at a price well above the inside bid (and

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[20] Paduano testified that she planned to repay her parents with money her ex-husband owed to her, but offered no explanation as to why she could not wait to purchase the shares until she could afford them without borrowing from her parents.

[21] Kirincic also admitted signing his parents' names to six other documents, including two other letters of authorization that transferred a total of $125,000 from his parents to his sister in May and June 2002, and four stock certificates that enabled the transfer of over 465,000 of his parents' KILN shares to KILN as part of its stock repurchase program, described herein, on April 10, April 22, and June 20, 2002. *See infra* notes 29 & 45.

[22] *See infra* Section III.B.

sometimes at or above the inside ask), receiving partial fills, and then shortly thereafter cancelling and resubmitting the order at a higher price – characterized his trading for Paduano throughout the Trading Period.[23] Paduano ultimately purchased 224,653 KILN shares in approximately 115 transactions, including 65 orders placed on the BRUT ECN at prices that equaled or exceeded the existing bid and frequently even equaled or exceeded the existing ask, for a total price of $219,952 during the Trading Period. Applicants' expert calculated that the average time lapse between Kirincic's original orders and his subsequent increases in his bid price was just under ninety minutes. The average daily volume during the Trading Period tripled to 32,019 shares per day based almost exclusively on the activity in Paduano's account,[24] compared to 9,904 shares per day from January 1 through March 15, 2002.[25] As discussed below, KILN's closing bid price rose from $.68 on March 18 to as high as $1.15 on April 16, closing at $1.01 at the end of the Trading Period on April 22.

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[23] For example, on March 19, Kirincic placed an order for 10,000 shares (showing 1,000 and with 9,000 in reserve) at a price of $.75, which was $.07 above the inside bid and just $.03 below the inside ask. About ninety minutes later, Kirincic cancelled that order and replaced it with one at the inside ask of $.78. He almost immediately received a fill on 5,000 shares. An hour later, Kirincic cancelled that order and replaced it with an order for 5,000 shares (showing 1,000 and with 4,000 in reserve) at $.81. He immediately received a fill on 1,000 shares but cancelled the order ninety minutes later, replacing it at 3:54 p.m. with an order for 4,000 shares (showing 1,000 and with 3,000 in reserve) at $.84. This order received a fill on 100 shares just before the market closed, and Kirincic's outstanding order set the inside closing bid that day at $.84. With Kirincic in the market buying shares for his sister using series of limit orders with increasingly higher bid prices, KILN's inside bid rose from a closing price of $.68 on March 18 to $.85 on March 26.

[24] Purchases by Kirlin customers, and trading by other market participants to provide those customers with a supply of KILN stock to purchase, composed more than 90% of the volume of trading of KILN during the Trading Period.

[25] A FINRA staff member who participated in the investigation of Applicants' conduct and who testified at the hearing calculated the comparative average daily volume inclusive of all trades in KILN, including the agency cross transactions for Kirincic's parents on March 5 and the stock buyback transactions on April 10 and 22 under KILN's stock repurchase program (discussed later in this opinion) that did not involve Paduano's account. Including these transactions yields a volume before the Trading Period of 15,396 shares per day compared to 56,579 shares per day during the Trading Period: this is an increase of 367%. For purposes of isolating the effect Kirincic's trading on behalf of Paduano had on the market for KILN, we exclude the cross and repurchase transactions which occurred at Kirlin but away from Paduano's account. This yields a change in the average daily volume of 32,019 shares during the Trading Period versus 9,904 prior to the Trading Period, which is an increase of 323%.

E. KILN's Board of Directors considers responses to the Nasdaq delisting letter

While Kirincic was beginning to place substantial orders to buy KILN shares for his sister's account at increasing prices, KILN's board of directors was considering its options for addressing its decreasing share price and the potential delisting notice from Nasdaq. The board, which consisted of Kirincic, Lindner, and three others,[26] met via conference call on March 19 and, according to the minutes of the meeting,

> discussed various actions the Corporation could take to regain compliance and maintain listing on Nasdaq including, exercising its ability to phase down to the Nasdaq SmallCap Market, which provides the Company with lengthier core periods in which to regain compliance with the $1.00 minimum bid price requirement, effectuating a repurchase of the Corporation's stock in the market, or effectuating a reverse stock-split.

The board minutes further note that Kirincic was "hoping the bid price of the Corporation's stock will go above the $1.00 minimum bid price on its own merit."[27] The board took no action at that time but decided to reconvene and discuss the matter further.

On March 27, 2002, KILN's board of directors met again to discuss the company's possible delisting from Nasdaq, as its stock price had still not reached the $1.00 mark. In its Form 10-K for the year ended December 31, 2001, which the company would file a few days after the March 27 meeting, KILN stated that, "[i]f we are delisted from the Nasdaq National Market the liquidity of our common stock may be adversely affected which may result in a decline in our stock price."[28] In order to "regain compliance and maintain listing on Nasdaq," KILN's board authorized a stock repurchase program in which the company agreed to buy back

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[26] The three other directors were Edward Casey (Kirlin's counsel); Harold Paul (a securities attorney); and Martin Schacker (the former chairman of a broker-dealer acquired by Kirlin in 2001).

[27] The board minutes state that "Kirincic notified the Board that the Corporation had hired a public relations firm," and that this was a source of hope that the stock price would rise. However, Kirincic testified that he did not hire a public relations firm but an investment banking firm, which had written a "small report" about KILN in December 2000. Kirincic explained that KILN "had hoped that in light of the fact that we had some knowledgeable exposure about our company and our desire to acquire other people, that that's where the thought process that the stock might go up over $1.00 on its own merits came from." Kirincic did not recall noticing the inaccuracy in the board minutes. He was not asked to elaborate on why a report written more than a year earlier was expected to affect the price of KILN stock in spring 2002.

[28] This statement appeared in the "risk factors" section of the Form 10-K, which disclosed several items that potential investors were encouraged to consider before investing in the company.

up to $1 million of KILN stock. Kirincic and Lindner were given authority to act as brokers on behalf of KILN's account and were given an upper limit of about $1.30 on the price per share KILN would pay.

F. Kirincic's orders increase in size and KILN's closing bid price rises over $1.00

On April 1 and 2, 2002, KILN made two news announcements that, although positive, had no significant impact on the market. After the market closed on April 1, KILN announced its earnings for 2001 and reported that its net loss of $3.6 million for 2001 was significantly less than its reported net loss of $11 million for 2000. The inside bid for KILN nevertheless dropped $.04, to $.73, on the morning of April 2. Later that morning, KILN publicly announced the stock repurchase program that the board had previously authorized on March 27.[29] Again, the market exhibited no significant response.[30]

A few minutes after the announcement of the repurchase plan, Kirincic resumed purchasing shares for his sister, now in amounts substantially larger than before.[31] Paduano testified, however, that she could not recall why the size of her orders increased in April. Paduano's account purchased a total of 12,500 shares through Herzog at prices beginning at $.9479 in the morning and ending at $.99 just before 3:00 p.m.[32] At approximately 3:30 p.m., the inside bid had risen to $.97; Kirincic placed an order for 50,000 shares (showing 2,500 with 47,500 in reserve) at a price of $1.02 ($.02 above the inside ask price) and immediately began receiving fills on 24,800 shares. Three minutes later, at 3:39 p.m., the inside bid had moved to $1.01. Kirincic cancelled the order for the remaining shares and replaced it with an order for 25,000 shares (showing 2,500 and with 22,500 in reserve) at the inside ask price of $1.04. He received a fill on 400 shares before the market closed, still reflecting his outstanding order as the inside bid price. KILN's inside bid closed at $1.04, the first time it had reached the $1.00 mark in three months.

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[29] KILN made its first purchase of shares through the repurchase program on April 10, 2002, when it purchased 260,000 shares from Kirincic's parents at a price of $1.02 per share. This price was $.02 less than the current inside bid of $1.04. Kirincic admitted that he signed his parents' names to stock certificates that facilitated the transfer of these shares to KILN. *See supra* note 21.

[30] The inside bid moved only $.01, to $.74.

[31] Israel was on vacation from April 1 through April 5 and did not assist Kirincic in placing any orders during that period.

[32] The record shows that 2,500 of these shares were bought at prices more than $.20 above the inside bid and within $.04 of the inside ask. The remaining 10,000 shares were bought at prices that were at or above the inside ask.

From April 3 through April 17, 2002, Kirincic continued placing orders of significant size for his sister's account at prices that generally increased from a low of $.95 on April 3 to a high of $1.15 on April 16.[33] KILN's inside bid price closed above $1.00 on each of these ten trading days. Throughout the period, Kirincic placed a total of seventeen orders on BRUT ECN, and the purchases he made on behalf of his sister (totaling over 100,000 shares at over $112,000 total cost) accounted for the vast majority of trading volume in KILN. He placed three orders on April 3 for 10,000 shares and one for 25,000 shares on April 5, but the remaining orders were in much larger amounts – 50,000 and 75,000 shares. Consistent with his strategy earlier in the Trading Period, Kirincic generally placed an order at a price above the inside bid, received partial fills, and then replaced the order with one at a higher price.[34]

Also during this period, on April 3, Kirincic placed an order for Paduano on Bank of New York's system, which was routed to Herzog, for 2,000 shares at $1.01. This order was placed just one minute after Kirincic placed an order for 50,000 shares at $1.02 on BRUT ECN. It was entered as "good til cancelled," which meant that the order remained active in the market without expiring until fully executed or cancelled. During the hearing, Kirincic testified that he had no "specific recollection" of why he placed this order while he was already placing large orders through BRUT ECN at higher prices, though he admittedly understood that the effect of doing so would create the appearance that there were two different purchasers of KILN in the market.[35] Kirincic received a fill on 1,000 shares on April 4, but the balance of the order remained active in the market until it was filled thirteen trading days later, on April 22. Kirincic's good til cancelled order therefore set a floor of $1.01 on the inside bid price from April 3 through April 22.

