UNITED STATES OF AMERICA

SECURITIES AND EXCHANGE COMMISSION

In the Matter of Application of

J. W. KORTH & COMPANY LIMITED PARTNERSHIP

SEC Admin. Proc. File No. 3-19206
FINRA Disciplinary Proceeding
No. 2012030738501

c/o James Korth and Michael Gibbons
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(CRD No. 26455)

To: Vanessa A. Countryman
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MOTION FOR STAY OF DISCIPLINARY ACTION TAKEN BY FINRA AND BRIEF IN SUPPORT THEREOF

On the following grounds, J. W. Korth & Company ("JWK") hereby moves pursuant to SEC Rule 401(d)(1) for the Securities and Exchange Commission to stay the Disciplinary Action by FINRA cited above.

OVERVIEW

A STAY OF FINRA'S ACTIONS IS IMPORTANT FOR PROTECTION OF INVESTORS, THE MAINTENANCE OF FAIR AND ORDERLY AND EFFICIENT MARKETS AND THE FACILITATION OF CAPITAL FORMATION.

The basic principles of this case are simple. FINRA using TRACE and EMMA data reviewed all approximately 20,000 trades completed during the 2009-2011 Financial Crisis period and identified the relatively few trades that were over 3.0%[1] and demanded that we reimburse our customers the difference. The trade sets involved 23 separate CUSIP Numbers and 51 separate generally small trades with retail customers. JWK maintained written guidelines for its markups based on FINRA and MSRB rules and interpretive guidance published at the time. Initially we used a 3.5% guideline which was thoughtfully raised to 3.9% as our volume decreased and the time to investigate and present investments increased as the Financial Crisis unfolded. We use the term "guideline" as these figures were used as nominal substitutes for the 5% guideline written in the FINRA markup rules. On riskless trades, these guideline numbers were only approached when the firm completed in depth research on obscure small bond issues or larger issuers that were under dire Financial Crisis related pressure [2]. On trades where the firm had completed the research and had riskand the market rose during the period the firm was at risk, the JWK earnings are higher.[3]

Years before JWK had clearly told FINRA of its markup policies. When FINRA suggested that JWK reimburse its customers, JWK provided written explanations of the work that was completed (Bates 001419). FINRA ignored JWK explanations and without any warning or discussions for months filed a

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[1] We showed that the 3.00% break point employed by FINRA was not based on any research and was simply an arbitrary number used by the FINRA staff to target trades.

[2] There were 13 trade sets where JWK acted as a market maker or the market changed while JWK owned the securities.

[3] Please note at the end of the NAC Decision (Bates 002823) there is a list of the trades and a column entitled: "markup in dispute". Where the answer is "no" the trades were riskless. Where the answer is "yes" JWK was acting either as a market maker or was simply long the bonds and the market moved during the volatile days of the Financial Crisis. Also please note that JWK also lost money on some positions during this period due to market moves down rather than up.

complaint and now demands through the NAC decision that JWK reimburse the minimal (the vast majority being less than 1.00% excess over 3.00% (or in a few limited cases, 3.5%) to its customers. In each separate case identified by the CUSIP Number, the customers generally benefitted handsomely from JWK's work and received no harm whatsoever. Further, in some cases, the sellers of securities who were customers of other firms most likely received better prices for their obscure or pressured securities.

While well intentioned, FINRA's actions here are a hindrance to "Fair and Orderly and Efficient Markets". The written rules for markups set a 5.0% guideline. It is commonly known as the "5% Rule". After explaining our policy to FINRA years before the complaint occurred, FINRA gave us no specific guidance that charges more than 3.00% would be presumed excessive and a review of the guidance generally and publically provided by FINRA showed no mention of 3.00% markups as an enforcement guideline. (Discussed in NAC Opening Brief Bates001745)

Lack of guidance and then enforcement "out of the blue" is highly disruptive and unsettling to dealers and therefore is disruptive to the business they do with clients. Unless dealers know clearly what FINRA expects and are able to charge for their research they cannot do the investigations necessary and when appropriate take inventory risk to provide liquidity for small issues. In these cases, JWK was the high bidder because it chose to do the investigations and thought it had "cleared" its policies with FINRA. JWK then acted within its policies and carefully considered the relevant factors (especially the resulting yield to the customer) and provided attractive opportunities to our clients they may not otherwise have had. Today, many dealers will pass on bidding for bonds that are from distressed or smaller issues because understanding the nature of the credits is time consuming and FINRA's arbitrary

unwritten guidelines make them afraid to charge what it costs to support an investor's need to sell at a fair price. [4]

Indeed bond market liquidity has been reduced because hundreds of small dealers have closed. FINRA's lack of clarity regarding its markup policies has left dealers wary and uncertain and this negatively affects the securities prices of US citizens. We recognize this is a complicated topic and we are on the same side as regulators when it comes to the importance of customer protection and treating them fairly. It is a circumstance where good intentions have resulted in a bad outcome for investors.