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[33] Although Israel did not discuss Paduano's purchases of KILN stock with Kirincic, Israel testified that he eventually became aware that Kirincic was working a large order for his sister. Israel claimed that Kirincic's trading did not cause him concern, observing that "I have seen Mr. Kirincic put orders in over the years in similar strategies. I have seen other brokers put similar strategies in. Nothing different than I have seen before and after."

[34] For example, on April 16, the inside market opened at $1.04 - $1.10. At 9:42 a.m., Kirincic placed an order for 25,000 shares (1,000 showing and with 24,000 in reserve) at $1.08. At 1:19 p.m., Kirincic cancelled that order and replaced it with one at a price of $1.15 ($.05 above the inside ask). After receiving a partial fill on 700 shares, Kirincic cancelled the order for the remaining shares, replaced it with an order for the same number of shares (24,300) at $1.14, then immediately replaced it again with an order at $1.15. Kirincic received a partial fill on 10,500 shares in five transactions before the market closed. Kirincic's bid of $1.15 caused BRUT to hold the inside bid at the close.

[35] Kirincic later testified, when questioned by the Hearing Panel, that the good til cancelled order "was entered incorrectly and checked off as Good Til Cancel as opposed to a day order because I never enter Good Til Cancel orders."

G. KILN regains compliance with Nasdaq listing requirements

On the morning of April 18, 2002, Nasdaq sent an e-mail to Kirincic noting that KILN's bid price had closed above $1.00 for twelve consecutive days. Nasdaq staff stated that, "[p]rovided the bid price does not close below $1.00 for the next two trading days, on Monday (4/22/02) Staff will issue a formal notice of compliance."

Kirincic placed a few more orders for his sister's account in April after receiving KILN's compliance notice, making purchases for her account totaling 6,200 shares at prices ranging from $1.041 to $1.1489 on April 18 and 22.[36] During subsequent months, Kirincic continued to purchase shares of KILN for Paduano's account, but with less apparent urgency.[37] During the five-week Trading Period, Paduano had purchased a total of 224,653 shares (for a total price of $219,952) on 19 out of 26 trading days;[38] she was therefore buying KILN shares on 73% of the days in the Trading Period with an average purchase of $8,641 per trading day.[39] Following the end of the Trading Period through October 2002, Paduano's account purchased 303,285 KILN shares (for a total price of $228,419) on 59 out of 133 trading days; she was therefore buying KILN shares on only 44% of the remaining days in 2002 with an average purchase of $1,717 per trading day. The price of KILN shares declined along with the frequency of Paduano's purchases. According to data provided by Applicants, KILN's inside bid price closed at or above $1.00 on only four more days in April, two days in May, and one day in June 2002.

On July 30, 2002, KILN received notice from Nasdaq that the stock was again out of compliance with the minimum bid price rule and was given *until* October 28, 2002 to regain compliance. On August 14, 2002, KILN filed a Form 10-Q for the period ending June 30, 2002, in which it noted that it "will need to phase down to the Nasdaq SmallCap Market," which would

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[36] For example, on April 18, Kirincic placed an order through the trading desk to buy 2,500 shares of KILN on BRUT for Paduano's account at a limit price of $1.08 (showing 1,000 shares with 1,500 in reserve). Eight minutes later, Kirincic cancelled that order and replaced it with an order for 25,000 shares at $1.08 (showing 1,000 shares with 24,000 in reserve). Kirnicic received two partial fills on the order totaling 3,900 shares and leaving 21,100 outstanding. At 12:49 p.m., shortly after receiving his last partial fill, Kirincic cancelled the order for the remaining shares. KILN's inside bid closed at $1.04.

[37] She purchased a total of only 4,500 shares from April 24 through the end of the month (for a total of 157,300 shares purchased in April) and another 54,850 in May.

[38] Paduano was in the market, however, on 23 out of 26 days because her good til cancelled order with a KILN market maker was active from April 3 through April 22.

[39] We arrive at this average by dividing the total number of shares Paduano purchased (224,653) by the number of days in the period (26).

extend the deadline for compliance with the $1.00 minimum bid price rule.[40] On October 25, 2002, KILN submitted an application to transfer to Nasdaq's Small Cap Market, which was granted on November 21, 2002.[41]

On December 24, 2002, Paduano sold back to KILN all of the shares she had bought that year: she sold 600,000 shares back to KILN at $.45 per share, for a total sale price of $270,000.[42] When asked why she sold most of her KILN holdings in December, Paduano testified that she was "really extended out there," "was going on a very expensive trip to Europe," and was still waiting for her ex-husband to pay her the money she was owed. She felt she "had to put this dream of my legacy on the back burner . . . ."

On January 6, 2003, KILN effected a one-for-eight reverse stock split, and the company's board of directors announced that it "hope[d] that a higher stock price with fewer shares outstanding will enable our Company to be better received by the marketplace in the future." KILN traded on the Small Cap Market until August 2008, when the company changed its name to Zen Holdings Corp., and is currently quoted in the Pink Sheets.

H. Execution of Lee's order to sell a large block of KILN shares

We turn now to a discussion of the facts regarding FINRA's finding that Israel and Kirlin failed to provide a customer, Daniel Lee, with best execution on his order to sell 114,000 shares of KILN stock. This order was given to Kirlin on April 22, 2002, just as KILN had regained compliance with Nasdaq's listing standards after its bid price had closed at or above $1.00 for fourteen days.

Daniel Lee maintained an account at Kirlin in which he held 114,000 shares of KILN and about 10,000 shares of a few other securities. In the spring of 2002, Lee was being treated for esophageal cancer and was not making or receiving telephone calls.[43] In mid-April, his financial advisors recommended that Lee "consolidate [his] accounts and get rid of some of the small

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[40] In this filing the company also stated that phasing down to the Small Cap Market was necessary because it would not be able to meet a new requirement that NNM companies have at least $10 million in stockholders' equity.

[41] Transfer to the Nasdaq Small Cap Market extended the deadline to regain compliance with Nasdaq's minimum bid price from 90 days to 180 days, which for KILN resulted in a new compliance deadline of January 27, 2003.

[42] After the sale, Paduano had approximately 96,000 shares of KILN remaining in her Kirlin account. She purchased a total of 8,017 more shares in 2003 but none in 2004 or 2005.

[43] Lee underwent surgery in March 2002 that made it a "strain" to speak. Lee testified at the hearing that he had made a complete recovery from the disease.

accounts[,] especially those with losing positions and [he would] start to invest into more significant markets." Lee's financial advisor put the request in writing, Lee signed it, and Lee's personal assistant, Christi Diver, faxed the request to Kirlin on April 22 at 1:24 p.m.[44]

By the time Kirlin received Lee's fax, three significant transactions had already taken place that day. As part of KILN's stock repurchase program, KILN purchased 125,498 shares from Kirincic's parents and 114,502 shares from his cousin.[45] Both sales were at a price of $1.05, which was $.04 above the inside bid for Kirincic's parents and, when the second purchase was executed a few minutes later, $.01 above the inside bid for Kirincic's cousin. In addition to these two trades, pending in the market was an order that Kirincic had placed on Paduano's behalf through Kirlin's trading desk to buy 24,700 shares of KILN at $1.10.[46]

The account executive for Lee's account, Patrick Byrne, was working from home that day when he learned about Lee's order to liquidate his account. Byrne attempted to reach Lee by phone at 2:43 p.m., but Diver took the call and informed Byrne that Lee was "incapacitated" and told Byrne to "accept the order as is." Byrne attempted to explain that "this was a very large order and a stock that did not trade a lot of volume. . . . I wanted to talk to [Lee] about maybe placing the order in a different way, in smaller pieces or a way that might not devastate the price that he gets." Bryne testified that Diver "said 'No,' and started to get a little agitated and told me, 'This is the writing, get it done.'" He further testified, "[S]he led me to believe this man was on his death bed."

Byrne called his assistant and told her to write out a market order ticket to sell Lee's shares, without specifying a price per share. At 2:53 p.m., Byrne called Israel to discuss the order. Byrne testified that Israel did not inform Byrne about Paduano's pending purchase order or the repurchases of stock from Kirincic's relatives earlier in the day.[47] According to Byrne, Israel

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[44] There is conflicting information in the record as to the time at which Kirlin received the fax from Diver. The electronic transmittal information imprinted by Kirlin's fax machine indicates the firm received the letter at 11:53 a.m.; however, the telephone bill for Lee's fax machine (which, Lee testified, is a dedicated fax line) reflects that a fax was sent to Kirlin at 12:24 p.m. Central Time, which translates to 1:24 p.m. at Kirlin's offices in Syosset. Diver did not testify, and no other information in the record clarifies the issue.

[45] Kirincic admitted that he signed his parents' names to a stock certificate that facilitated the transfer of their shares to KILN in this sale. *See supra* note 21.

[46] Kirincic's order was originally for 25,000 shares at $1.10 and had already received a fill of 300 shares.

[47] Israel admitted that he did not tell Byrne about Paduano's outstanding order, but testified, ambiguously, that "Patrick was aware of the shares in Kirlin earlier that day from the

(continued...)

"was concerned that it was such a large order and what was going on, and I believe at that point he told me he was going to talk to Tony [Kirincic] and see what the price was of this thing." Israel failed to reach Kirincic, who was out of the office that day but spoke instead to Lindner.

Lindner testified that, when he spoke to Israel,[48] Lindner learned that the bid price for KILN at the time "was approximately a dollar a share or somewhere in that area."[49] Lindner knew that KILN had repurchased "$250,000 worth of stock" in the repurchase program earlier in the day, but testified that he did not know the price paid per share and did not know about Paduano's outstanding order to buy KILN shares.[50] Lindner was "nervous" about buying more shares on behalf of KILN without discussing it with others; however, it was late in the afternoon, and Lindner understood from Israel that Lee was "on his death bed and will not be able to make it to the next day and he has to transfer it into the trust." Lindner, who "spent all [his] time on investment banking" for KILN, used his experience in pricing secondary offerings and decided to bid, on behalf of KILN, $.80 per share to repurchase Lee's 114,000 shares.

Israel called Byrne with the $.80-per-share offer and told him that, if he did not like that offer, Israel could put Lee's order into the marketplace. Byrne told Israel to execute the order for $.80, but it was not executed until Byrne's assistant handed Israel the order ticket, some "five to

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47 (...continued)
conversation." The Hearing Panel found that, "[g]iven the ambiguity of Israel's testimony, the clarity and credibility of Byrne's testimony that he was unaware of trading activity in KILN, and the demeanor of the witnesses, . . . Israel did not inform Byrne that KILN had repurchased shares from Kirincic family members that day." The National Adjudicatory Council ("NAC") noted the Panel's finding but did not rely on it for its finding that Israel failed to give Lee best execution.

48 Lindner was out of the office that day. He recalled that he spoke to Pat Byrne on the phone about Lee's order, not Israel. Given that Israel and Byrne both testified that the conversation was between Israel and Lindner, not Byrne and Lindner, we conclude that Lindner's testimony is inaccurate in this regard.

49 Israel testified that he knew generally what the price of KILN was "at most days."

50 Lindner testified that he "was surprised" when he found out that KILN had paid $1.05 for Kirincic's relatives' repurchased shares. However, the Hearing Panel rejected Lindner's testimony and found that he knew when he spoke to Israel that Kirincic's relatives received $1.05 for their shares that morning and also that Paduano was in the market for 24,000 shares at $1.10. The NAC found it unnecessary to determine the credibility of Lindner's assertions because it found that he "should have known" the facts about the market for KILN before he selected a price for Lee's shares.

fifteen minutes" later, at 3:18 p.m.[51] In the meantime, at 3:05 p.m., Israel began selling the shares of other securities Lee held in his Kirlin account. At 3:08 p.m., Kirincic called Kirlin's trading desk and cancelled Paduano's order to buy 24,700 KILN shares at $1.10.[52] Neither Kirincic nor Israel could recall a conversation about the cancellation.[53] At 3:18 p.m., Israel executed Lee's order to sell 114,000 shares of KILN at $.80.[54] Twenty minutes after Lee's trade was executed, Kirincic called the trading desk again and placed a smaller order of 5,000 shares for his sister's account. This order, with a bid price of $1.01, remained unfilled and set the inside bid at the close.[55]

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[51] Byrne understood that the price for a block trade would likely be at a discount from the current market price. He testified that, at the time, he thought $.80 was a "great price" because the trade was for "100,000 shares of a stock that trades hundreds of shares [in daily volume]." Byrne left Kirlin in May 2002 but the record does not suggest his departure was related to these events. FINRA did not charge him with any wrongdoing.

[52] When asked whether he considered crossing Paduano's open order for 24,700 shares with Lee's order to sell, Israel responded that he "couldn't tell you exactly" what his thought process was at the time.

[53] Israel testified that he did not tell Kirincic about Lee's order. However, the Hearing Panel found that, "based upon the circumstantial evidence presented," Kirincic knew about Lee's pending order and cancelled Paduano's pending order based on that knowledge.

[54] When Israel entered Lee's order into the Bank of New York system for execution, he appended a ".w" modifier to the transaction. Under Nasdaq Marketplace Rule 6420, brokers were required to append this modifier when they reported to Nasdaq "transactions occurring at prices based on average-weighting or other special-pricing formulae." *Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the Nat'l Assn. of Secs. Dealers, Inc. Relating to Trade-Reporting of Average-Price Trades in Nasdaq-Listed Secs.*, 65 Fed. Reg. 36,482 (June 8, 2000). Nasdaq required use of the modifier for specially-priced transactions in order to "increase pricing transparency and eliminate investor confusion that could occur if investors see prints go across the tape that are unrelated to the current market." *Id.*, 65 Fed. Reg. at 36,483. Israel testified that he did not know why he appended the ".w" modifier to the Lee trade; he did not use the modifier for the earlier agency cross transactions with Kirincic's parents and cousin.

[55] When Lee's financial advisor received a copy of his account statement from Kirlin, he told Lee "there was something strange about this [KILN] trade." On Lee's behalf, the financial advisor unsuccessfully attempted to resolve the dispute with Kirlin over the price Lee received and filed a complaint with FINRA that ultimately led to these proceedings.

III.

A. Manipulation

Section 10(b) of the Exchange Act and Exchange Act Rule 10b-5, as well as NASD Rule 2120, make it unlawful for any person to use any manipulative or fraudulent device in connection with the purchase or sale of any security, which includes manipulative trading.[56] We have characterized manipulation as "the creation of deceptive value or market activity for a security, accomplished by an intentional interference with the free forces of supply and demand."[57] Manipulation of the market for securities is at the core of conduct that the securities laws were designed to prevent. Indeed, it "strikes at the heart of the pricing process on which all investors rely [and] attacks the very foundation and integrity of the free market system."[58] We have explained in the past that, "[w]hen investors and prospective investors see activity, they are entitled to assume that it is real activity."[59]

In determining whether a manipulation has occurred, the Commission generally looks to see whether the trading and surrounding circumstances suggest an effort to "interfere[] with the

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[56] *Terrance Yoshikawa*, Exchange Act Rel. No. 53731 (April 26, 2006), 87 SEC Docket 2924, 2930-31 & n.19 (*citing Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 199 (1976)). We have previously explained:

> When individuals occupying a dominant market position engage in a scheme to distort the price of a security for their own benefit, they violate the securities laws by perpetrating a fraud on all public investors. In addition, their failure to disclose that market prices are being manipulated not only constitutes an element of a scheme to defraud, but is also a material omission of fact in the offer and sale of securities.

Pagel, Inc., 48 S.E.C. 223, 228 (1985), *aff'd*, 803 F.2d 942 (8th Cir. 1986).

[57] *Swartwood, Hesse, Inc.*, 50 S.E.C. 1301, 1307 (1992) (*citing Hochfelder*, 425 U.S. at 199; *Schreiber v. Burlington Northern, Inc.*, 472 U.S. 1 (1985); *Feldbaum v. Avon Products, Inc.*, 741 F.2d 234 (8th Cir. 1984)).

[58] *L.C. Wegard & Co.*, 53 S.E.C. 607, 617 (1998), *aff'd*, 189 F.3d 461 (2d Cir. 1999) (Table). *See also SEC v. First Jersey Sec., Inc.*, 101 F.3d 1450, 1466 (2d Cir. 1996) ("The basic aim of the antifraud provisions is to 'prevent rigging of the market and to permit operation of the natural law of supply and demand.'" (*quoting United States v. Stein*, 456 F.2d 844, 850 (2d Cir. 1972), *cert. denied*, 408 U.S. 922)).

[59] *Edward J. Mawod & Co.*, 46 S.E.C. 865, 871 (1977), *aff'd*, 591 F.2d 588 (10th Cir. 1979).

free forces of supply and demand."[60] We have noted that "[p]roof of a manipulation almost always depends on inferences drawn from a mass of factual detail"[61] including "patterns of behavior[] and . . . trading data."[62] We have also observed that manipulations often display several characteristics, including, among other things, a rapid surge in the price of a security, little investor interest in the security, the absence of any known prospects for the issuer or favorable developments affecting the issuer or its business, and market domination.[63]

In order to establish that the manipulative conduct at issue constitutes a violation of Exchange Act Section 10(b) and Rule 10b-5 thereunder, as well as analogous NASD rules, we must also find that Applicants acted with scienter, defined as "a mental state embracing intent to deceive, manipulate, or defraud."[64] A finding that Applicants acted recklessly can satisfy this requirement.[65] Recklessness in this context has been defined as "an extreme departure from the standards of ordinary care, . . . which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it."[66]

The evidence demonstrates that Kirincic traded in KILN during the Trading Period, as assisted by Israel, for the purpose of increasing the inside bid price of KILN shares. Kirincic's trading in KILN on behalf of his family displays many of the common characteristics of a manipulative scheme. The price of KILN dramatically increased over the Trading Period, rising from $.68 on March 18 to $1.15 on April 16, closing at $1.01 on the last day of the Trading Period. This is an increase of up to 69% despite the lack of any public news that could explain the change and despite the lack of any significant outside interest in KILN stock. Moreover, the trading Kirincic brokered on behalf of his family accounted for the vast majority of volume in KILN shares during the Trading Period: Paduano's purchases (plus trading in KILN shares by

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[60] *Pagel, Inc.*, 48 S.E.C. at 226 (*citing U.S. v. Stein*, 456 F.2d 844, 850 (2d Cir. 1972).

[61] *Id.*

[62] *Amr Elgindy*, 57 S.E.C. 431, 438 (2004), *aff'd sub. nom.*, *NASD v. SEC*, 431 F.3d 803 (D.C. Cir. 2005) (*citing Brooklyn Capital & Sec. Trading, Inc.*, 52 S.E.C. 1286, 1290 (1997)).

[63] *Elgindy*, 57 S.E.C. at 439 (*citing Brooklyn Capital*, 52 S.E.C. at 1290, and *Michael J. Markowski*, 54 S.E.C. 830, 834 (2000), *reconsid. denied*, 54 S.E.C. 957)).

[64] *Hochfelder*, 425 U.S. at 193 n.12.

[65] *SEC v. U.S. Envtl., Inc.*, 155 F.3d 107 (2d Cir. 1998) (finding allegation of reckless participation in a market manipulation sufficient to state a claim of violation of Exchange Act Section 10(b)).