JWK is a very clear case in point. Because of FINRA's actions here we have ceased doing extensive research on smaller bond issues for retail customers and making those opportunities available for them, which in many cases also requires us to take on financial and opportunity risk by purchasing them for our inventory prior to having any client orders. Unfortunately, this all contributes towards reducing market liquidity. We have refocused our efforts to serve institutional customers where lower percentage markups pay sufficiently as they are spread over larger trades and have largely abandoned serving smaller retail customers with distressed or obscure securities.

How the Case Proceeded –FINRA Clearly Ignored our Explanations and our Additional Evidence

After reviewing three years of trade records or about 20,000 trades from 2009 -2011 using TRACE and EMMA records, all of which occurred during the Financial Crisis from 2009 to 2011, FINRA contacted JWK with a list of about 70 trades that exceeded a 3.00% markup and asked the firm to reimburse its customers the difference. JWK refused and provided FINRA with a written copy of its markup policies and a detailed statement regarding the work completed on each trade set. Many

[4] FINRA has never made it clear as to what its mark-up rules are and dealers are often gun shy of charging even 2.0% on bond transactions. The legal cost of a FINRA investigation is overwhelming to many small dealers and many have chosen to restrict their trades to investment grade rated securities or leave the business rather than try to cover their costs.

months later "out of the blue" the FINRA Department of Enforcement filed a complaint against JWK. JWK responded in a timely fashion and for the next three years JWK sought information from FINRA regarding how they could make such a judgement when we had explained our markup policies and business plan to examiners years before. JWK was stonewalled at every turn except from the FINRA Ombudsman who made a clear statement that FINRA had never done any research or investigations to establish its 3.00% threshold for maximum trade markups. (Bates001467). JWK even sought to call Mr. Richard Ketchum, then chairman of FINRA to explain FINRA's regulatory approach, but was denied based on a tortured argument that Mr. Ketchum who served at the pleasure of the board was not under the jurisdiction of FINRA. FINRA provided Declarations of Experts and JWK thoroughly rebutted their qualifications and arguments (Bates 001437).

Eventually, the Office of Hearing Officers issued a panel decision (Bates 001515) that essentially dismissed expert Paviolitus and that reviewed each trade set, dismissing several from the market records and stating over and over they did not have enough information on the balance. They also made this statement:

"We do not find the firm (J.W. Korth) intentionally or recklessly overcharged its customers. It had in place a policy for determining markups that it openly explained to FINRA and reliably implemented" and "we do not find the firm exhibited a pattern of charging excessive mark-ups"-(Hearing Panel Decision Page 22. Bates 001515)

By the fact that they found that we "reliably implemented our openly explained policy", is it not absolutely logical to conclude that we had good reasons for charging higher mark-ups on the relative

few trades in question out of the many thousands we did during the same period. **(This statement by the OHO Panel alone is a strong reason for the Commission to stay the proceeding.)**

JWK appealed the decision to the FINRA National Adjudicatory Council (NAC) and its first action under the appeal was to make a Motion to provide Additional Evidence. (Bates 001635) The Motion was accepted by the NAC Subcommittee assigned to the case. JWK then spent weeks gathering extensive information and filed its Opening Brief with the first part of the Additional Evidence (Bates 001745) and the balance in the next few days (Bates 001901; 002033). JWK then made a motion to remand the proceeding to the OHO Hearing Panel to provide them the Additional Evidence to reconsider their decision on each trade set. This was denied on nebulous grounds (Bates 002651).

A hearing ensued in which James Korth, Managing Partner and Michael Gibbons, Chief Compliance Officer of JWK attended. During this hearing James Korth made the initial presentation in behalf of JWK left the hearing and relied on Michael Gibbons to rebut the arguments of the Department of Enforcement but Michael Gibbons essentially received a "gag order" and was not allowed to speak. Thus no rebuttal of FINRA's position was ever made.

14 months later JWK received the NAC decision (Bates 002823). This decision essentially ignored all the Additional Evidence and dismissed it with a broad brush. It is actually clear only a cursory review was made. In a nutshell, the decision ignored the Additional Evidence, regurgitated the process of analyzing markups which relies heavily on the firm providing evidence, referenced several precedents that were shown to be inapplicable in our Opening Brief (Bates 001745) and cited the experts both of which were shown to be unqualified in a previous Filing (Korth's Objections to Experts Reports (Bates 001437) JWK immediately filed an Application for Review with the Commission.

The Crux of the this Matter – This is essentially 23 separate trade sets or individual cases that have not been properly investigated by FINRA as described in the rules.