[66] *Sundstrand Corp. v. Sun Chem. Corp.*, 553 F.2d 1033, 1045 (7th Cir. 1977).

other market participants that was necessary to fill her orders) represented 43% of all trading in KILN. The figure climbs to 79% when including KILN's repurchases from Kirincic's parents and cousin. We find KILN's dramatic movement in price, unexplained by other legitimate market forces and considered along with Kirlin's domination of the market for KILN, constitute compelling evidence that Kirincic manipulated the market for KILN.[67]

The specific pattern of trading Kirincic used also strongly suggests fraud. Kirincic learned in late February 2002 that KILN faced delisting from the NNM. Shortly thereafter, in early March, he placed several trades for his parents with a KILN market maker that did not increase KILN's closing bid price. The day after KILN's bid price closed at a historic low despite his parents' purchases, Kirincic began placing orders for his sister's account using a different strategy – placing orders on an ECN at a price above the inside bid (often well above the inside bid), and cancelling and re-entering the order at increasingly higher prices even after his lower bids had generated market interest.[68] On April 2, as KILN's bid price approached $1.00 for the first time in months, Kirincic began placing substantially larger orders for his sister – orders of a size that dwarfed the normal daily volume for the stock – while continuing to enter increasingly higher bids. According to Applicants' exhibits, Kirincic's orders set a new inside bid or equaled the inside bid more than 90% of the time during the Trading Period and were placed at or above the inside ask more than 30% of the time. This kind of price leadership, especially for the stock of a company dealing with substantial financial losses, declining stock prices, and potential delisting from the Nasdaq, is a "classic element[]" of manipulation.[69]

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[67] *See Brooklyn Capital & Sec. Trading, Inc.*, 52 S.E.C. 1286, 1290 (1997) (finding market manipulation where there was "a rapid price surge dictated by the firm that controlled the security's market, little investor interest, an abundant supply, and the absence of any known prospects for the issuer or favorable developments affecting it" (*quoting Patten Sec. Corp.*, 51 S.E.C. 568, 573 (1993))); *Pagel, Inc.*, 48 S.E.C. at 227-28 (finding market manipulation where "individuals occupying a dominant market position engage[d] in a scheme to distort the price of a security" and noting that the stock's price change was not shown to result from "general economic conditions" nor was "related to the market for the company's stock").

[68] *See Yoshikawa*, 87 SEC Docket at 2933-34 & n.31 (rejecting argument that "there is nothing inherently manipulative or fraudulent in entering orders and cancelling them shortly thereafter, and finding that "mass of factual details" established that applicant "engaged in a manipulative scheme by artificially moving the [national best bid or offer] in the specified securities and thereby fraudulently affected the nature of the market for these securities.") (*citing Keith Springer*, 55 S.E.C. 632, 642 (2002)).

[69] *SEC v. Resch-Cassin & Co.*, 362 F. Supp. 964, 978 (S.D.N.Y. 1973); *Dlugash v. SEC*, 373 F.2d 107, 109 (2d Cir. 1967) (noting existence of a manipulative scheme where the condition of the company whose stock was sold at inflated prices was "not favorable," there was "no demand" for the stock, and "rapidly rising prices in the absence of any demand are well-known symptoms of such unlawful market operations").

Kirincic's intent to move the price of KILN upward is further supported by the circumstances surrounding his purchases. KILN's board of directors, of which Kirincic was a member, consistently declared in its meeting minutes and public filings that it considered its listing on the NNM to be important, noting in a 10-K filing that delisting could "adversely affect" the company's liquidity and depress its stock price. Kirincic himself conceded that, "[g]iven the choice of being on either [National or Small Cap Market], I would prefer to be on one that was more highly recognized by the market." Moreover, even if the company would ultimately have to phase down to the Small Cap Market because it could not maintain the shareholder equity requirements of the National Market, KILN still needed to maintain a $1.00 minimum closing bid price to qualify for Nasdaq's Small Cap market. Kirincic was also a significant holder of KILN stock, and, although he himself never sold his holdings, Kirincic's parents and cousin sold substantial amounts of KILN stock back to the company in its repurchase program and received an inflated price for their shares.

We also find that the record establishes that Israel, who placed or reviewed many of Kirincic's orders and who admitted that he was aware that Kirincic was making significant purchases for his sister, was at least reckless in his participation in the scheme. Israel had been with Kirlin for over twelve years and had been promoted to head equity trader in 2002, shortly before the period at issue. He testified that he knew KILN was thinly traded, knew most of the float was held in accounts at Kirlin, and was generally aware of KILN's price movements. Yet, as he admitted, he never questioned Kirincic about his trading despite its many suspicious features. Given these facts, we conclude that Israel knew, or must have known, that Kirincic's trading strategy – *i.e.*, placing orders above the inside bid, cancelling them (often after receiving partial fills) and replacing them with orders with successively higher bids – had the effect of artificially driving up the price of KILN shares. Although the record suggests that Kirincic, and not Israel, directed the placement of the manipulative purchase orders, this does not absolve Israel of responsibility for the part he recklessly played in the scheme.[70]

Applicants argue that they did not engage in manipulation and that, rather, "[t]he trading pattern exhibited by Kirlin's purchases for the Paduano account is consistent with a prudent accumulation strategy designed to minimize the affect [sic] on KILN's market price and to acquire large amounts of stock at better prices." However, neither Kirincic nor Paduano could adequately or credibly explain the reasons for his trading on her behalf: the National Adjudicatory Council ("NAC") accepted the Hearing Panel's finding that "Kirincic's attempts to explain the trading in [Paduano's] account, his claim that [Paduano] directed and initiated the

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[70] *See, e.g., John Montelbano*, 56 S.E.C. 76, 91-92 (2003) (stating that "[a] trader's manipulative activity cannot be excused because it was dictated by others" (*citing Jeffrey D. Field*, 51 S.E.C. 1074, 1076 (1994))); *Hibbard, Brown & Co.*, 52 S.E.C. 170, 180 (1995) (rejecting applicant's argument that he was merely a trader performing his duties and taking orders from his superior and finding that applicant's position as head trader, his "many years of experience," and his intimate involvement in the mechanics of the scheme put him "on notice" that the firm was charging excessive markups).

purchases in her account, and [Paduano's] explanation that the increased trading in her account was meant to leave a legacy of Kirlin Holding stock for her children were not credible." We, too, find no basis to disturb FINRA's rejection of Kirincic's and Paduano's explanation of the trading in her account.[71]

Applicants further assert that "[t]he manner in which Mr. Kirincic placed orders through BRUT allowed him to obtain lower prices for Ms. Paduano. If the total size of the orders had been exposed, the market might have viewed that order differently and could have been more aggressive in its pricing. In this case, the orders entered by Mr. Kirincic did not drive the price up." However, the record evidence demonstrates otherwise. With Paduano as the only significant participant in the market during the Trading Period, excluding the other repurchase transactions by Kirincic's parents and cousin, and with no other market developments or news that had any apparent effect on the market for KILN, the price of KILN rose from a near historic low of $.68 to as high as $1.15. This price change occurred while Kirincic was placing orders for Paduano that habitually set new inside bid prices.[72] Moreover, although Kirincic did not show the entire amount of his order when he placed orders on BRUT, his pricing strategy – entering orders well above the inside bid, receiving partial fills, and shortly thereafter re-entering the order at a higher price – is inconsistent with a strategy to obtain the best price for Paduano. Kirincic's willingness to bid increasingly higher prices without waiting long for the market to come to him suggests an urgency to his acquisition of stock that neither he nor his sister could explain.[73] Moreover, Applicants fail to explain how Paduano's eventual liquidation in December 2002 of all the shares she acquired that year is consistent with her professed legitimate acquisition strategy.

Applicants also argue that "the trade data shows support for the market when Kirlin had no ECN orders pending as well as activity not involving the firm. This is further evidence that the price of KILN was set as a result of the independent judgments of the various market makers

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[71] As we have noted in previous decisions, the credibility determination of an initial fact finder is entitled to considerable weight and deference because it is based on hearing the witnesses' testimony and observing their demeanor. *See, e.g.*, *Rita J. McConville*, Exchange Act Rel. No. 51950 (June 30, 2005), 85 SEC Docket 3127, 3136 n.21, *petition denied*, 465 F.3d 780 (7th Cir. 2006). Such determinations generally "can be overcome only where the record contains substantial evidence for doing so." *Laurie Jones Canady*, 54 S.E.C. 65, 78 (1999) (*citing Anthony Tricarico*, 51 S.E.C. 457, 460 (1993), *petition denied*, 230 F.3d 362 (D.C. Cir. 2000)). As noted, we do not find the record contains such evidence here.

[72] As noted, Applicants' own expert calculated that, of the 65 orders Kirincic placed on BRUT for Paduano, 41 of them were entered at or above the inside bid, and 20 were entered at or above the inside ask.

[73] Indeed, as Applicants' expert noted in the trade data reports he produced for this case, the average time that lapsed between Kirincic's increases in the prices of his orders was only ninety minutes.

providing a market and liquidity in the security." Again, the record evidence demonstrates otherwise. As noted, transactions by Kirincic's family members accounted for 79% of the trading in KILN during the Trading Period. Although there were five days during the Trading Period when Kirincic did not place orders on BRUT while the bid price still remained over $1.00, the April 3 good-til-cancelled order for 2,000 shares at a limit price of $1.01 (which received a partial fill on April 4) was pending with Herzog and supported the price on all of those days. Moreover, after the Trading Period, when Kirincic was no longer making frequent purchases for Paduano, the price of KILN dropped dramatically and steadily declined. The record does not support Applicants' argument, therefore, that the market supported a price over $1.00 for KILN during the Trading Period without Kirincic's intervention.[74]

Applicants argue that at least one district court has held that, in open market transactions in which "the beneficial ownership of the securities change and the volume of trading reflects actual market activity," the Commission "must prove that but for the manipulative intent, the defendant would not have conducted the transaction."[75] Moreover, Applicants argue, "if a securities transaction was made 'for an investment purpose,' then 'there is no manipulation, even if an increase or domination in price was a foreseeable consequence of the investment.'"[76] As discussed, the Hearing Panel that observed their demeanor did not credit the testimony of Kirincic and Paduano that Kirincic placed trades in Paduano's account "for an investment purpose," *i.e.*, as part of a legitimate strategy to acquire KILN shares as a legacy for Paduano's children,[77] and we have acceded to that determination. In addition, Paduano's subsequent liquidation of KILN shares in December 2002 further contradicts her stated "investment

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[74] Noting that FINRA's expert's testimony was ultimately stricken from the record because he became too ill to complete his testimony, Applicants suggest that FINRA could not, and we cannot, draw a conclusion that a manipulation occurred without express expert testimony making such a finding. We disagree, because neither we nor NASD is hindered by the lack of, or is bound by, expert testimony. *See Meyer Blinder*, 50 S.E.C. 1215, 1222 n.32 (1992) ("[T]he absence of expert testimony or the fact that only one party has offered such evidence is hardly dispositive. As we have previously noted, the NASD itself is an expert body whose 'businessman's judgment' may be brought to bear in reaching its decision."); *Gregory M. Dearlove*, Exchange Act Rel. No. 57244 (Jan. 31, 2008), *aff'd*, 2009 U.S. App. LEXIS 16602 (D.C. Cir. July 24, 2009) ("The Commission may consider expert testimony, but it is not bound by such testimony even where it is available.") As discussed above, there is ample evidence in this case, including exhibits, data, and analysis provided by Applicants, as well as Applicants' own testimony, to support FINRA's finding that Applicants engaged in market manipulation.

[75] *SEC v. Masri*, 523 F. Supp. 2d 361, 367 (S.D.N.Y. 2007).

[76] *Quoting United States v. Mulheren*, 938 F.2d 364, 368-69, 372 (2d Cir. 1991).

[77] *See Swartwood, Hesse*, 50 S.E.C. at 1307 (rejecting respondent's argument that he did not manipulate the market and finding that "the pattern of [respondent's] trading contradicts his contention that his objective was merely the long-term accumulation of [the affected] stock").

purpose." Moreover, the Commission has consistently held that an applicant's scienter renders his interference with the market illegal,[78] and this understanding of the antifraud provisions has been explicitly ratified by at least one reviewing court.[79]

We conclude, therefore, that Kirincic manipulated the market for KILN and that Israel, who entered or reviewed all of Kirincic's orders excepting one week in April, was at least reckless in his participation in the scheme. Based on Kirincic's and Israel's conduct, Kirlin is also liable for the manipulation.[80] We affirm FINRA's finding that Kirincic, Israel, and Kirlin thereby violated Exchange Act Section 10(b), Exchange Act Rule 10b-5, and NASD Rules 2120 and 2110.[81]

B. Improperly signing customer names to transactional documents

FINRA charged that Kirincic violated NASD Rule 2110 when he signed his parents' signatures to four stock certificates and three letters of authorization "in disregard of: (a) NASD's Conduct Rules that prohibit that behavior and (b) Kirlin's written supervisory procedures that

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[78] *See, e.g., Yoshikawa*, 87 SEC Docket at 2931 (defining manipulation as "intentional interference with the free forces of supply and demand"); *Pagel, Inc.*, 48 S.E.C. at 226 (same); *Vladlen "Larry" Vindman*, Exchange Act Rel. No. 53654 (Apr. 14, 2006), 87 SEC Docket 2626, 2634 & n.24 (defining manipulation as "intentional or willful conduct designed to deceive or defraud investors by controlling or artificially affecting the price of securities"); *Robert J. Setteducati*, Exchange Act Rel. No. 48759 (Nov. 7, 2003), 81 SEC Docket 2223, 2230-31 & n.22 (same).

[79] *See Markowski v. SEC*, 274 F.3d 525, 528-29 (D.C. Cir. 2001) (discussing arguments against making manipulation illegal where respondent's legitimate purposes coexist with fraudulent purposes, and concluding that "[w]hatever the practical concerns, we cannot find the Commission's interpretation [of Exchange Act Section 10b-5 as prohibiting manipulation based on intent] to be unreasonable in light of what appears to be Congress's determination that 'manipulation' can be illegal solely because of the actor's purpose").

[80] *See SIG Specialists, Inc.*, Exchange Act Rel. No. 51867 (June 17, 2005), 85 SEC Docket 2679, 2692 & n.35 ("It is well established that a firm may be held accountable for the misconduct of its associated persons because it is through such persons that a firm acts."); *Kirk A. Knapp*, 50 S.E.C. 858, 860 n.7 (1992) (noting that NASD properly attributed scienter of firm's owner to firm and thereby found primary antifraud violation by firm based on owner's conduct) (*citing SEC v. Manor Nursing Centers, Inc.*, 458 F.2d 1082, 1096-97 nn.16-18 (2d Cir. 1972)).

[81] It is well established that a violation of a Commission or NASD rule or regulation is inconsistent with just and equitable principles of trade, and is therefore also a violation of Rule 2110. *Frank Thomas Devine*, 55 S.E.C. 1180, 1192 n.30 (2002).

specifically prohibit employees from signing documents on behalf of customers."[82] During his investigative testimony, Kirincic originally denied signing his parents' names to these documents, asserting that his parents signed the documents themselves; however, after an off-the-record consultation with counsel, Kirincic then admitted signing their names but claimed that he had their authorization to do so. Kirincic argues that FINRA has not established that he lacked such authorization. FINRA argues, in turn, that Kirincic, whose testimony regarding his parents' permission to sign the documents was rejected by the Hearing Panel, did not establish that he had authorization.

Kirincic's claim that his parents authorized him to sign the documents is uncontroverted, though also unsupported, by any other evidence, with the exception of a letter apparently written and signed by Kirincic's parents that Applicants produced for the first time with their opening brief to the Commission. This letter, dated February 6, 2008, states that "[t]he transactions that took place in our account during 2002 relating to the transfer of Kirlin Holding Corp. stock certificates back into our account and the transfer of monies to Susan Paduano, our daughter, was fully authorized by us and you [*i.e.*, Kirincic] acted on our verbal instructions."[83]

Under Commission Rule of Practice 452,[84] we may permit the admission of additional evidence where the evidence is material and where there exist reasonable grounds for failing to produce the evidence earlier. However, Applicants have not adequately explained their failure to adduce the letter before now. Applicants claim that they "chose not to impose on Kirincic's parents" to appear as witnesses regarding the forgery because they believed that FINRA "failed to meet its burden of proof." However, we have held that an applicant's unsuccessful litigation strategy "does not warrant reopening the record."[85] Applicants concede that they understood the Hearing Panel's decision at least "intimated" that it did not accept Kirincic's testimony that his parents authorized him to sign the documents at issue, and Kirincic's parents executed their letter more than a year before the NAC issued its decision. Applicants have not explained why, regardless of their decision not to call Kirincic's parents as witnesses, they did not offer into

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[82] The Firm's procedures provided that "[e]mployees are not permitted to sign documents on behalf of customers, even when doing so is meant to accommodate a customer's request. Customer signatures must be original by the customer on all documents."

[83] This letter is notarized but does not purport to be sworn under oath or affirmation as is required of testimony given by persons subject to FINRA's jurisdiction. *See* FINRA Rule 9262.

[84] 17 C.F.R. § 201.452.

[85] *Russo Secs., Inc.*, 55 S.E.C. 58, 78 (2001). *See also David T. Fleischman*, 43 S.E.C. 518, 522 (1967) ("Public policy considerations favor the expeditious disposition of litigation, and a respondent cannot be permitted to gamble on one course of action and, upon an unfavorable decision, to try another course of action.")

evidence before the NAC the letter that had already been executed. Therefore, we have not considered this letter in deciding Kirincic's liability.[86] In any event, we find that Kirincic's signing of the documents violated Rule 2110, regardless of whether Kirincic's parents authorized him to sign the documents at issue, as explained below.[87]

NASD Rule 2110 requires that NASD members (and, through NASD Rule 115, associated persons) "observe high standards of commercial honor and just and equitable principles of trade." It is well established that a violation of other NASD rules or securities laws or regulations also constitutes a violation of Rule 2110.[88] However, in the absence of a violation of another securities rule or law, conduct may violate Rule 2110 if it is "unethical" or committed in "bad faith."[89] In order to prove that Kirincic violated the rule, FINRA therefore must show

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[86] *See CMG Institutional Trading, LLC*, Exchange Act Rel. No. 59325 (Jan. 30, 2009), 95 SEC Docket 13802, 13809 & n.20 (determining not to adduce into the record documents proffered by applicants not admitted into the record before FINRA and unaccompanied by a motion showing, as Rule 452 requires, "with particularity that the evidence is material and that there were reasonable grounds for the failure to adduce such evidence previously").

[87] Both parties argue that the other bore the burden of proving (or disproving) that Kirincic had authority to sign the documents at issue. In doing so they focus on criminal forgery cases, namely *United States v. George*, 386 F.3d 383 (2d Cir. 2004), and *United States v. West*, 666 F.2d 16 (2d Cir. 1981). However, we do not find these cases instructive because criminal forgery requires proof of specific intent, *see U.S. v. Brantley*, 786 F.2d 1322, 1329 (7th Cir. 1986), *cert. denied* 477 U.S. 908, whereas a violation of Rule 2110 does not require any showing of scienter. *Dane S. Faber*, 57 S.E.C. 297, 308 & n.19 (2004). As always, the burden of proving that an applicant engaged in conduct violating Rule 2110 rests with FINRA; however, as we have stated previously, the applicant bears the burden of producing evidence to support his claimed defenses. *James M. Bowen*, 51 S.E.C. 1152, 1154 n.9 (1994) (stating that, although applicant bore the burden of producing evidence to support his purported defense, "[t]he burden of proof [ultimately] remains with the NASD" to establish a violation of its rules); *see also Mark David Anderson*, 56 S.E.C. 840, 855-56 & n.41 (2003) (finding same). As explained herein, we find FINRA met that burden.