Putting aside all the peripheral issues where exceptions could be made, it is clear that the FINRA Department of Enforcement and the NAC failed to properly investigate each trade set individually even after the providing of detailed Additional Evidence was motioned, argued, accepted by the NAC Panel and timely delivered. It is clear that FINRA's Department of Enforcement would much rather win than do the right thing for us, the industry and investors[5]. When the OHO Hearing Panel (Decision Bates 001515) stated it lacked evidence and we motioned to provide it they fought us tooth and nail. Now, after it was provided to the NAC, in the NAC decision it was clearly not addressed except with broad brush type statements.

Much of the Additional Evidence shows very clearly that JWK carefully considered the resulting yield to the customer, performed an extraordinary amount of work beyond normal due diligence and in some cases that the markets changed or that we were acting as market makers / position traders. We sincerely hope the Commission will review the Additional Evidence (Bates 001745; 001901; 002033) and decide for itself whether we have met our burden of proof of extraordinary service on each individual trade set or remand the case to the FINRA OHO Hearing Panel (who stated over and over in their decision they needed more information) to reconsider its decision on each trade set.

Specific Requests to the Commission

1. We ask the Commission to make a review of FINRA's approach to markup enforcement. More specifically:

    a. We ask that the Commission investigate FINRA's approach to markup enforcement, its effect on bond dealers and the liquidity and fairness to customers. We sincerely hope this results in a recommendation to FINRA to clarify their approach with:

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[5] Mr. Christopher Burky, FINRA's Department of Enforcement's lead lawyer on this case, stated to James Korth that winning this case was very important for his career and standing at FINRA. Most small securities dealers cannot afford to fight the battle we have undertaken here. The legal fees would be just too much. Therefore they capitulate and change their business to avoid FINRA investigations of markups. This hurts market liquidity. FINRA should have a clearly defined way to review firm research efforts and market making and not deal with its Members with a broad brush approach. Capital formation and fair and orderly markets require it.

i. What clear level of markups will be reviewed and questioned. (*Note: this could easily be some kind of a grid based on trade size.)*
ii. A statement of the nature of the supporting evidence that will be expected should trades fall outside the grid.
iii. A statement that each trade should be reviewed individual in the cases where no pattern exists.

2. For this case, we sincerely hope the Commission will review the Additional Evidence for each of the 23 trade sets in question individually as if they were a separate case and decide whether or not we charged the customers reasonably for the work we performed under the specific market conditions surrounding each trade set at the time.

Important Note: The Additional Evidence (Bates 001745; 001901; 002033) is organized by CUSIP Number, has a summary page and shows the exception we have to the OHO Hearing Panel Decision along with emails, research reports, instant messages, communications with customers, communications with chief financial officers of issuers, prospectus and offering memorandum cover sheets showing the complicated nature of issues and affidavits by individuals who worked on the trades. To any reasonable business person, it should be clear there was a substantial amount of work on each trade beyond basic due diligence which would be comprised generally of verifying the existence of the issuer, the securities ratings, news regarding the issuer and reviewing last trade information to verify reasonableness of pricing.

Thank you for your review.

James W. Korth, Managing Partner

Michael Gibbons, Chief Financial Officer

1. FINRA improperly shifted the Burden of Proof to the Firm on all trades that had mark-ups within our policy. First it is undisputed that we had a mark-up policy using a 3.9% guideline and it was communicated both to FINRA and the SEC. (Hearing Panel Decision Bates 01551). Second we show that other cases showed that a 5% mark-up was the threshold where the burden shifted. (Opening Brief Bates 02689) Third, we showed Third we showed that FINRA has no research or any other logical basis to use a 3.00% or 3.50% basis to shift the burden to JWK. (email Christopher Cook Bates 001467). FINRA states in its NAC Decision (Bates 002791 Page 16) "The burden shifts to the respondent to justify its markup once FINRA presents evidence that a firm's mark-up is unfair or unreasonable regardless of the numeric percentage." At the outset of this case and never afterward has FINRA presented any hard evidence that our markups were unfair only the opinion of discredited experts (Bates 001437) neither of which ever had Profit and Loss management responsibility at a securities firm. For the lack of evidence that our markups were unfair the case should be stayed.