[88] *See supra* note 80.

[89] *Thomas W. Heath, III*, Exchange Act Rel. No. 59223 (Jan. 9, 2009), 94 SEC Docket 13242, 13246 (discussing New York Stock Exchange Rule 476(a)(6), which contains an identical formulation of the "just and equitable principles" or "J&E" rule found in NASD Rule 2110), *aff'd*, No. 09-0825-ag, 2009 U.S. App. LEXIS 24128 (2d Cir. Nov. 4, 2009). We have explained that Rule 2110, and equivalent J&E rules in use by other self-regulatory organizations, "incorporates 'broad ethical principles,' and focuses on the 'ethical implications of the [a]pplicant's conduct.'" *Id.* at 13248 & nn.10-11 (*quoting Peter Martin Toczek*, 51 S.E.C. 781,

(continued...)

that he not only signed his parents' signatures to the documents at issue, but also that he did so unethically or in bad faith.

We find that Kirincic acted unethically when he signed his parents' names to the documents. First, Kirincic signed the documents in direct violation of Kirlin's written supervisory procedures, which prohibit Kirlin employees from signing any documents for customers, even with their express permission. The Commission has, in the past, "looked to internal firm compliance policies to inform our determination of whether applicants' conduct . . . violated the professional standards of ethics covered by [Rule 2110]."[90] Here, Kirlin's rule is aimed at ensuring the Firm's customers are protected against unauthorized transactions in their accounts by requiring that all documentation be completed by the customers themselves, with their demonstrated consent and approval. Kirincic's signing of the documents, at best, unacceptably placed administrative convenience above the integrity of customer assets.[91]

However, Kirincic's conduct not only violated a Firm policy rooted in the protection of customers, it also furthered his fraud on the market for KILN shares. One of the letters of authorization Kirincic signed transferred $75,000 in cash from Kirincic's parents' account at Kirlin to Paduano's account, which Paduano admitted was used, at least in part, to fund the

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[89] (...continued)
788 n.14 (1993); *Robert E. Kauffman*, 51 S.E.C. 838, 839 n.5 (1993); *William F. Rembert*, 51 S.E.C. 825, 826 n.3 (1993); *Timothy L. Burkes*, 51 S.E.C. 356, 360 (1993), *aff'd*, 29 F.3d 630 (9th Cir. 1994) (Table); *Ben B. Reuben*, 46 S.E.C. 719, 722 n.7 (1976)).

[90] *Heath*, 94 SEC Docket at 13253 & n.21 (*citing Dan Adlai Druz*, 52 S.E.C. 416, 425 (1995) (finding that the respondent violated the J&E rule by settling customer complaints without notifying the legal department when such action violated firm policy), *aff'd*, 103 F.3d 112 (D.C. Cir. 1996) (Table); *see also, e.g., Thomas P. Garrity*, 48 S.E.C. 880, 884 (1987) (finding that failure to adhere to limits on trading of options under the firm's compliance policy violated the J&E Rule).

[91] *See William J. Murphy*, 54 S.E.C. 303, 307 & n.5 (1999) (finding violation of J&E rule where broker failed to obtain prior written authorization for trades from client and firm, which was not a violation of a specific rule of the Chicago Board Options Exchange but was a violation of firm's written procedures, and noting that compliance with the firm's rule was "important to assure a firm that the trading is being done with the consent of the customer and to alert the firm that extra oversight of the sales representative's handling of the account may be necessary to protect against improper or unsuitable trading."); *John F. Lebens*, 52 S.E.C. 606, 608 (1996) (finding that broker violated J&E rule by improperly allocating losing personal trades to proprietary accounts of his firm, which had lax internal controls, and noting that "[i]t is important that broker-dealers conduct their business operations with regularity and that their records accurately reflect those operations; it is unethical conduct for their employees to take advantage of loose internal controls to prevent achievement of these principles").

purchases of KILN shares during the Trading Period.[92] Three of the stock certificates that Kirincic signed facilitated the transfer of KILN stock from Kirincic's parents to KILN when they sold over 385,000 shares to the company at artificially high prices during the Trading Period.[93] Kirincic's signatures on the documents – which he initially denied were his – were not merely an innocent administrative convenience but rather facilitated Kirincic's manipulative transactions. We therefore affirm FINRA's finding that Kirincic's conduct was inconsistent with just and equitable principles of trade.[94]

C. Best execution

We now turn to FINRA's finding that Israel, and, through Lindner and Israel, Kirlin, violated NASD Rule 2320(a) in failing to give Lee "best execution" on his order to liquidate his

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[92] The remaining two letters of authorization transferred a total of $125,000 to Paduano's account in May and June 2002; it is unclear what role these funds may have had in the purchases of KILN that Paduano made.

[93] Although Applicants argue that no rule violation can be found here because there is no evidence that Kirincic's parents (who sold KILN stock back to the company at artificially inflated prices during the Trading Period) were harmed by the forgery, we have held that FINRA's authority to enforce its rules "is independent of a customer's decision not to complain." *Maximo Justo Guevara*, 54 S.E.C. 655, 664 & n.18 (2000) (*citing Bernard D. Gorniak*, 52 S.E.C. 371 (1995); *Ronald J. Gogul*, 52 S.E.C. 307 (1995)), *petition denied*, 47 Fed. Appx. 198 (3d Cir. 2002) (Table). In addition, we have found that an applicant may violate Rule 2110 not only where the misconduct defrauds a customer but also where it otherwise benefits the wrongdoer. *Geoffrey Ortiz*, Exchange Act Rel. No. 58416 (Aug. 22, 2008), 93 SEC Docket 8977 (finding broker, who signed customers' initials to account applications without their consent, stood to benefit from misconduct by increasing his compensation while also defrauding customer, and thereby violated J&E rule).

[94] *See James A. Goetz*, 53 S.E.C. 472, 477 (1998) (finding that broker's "misconduct," which included disregarding the rules of his firm's charitable organization and misleading the organization, "reflects directly on [his] ability both to comply with regulatory requirements fundamental to the securities business and to fulfill his fiduciary responsibilities in handling other people's money" and thereby was inconsistent with just and equitable principles of trade). *Accord, e.g., Mark F. Mizenko*, Exchange Act Rel. No. 52600 (Oct. 13, 2005), 86 SEC Docket 1515 (finding broker violated NASD Rule 2110 when he admittedly signed someone else's name to a document without permission or authority to do so and where doing so resulted in exposure of firm to liability without its knowledge); *Eliezer Gurfel*, 54 S.E.C. 56 (1999), *petition denied*, 205 F.3d 400 (D.C. Cir. 2000) (finding broker violated NASD Rule 2110 where record evidence, including other witness's testimony, demonstrated that applicant signed documents without permission despite his denial of wrongdoing, and where doing so resulted in conversion of funds due his firm).

KILN shares.[95] Rule 2320(a) requires that FINRA members and associated persons must "use reasonable diligence to ascertain the best market for the subject security and buy or sell in such market so that the resultant price to the customer is as favorable as possible under prevailing market conditions." In determining whether a broker has used "reasonable diligence," FINRA considers, among other things: (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; and (4) accessability of the quotation.[96]

In finding Applicants liable, FINRA held that "[t]he record is devoid of any evidence demonstrating that either Lindner or Israel was diligent in seeking the most favorable price for [Lee] under the circumstances."[97] We agree with FINRA that Israel, who "was the only person during the afternoon of April 22, 2002, with instant access to market information and a complete picture of the trading that had occurred earlier in the day," did not apply reasonable diligence to obtain the best price for Lee.

Israel admitted that, when he learned of Lee's order to liquidate his KILN holdings, he was aware of Paduano's pending order to buy 24,700 shares at $1.10. Yet he also admitted that he did not disclose this information to Lee's broker, Byrne, or to Lindner. Israel did not

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[95] It is well established that brokers owe their customers a duty of best execution, which requires broker-dealers to execute customers' trades at the most favorable terms reasonably available under the circumstances, *i.e.*, at the best reasonably available price. *See Newton v. Merrill, Lynch, Pierce, Fenner & Smith, Inc.*, 135 F.3d 266, 270-73 (3rd Cir. 1998) (noting that the duty of best execution derives from the "mutual understanding that the client is engaging in the trade – and retaining the services of the broker as his agent – solely for the purposes of maximizing his own economic benefit, and that the broker receives her compensation because she assists the client in reaching that goal"); *Report of the Special Study of Securities Markets*, H.R. Doc. No. 95, 88th Cong., 1st Sess. Pt. II, 624 (1963) ("[T]he integrity of the [securities] industry can be maintained only if the fundamental principle that a customer should at all times get the best available price which can reasonably be obtained for him is followed.").

[96] NASD Rule 2320(a). A fifth factor, "the terms and conditions of the order which result in the transaction, as communicated to the member and persons associated with the member," was added to the rule effective November 8, 2006.

[97] FINRA concluded that Lindner "should have known that[,] at the time he arbitrarily selected a price of $.80 per share for [Lee's] sell order," KILN's inside bid price was $1.04, KILN had just purchased shares from Kirincic's relatives at $1.05, and Paduano had an outstanding order to buy shares at $1.10. Because, as noted *supra* note 5, Lindner withdrew his application for review of these proceedings, we do not address FINRA's findings as to him.

immediately begin liquidating Lee's position, as the customer *instructed*,[98] and did not cross Lee's order with Paduano's, but, instead, appeared to delay the execution until after Kirincic cancelled Paduano's $1.10 buy order. Nor did he attempt to inquire whether Kirincic's sister might be interested in acquiring more of Lee's shares, even though he was aware that Paduano had been making large purchases of KILN in her account for several weeks. Instead, Israel, who knowingly or recklessly had been participating in Kirincic's scheme to artificially increase KILN's bid price, and who testified that he understood that a market order as large as Lee's could significantly depress KILN's bid price, ignored Paduano's pending order and sought a price for Lee's shares away from the market.[99] Under the circumstances, we find that Israel, and through Israel, Kirlin, violated NASD Rules 2320(a) and 2110.[100]

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[98] *See Brown & Co.*, 43 S.E.C. 490, 495 (1967) ("A broker receiving a market order from his customer . . . cannot delay execution for such periods of time but must execute reasonably promptly and be in a position to report the details to the customer . . . without undue delay.").

[99] *See Bateman Eichler*, 47 S.E.C. 692, 694 n.5 (1982) ("We have repeatedly held that, in the absence of a clear understanding or indication to the contrary, trade custom requires a dealer to consummate transactions with customers promptly and to charge prices that are reasonably related to the prevailing market price." (*citing Carl J. Bliedung*, 38 S.E.C. 518, 521 (1958); *Lewis H. Ankeny*, 29 S.E.C. 514, 516 (1949))). As noted, Israel appended a modifier to the Lee transaction indicating that the trade was executed based on a special pricing formula. *See supra* note 54.

[100] Applicants' briefs filed with the Commission make no arguments with respect to Israel's and Kirlin's best execution violation. However, in Israel's post-hearing brief, he argued that "there is no evidence that . . . Mr. Lee would have done any better than an average price of $.80" if Israel had crossed Lee's order with Paduano's. A violation of a broker's duty of best execution does not require proof that the customer would have received a better price if the broker had fulfilled his duty; it requires proof that the broker failed to use reasonable diligence to acquire the best price. We find that the evidence demonstrates that, regardless of the price Lee received, Israel – motivated to support Kirincic's scheme to prop up KILN's price – failed to explore an obvious source of interest for Lee's shares in the market and thereby failed to apply reasonable diligence to get the best price for Lee.

Israel also asserted in his post-hearing brief that he did, in fact, reach out to Paduano's broker (*i.e.*, Kirincic) before calling Lindner, implying that Israel did make an attempt to gauge her interest in a cross-trade with Lee. However, during the hearing Israel testified that he called Kirincic first "to see if [KILN] would be willing to buy the stock." He could not recall specifically whether he considered crossing Lee's order with Paduano's at the time, testifying that he "couldn't tell you exactly" what was going through his mind then. We find that the record does not, therefore, support Israel's contention that he made a reasonable effort to seek Paduano's interest in buying any portion of Lee's shares.

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IV.

Applicants contend that FINRA's findings are flawed because of two procedural defects related to (a) Applicants' efforts to use local New York state court procedures to subpoena witnesses, and (b) FINRA's alleged failure to provide "'backup data' in connection with a number of [the Department of] Enforcement's summary exhibits." We discuss each in turn.

A. Subpoenas

Applicants argue that they were deprived of a fair hearing when the FINRA Hearing Officer "abused her discretion" by denying them the opportunity to issue subpoenas for the testimony of KILN market makers, which, they contend, "would have been crucial." Because FINRA rules do not provide for the use of subpoenas, Applicants sought to invoke Section 2302(a) of New York's Civil Practice Law and Rules ("C.P.L.R.") to issue subpoenas for certain information and witnesses.[101] C.P.L.R. Section 2302(a) 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

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[100] (...continued)

Applicants also argued in their appellate brief to the NAC that the purchase of Lee's shares was a negotiated block transaction and that, therefore, "[t]here can be no argument that the best execution rule does not apply to block transactions." However, as the NAC pointed out, "nothing in the record supports [Applicants'] argument that the transaction (including the purchase price) was negotiated." Indeed, Lee's instructions were simply to liquidate his holdings, and he was not informed of the price he was given for his shares until he received his account statement weeks later. Israel's and Kirlin's duty to provide best execution to Lee attached when they received his order, regardless of the fact that they ultimately (and unilaterally) determined to execute the order as a single block transaction.

[101] *But see* FINRA Rules 8210, 9252 (permitting respondents in disciplinary proceedings to request that Enforcement compel the production of documents or testimony to persons subject to FINRA's jurisdiction). The Hearing Officer's order directed Applicants' attention to these provisions as an alternative to the issuance of subpoenas. Applicants eventually availed themselves of this procedure and were granted access to Byrne (and certain of his telephone records) as a witness at the hearing; however, the Hearing Officer denied Applicants' other requests for data and testimony because she found that Applicants did not make good faith efforts to obtain the information elsewhere and/or the information was not relevant. For example, Applicants requested that NASD itself provide, or compel Nasdaq to provide, "trading data for block trades in all Nasdaq securities with average daily trading volume of 25,000 shares or less," but did not attempt to contact vendors such as FACTSET or Thompson to request such information even though Nasdaq had suggested that approach. Applicants do not challenge the Hearing Officer's denial of these other requests, which appear from the record to be justified.

witness may be required."[102] In prohibiting Applicants from issuing subpoenas under this law, the Hearing Officer concluded that C.P.L.R. Section 2302(a) did not apply because Applicants' disciplinary hearing was not an "administrative proceeding" for purposes of the New York rule. The NAC affirmed the Hearing Officer's reasoning and rejected Applicants' objection, as do we.

As we recently explained in *Andrew P. Gonchar*,[103] the New York Supreme Court has determined that C.P.L.R. Section 2302 does not apply to disciplinary proceedings brought by FINRA.[104] We noted that the court's ruling was "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."[105]

Applicants cite *Crimmins v. American Stock Exchange, Inc.*[106] as an example of "at least one court [that] has found that the statute allows for attorneys to issue subpoenas in securities disciplinary proceedings." However, as we have previously noted, *Crimmins* is inapposite. Although the court in *Crimmins* "theorized that C.P.L.R. § 2302 may empower parties to subpoena witnesses in administrative proceedings," the case did not involve FINRA or its rules, did not allow the parties to obtain subpoenas, and addressed the applicability of the statute only in dicta.[107]

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

[103] Exchange Act Rel. No. 60506 (Aug. 14, 2009), 96 SEC Docket 19852, 19870, *appeal filed*, No. 09-4215 (2d Cir. Oct. 8, 2009).

[104] *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).

[105] *Gonchar*, 96 SEC Docket at 19870 (citing *Application of NASD Regulation, Inc., Dep't of Enforcement v. Rosato*, Index No. 119971-1998, at 2 (N.Y. Sup. Ct. Nov. 5, 1998)).

[106] 368 F. Supp. 270, 277 (S.D.N.Y. 1973).

[107] *Crimmins*, 368 F. Supp. at 277 (noting that C.P.L.R. Section 2302 "seems" 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 refusal of the American Stock Exchange to subpoena certain witnesses).

Applicants also argue that *NASD v. SEC*, 431 F.3d 803 (D.C. Cir. 2005), stands for the proposition that FINRA, "in carrying out the disciplinary authority granted to it by the SEC[,] acts as an administrative agency" and that, therefore, "[t]here is no question that FINRA

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Moreover, "an applicant's inability to subpoena witnesses is not grounds for overturning a disciplinary action unless the applicant can show prejudice."[108] Here, Applicants contend without elaboration that testimony from market makers would have "provide[d] insight as to how quotations for KILN were established" and would have "countered any evidence put forth by Enforcement as to how KILN traded and the depth of the market for KILN." However, Applicants themselves testified repeatedly and consistently that KILN was a thinly-traded stock with an average daily volume of less than 10,000 shares that enjoyed negligible interest from institutional investors and non-Kirlin customers. The record also established that trading by Kirincic in March and April accounted for more than 90% of the volume in KILN. Market maker testimony is therefore unlikely to have added to the description of the market activity in KILN already provided by Applicants. Moreover, Applicants do not explain how market maker testimony would be meaningful in determining whether Kirincic's economically irrational

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[107] (...continued)
disciplinary proceedings constitute an 'administrative proceeding' for purpose[s] of CPLR § 2302(a)." Applicants misapprehend the import of that case, which simply confirmed that NASD (and now, FINRA) cannot appeal adjudicatory decisions of the Commission because "the authority [NASD] exercises ultimately belongs to the SEC, and the legal views of the self-regulatory organization must yield to the Commission's view of the law." *Id.* at 806. Nothing in *NASD* compels the conclusion that the disciplinary process of FINRA, which has consistently been deemed a "private actor, not a state actor," *D.L. Cromwell Invs., Inc. v. NASD Regulation, Inc.*, 279 F.3d 155, 162 (2d Cir. 2002), is equivalent to an "administrative process" as defined by C.L.P.R. Section 2302(a).

Cf. Administrative Procedure Act, 5 U.S.C. § 551(a) (defining "agency" as "each authority of the Government of the United States" with certain enumerated exceptions, and defining "agency process" as adjudications, rulemakings, and licensing processes of those government agencies); New York State Administrative Procedure Act, Art. I, § 100 (stating that a reason for the enactment of the law was to make more consistent "the administrative rule making, adjudicatory and licensing processes among the agencies of state government" and defining "agency" as "any department, board, bureau, commission, division, office, council, committee or officer of the state," with certain enumerated exceptions).

[108] *Gonchar*, 96 SEC Docket at 19871 & n.49 (citing *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); *Thomas E. Warren, III*, 51 S.E.C. 1015, 1020 n.22 (1994) (dismissing allegation that applicant was disadvantaged 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)). *See also 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.").

method of placing trades in his sister's account – which often involved entering orders with limit prices far in excess of the inside bid prices set by market makers and then successively raising his limit price – was manipulative. We therefore find that Applicants have not demonstrated that they suffered any prejudice to their case because of their inability to subpoena market maker testimony, and we sustain FINRA's finding that "the Hearing Officer properly refused to permit [them] to use subpoenas."