2. "J. W. Korth Failed to demonstrate that Its Markups and Markdowns were Fair" JWK provided the NAC with substantial evidence regarding each trade set. This evidence included emails, instant messages, research reports, evidence of communications with the issuers, extensive written communications with clients specifically regarding the securities, market reports and a statement regarding each trade set along with affidavits. This evidence took nearly 6 weeks to compile and it was dismissed out of hand by FINRA saying it the firm "did not quantify the time" and it "failed to show its services were any different than provided by other dealers" (NAC Decision Bates 002823). Regarding the "time" no logical person can look at that evidence and fail to conclude it took a lot of time and was extensive work. Regarding the "failure to show the services were different than

provided by other firms" this is not in any way relevant when it was shown the services were extensive. We implore the Commission to look at the evidence regarding the trade sets provided and stay the case on the fact that the preponderance of evidence shows that we provided extensive and valuable services fairly to our customers. (Bates 001745,001901,002033).

3. The specific finding that a firm cannot bundle its services and get paid an "average fair profit" for serving its customers. In one of the trade sets during the financial crisis JWK provided a customer with extensive advice the timing and pricing for liquidation of securities that were distressed and then charged him a larger, yet reasonable, mark-up on the bonds he bought to pay for the time spent. We believe this was proper and we were not unduly rewarded. The Commission should remove any weight given to this finding in its decision whether to stay the proceeding.
4. The specific finding that "it (the firm) has shown only that it engaged in the basic due diligence before recommending a bond We believe the NAC panel had no grounds to make this assertion. We showed research reports, calls to companies, extensive reviews of balance sheets and income statements (Bates 001745,001901,002033 Evidence of Research). This is not basic due diligence which would be checking the current securities ratings, looking up the CUSIP number to be sure the bond exists and perhaps searching current news on the issuer.
5. The use of the "Paviolitus" report. Mr. Paviolitus had no experience whatsoever in retailing bonds. He had no profit and loss responsibility and was at a wholesale firm. (Bates 001437,000613 Objections to Experts Reports). The Commission should remove any weight given to Mr. Paviolitus report in its decision regarding this matter.
6. The lack of any consideration whatsoever by FINRA of the fact the 100% of trades in question occurred the Financial Crisis 2009-2011. At that time all investors required additional comfort and reassurance through research to purchase nearly any security. Further the market volatility and risk of ownership of securities in inventory was substantially higher than normal times. (Bates 002823

NAC Decision schedule at end). Since the markups on all trades are only marginal (less than 1%) for all trades except where we acted as a market maker/position trader we believe the Commission should stay the proceeding due to the fact the times required marginally more work and FINRA gave us no consideration of this fact.

7. The application of various other adjudicated decisions regarding markups. All of the judicial decisions applied to the JWK case were regarding dealers or individuals who acted egregiously, or were self-dealing or otherwise fraudulently dealing with securities. We believe none of these cases should act as a precedent for JWK who was found by the Hearing Panel to **"have in place a policy for determining markups that it openly explained to FINRA and reliably implemented"** (Hearing Panel Decision Page 22. Bates 001551). We believe that in reviewing our case the Commission should disregard all these cases. (Please see specific arguments in Opening Brief Bates 02689)

8. The combined facts that a. FINRA had an unpublished 3% guideline when the firm was operating under the 5% guideline provided by the written rules and b. the firm had specific written policies **that it "openly explained to FINRA and reliably implemented"** (Hearing Panel Decision Page 22. Bates 001515). And c. the customers received high value from JWK research. (Bates 002823 NAC Decision schedule at end) Please note all of the bonds provided to customers provided value even the Puerto Rico bonds are trading 4 points higher than the sale price and are FGIC insured. All were provided to customers at deep discounts. We believe these combined facts provide a reason to stay the proceedings.

9. The finding that the firm should pay restitution to its customers. We believe the record shows that we did extraordinary work for which we charged fairly (Bates 001745,001901,002033 Evidence of Research). The record also shows that our charges on all but those trades where we were market

makers/position traders were far less than 1% higher than the 3.00 to 3.5% threshold. The record also shows that all the margin was spread over just a small amount of bonds (Bates 002823 NAC Decision schedule at end). For these reasons we believe the proceeding should be stayed and we should not have to pay restitution to customers who benefitted highly from our work.

10. The finding that it should hire an independent consultant to manage its pricing procedures. These trades happened more than 8 years ago (Bates 002823 NAC Decision schedule at end). Since that time JWK's policies have evolved and improved as is customary in this industry. As noted previously, it has essentially ended its small trade research business and in most cases does not charge markups in excess of 2.5% indeed our average markup is much lower. Further, for at least the past five years it has been customary for our compliance department to conduct yield specific reviews for trades executed with markups or markdowns of either 2 points or higher than 2.25%. This was attempted to be brought up at the NAC hearing but was unable to be discussed due to time constraints. In addition to the evolvement of general policy, we believe there is no need for a consultant to our business as we are now primarily and institutional firm dealing only with accredited investors or institutional buyers.

Dated: August 19th, 2019

Signed: _____

James W. Korth

Signed: 

Michael Gibbons

Notices may be sent to the above via email and certified mail as follows:

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