B. Access to "backup data"

Applicants contend that "Enforcement obviously had access to a tremendous amount of market/trade data, which [Applicants] did not, and Enforcement manipulated the data in a light most favorable to Enforcement's case." Applicants represent that they "had requested access to the same data so that they could perform their own analyses and perhaps demonstrate how Enforcement was wrong," but claim FINRA failed to provide that data. However, the record demonstrates that Applicants were given the data FINRA used to create its hearing exhibits.

Applicants do not now specify what data they claim to lack or even which of Enforcement's exhibits they find to be incorrect, unsubstantiated, or otherwise objectionable. In this regard, we also find it significant that Applicants' expert represented in his report that, in forming his expert opinion that Kirincic did not manipulate the market for KILN, he reviewed electronic market data produced by FINRA, draft market analyses produced by FINRA, and "various charts of the market data created by [Applicants' own] chartists," and made no mention of having insufficient information to form that opinion. Moreover, in making our findings of liability regarding Applicants' manipulation of KILN, we have based our findings in significant part upon exhibits created and submitted by Applicants themselves.[109] Because Applicants have failed to establish what information they were denied and how that denial prejudiced their case, we reject Applicants' argument that the proceedings against them were procedurally flawed.[110]

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[109] For example, we drew upon trade activity reports and account statements for Paduano's and Kirincic's parents' accounts at Kirlin (Applicants' Exhibits 173(6), 230(3), 245); reports showing the intraday movement of KILN's bid and ask prices (Applicants' Exhibits 161(29) and 215(25)); line graphs and tables of the price movement in KILN (Applicants' Exhibits 114, 115, 118, 213(4)); a lengthy and detailed spreadsheet showing Kirincic's orders and executions on BRUT along with the contemporaneous bid and ask prices for KILN for each day during the Trading Period (Applicants' Exhibit 208(20)); and various public filings and correspondence that relate to the KILN's delisting from Nasdaq (Applicants' Exhibits 100, 125, 188(18)).

[110] *See Gateway Stock & Bond*, 43 S.E.C. at 195 & n.9 (rejecting applicants' argument that they were denied due process in the conduct of the proceedings against them because "[a]pplicants have not shown that they were prejudiced by the manner in which evidence was presented . . . or that any material evidence was not produced").

V.

Because we affirm FINRA's findings of violation against Applicants and reject Applicants' procedural arguments, we turn now to a review of the sanctions FINRA imposed. Exchange Act Section 19(e)(2) directs us to sustain the sanctions imposed by FINRA unless we find, having due regard for the public interest and the protection of investors, that the sanctions are excessive or oppressive or impose an unnecessary or inappropriate burden on competition.[111] Applicants make no specific arguments as to the propriety of the sanctions FINRA imposed, but they assert generally that "the sanctions imposed by the Hearing Panel and confirmed by the NAC exceed the sanctions called for under the circumstances" and "should be reduced to be commensurate with the FINRA guidelines."

A. Market manipulation: Kirincic, Israel, and Kirlin

For manipulating the market in KILN stock, FINRA barred Kirincic and Israel in all capacities and expelled Kirlin from FINRA membership. In deciding upon these sanctions, FINRA noted that its Sanction Guidelines do not specifically address market manipulation as a distinct violation, but do provide guidance for sanctioning general misrepresentations or omissions of material fact: this guideline recommends a suspension of up to two years for intentional or reckless misconduct, or a bar (or expulsion, for firms) in egregious cases.[112] FINRA also "look[ed] to Commission precedent regarding the gravity of the violation and to the general considerations in determining sanctions, as set forth in the Guidelines."

We find that FINRA appropriately considered the relevant guidelines as well as aggravating and mitigating circumstances in deciding to bar Kirincic and expel Kirlin. As FINRA observed, "'there are few, if any, more serious offenses than manipulation. Such misconduct is a fraud perpetrated not merely on particular customers but on the entire market.'"[113] FINRA properly concluded that the manipulative conduct here was egregious, finding that the scheme was "intentional, extensive, and involved more than 115 trades spanning a five-week period." FINRA further took into account the fact that Kirincic and Kirlin have disciplinary

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[111] 15 U.S.C. § 78s(e)(2). Applicants do not allege, and the record does not show, that FINRA's action imposed an undue burden on competition.

[112] *See Charles C. Fawcett, IV*, Exchange Act Rel. No. 56770 (Nov. 8, 2007), 91 SEC Docket 3147, 3156 n.24 ("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).").

[113] *Quoting John Montelbano*, 56 S.E.C. 76, 105 (Jan. 22, 2003); *see also Pagel*, 48 S.E.C. at 231-32 ("Manipulation strikes at the heart of the pricing process on which all investors rely. It attacks the very foundation and integrity of the free market system. Thus it runs counter to the basic objectives of the securities laws.").

histories that bear on this case, pointing out that they entered into four Letters of Acceptance, Waiver, and Consent with FINRA since 2001, including one in 2004 based on allegations that, among other things, they both "failed to disclose material facts and made material misrepresentations."[114] It also took into consideration that the manipulative scheme inured to the benefit of KILN, of which Kirincic owned twenty percent, and to the benefit of Kirincic's relatives, who sold KILN stock at inflated prices during the Trading Period. The bar FINRA imposed against Kirincic and the expulsion of Kirlin are in accordance with FINRA's guidelines under the circumstances of this case and will protect the market and investors from the risk of future violations that they present while also deterring others from engaging in the same serious misconduct. We therefore find that these sanctions are neither excessive nor oppressive.[115]

However, we find that the bar against Israel is excessive. As explained above, Israel's involvement in the manipulative scheme was reckless, but the record does not demonstrate that he acted with the same degree of intent as that of Kirincic, who orchestrated the scheme and exercised all price and time discretion over the manipulative trades. Israel was also physically absent from Kirlin while on vacation for one week in April, which included the day (April 3) when Kirincic placed a 2,000-share purchase order with Herzog that was responsible for supporting KILN's price throughout the latter half of the Trading Period. Moreover, unlike Kirincic, Israel does not appear to have had any direct or significant financial stake in the scheme: he testified that his only KILN share holdings were in the form of a few thousand options that had not yet vested.[116] These factors serve to mitigate the sanctions against Israel. We conclude, therefore, that an associational bar with a right to reapply after five years is more commensurate with the circumstances of Israel's conduct and is sufficient to encourage him, and others in the industry confronted with similar situations, to conduct themselves with more attention to compliance with the securities laws.

B. Best execution: Israel and Kirlin

For failing to provide Lee with best execution on his trade, FINRA ordered Israel and Kirlin to pay restitution in the amount of $26,163, plus interest. As FINRA noted in its decision, "[r]estitution is 'used to restore the status quo ante where a victim otherwise would unjustly suffer loss' [and] 'seeks to restore a respondent's victim to the position he was in prior to the

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[114] Kirlin agreed, among other things, to pay a fine of $155,800 and restitution of over $1 million; Kirincic agreed to a $25,000 fine and a thirty-day suspension from associating with an NASD member in a general securities principal capacity.

[115] In light of the bar against Kirincic for his fraudulent manipulation of the market for KILN shares, we have determined to set aside the additional bar that FINRA imposed upon Kirincic for signing his parents' names to several transactional documents.

[116] In his post-hearing brief filed with the FINRA Hearing Panel, Israel represented that his salary was approximately $75,000 annually.

transaction by returning to the victim the amount by which the victim was deprived.'"[117] FINRA calculated the amount owed to Lee by adding together (a) $7,410, representing the difference in price on 24,700 shares at $1.10 per share (versus $.80 per share) that Lee would have received if his order had been crossed with Paduano's outstanding buy order; and (b) $18,753, representing the difference in price on the remaining 89,300 shares of Lee's order at $1.01 per share (versus $.80 per share), which FINRA deemed "the lowest price that the market would have reached that day *given the market manipulation*."[118] FINRA therefore based its restitution award on a comparison of the price Lee received to the price at which KILN was trading in a fraudulently manipulated market. As noted, KILN's closing price averaged $.92 in January 2002, $.86 in February 2002, and had dropped to $.64 on March 15, 2002, the trading day before Kirincic began placing orders in his sister's account (roughly a month before the Lee transaction). Given the size of Lee's sale order, the thinly-traded nature of KILN, and the low prices at which KILN would have traded without being artificially inflated by Kirincic's scheme, we cannot conclude that $.80 per share was an objectively unfair price such that Lee can be said to have suffered a "loss" that must be remedied.[119] To reimburse a customer for a share price difference that would likely never have existed but for fraud would not serve the purposes of restitution.[120] Under the circumstances, therefore, we do not believe restitution is appropriate here.

In sum, we sustain FINRA's findings of violation but set aside and reduce certain of the sanctions imposed, as described herein.[121] An appropriate order will issue.

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

Elizabeth M. Murphy
Secretary

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[117] Citations omitted.

[118] Emphasis added.

[119] As discussed, however, we find that although Lee happened to have received a price consistent with, and likely above, the price for KILN shares in an unmanipulated market, nevertheless, the way in which that price was determined did not comply with best execution requirements. *See supra* note 100 and accompanying text.

[120] *See Hibbard, Brown & Co., Inc.*, 52 S.E.C. 170, 183 n.65 (1995) (noting the distinction between the remedial purposes of fines, which are "normally imposed as a deterrent against future misconduct," and restitution, which "requires a wrongdoer to restore his victim to the status quo ante").

[121] We have considered all of the arguments of the parties. We reject or sustain them to the extent that they are inconsistent or in accord with the views expressed in this opinion.