

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
Release No. 94581 / April 1, 2022

Admin. Proc. File No. 3-19206

In the Matter of the Application of
J.W. KORTH & COMPANY, LP
For Review of Disciplinary Action Taken By
FINRA

OPINION OF THE COMMISSION

REGISTERED SECURITIES ASSOCIATION — REVIEW OF DISCIPLINARY
PROCEEDING

Member firm of registered securities association charged excessive markups and markdowns to its customers. *Held*, registered securities association's findings of violations and sanctions are *sustained*.

APPEARANCES:

James W. Korth, Managing Partner, and Michael Gibbons, Chief Compliance Officer, for J.W. Korth & Company, LP.

Alan Lawhead, Andrew Love, and Colleen E. Durbin, for FINRA.

Appeal filed: June 18, 2019

Last brief received: October 7, 2019

J.W. Korth & Company, LP (“Korth” or the “Firm”), a FINRA member firm, seeks review of FINRA disciplinary action based on markups or markdowns it charged on 38 municipal bond transactions and 13 corporate bond transactions between itself and retail customers from April 2009 through December 2011.¹ FINRA found that Korth violated MSRB Rules G-17 and G-30 by charging customers excessive markups on 38 sales of municipal bonds—the markups FINRA found excessive ranged from 3.10% to 8.33%.² FINRA also found that Korth violated NASD Rule 2440, IM-2440, and FINRA Rule 2010 by charging excessive markups and markdowns on nine sales and four purchases of corporate bonds—the markups and markdowns FINRA found excessive ranged from 3.24% to 5.56%. For these violations, FINRA censured Korth, ordered it to pay restitution plus prejudgment interest, and required it to retain an independent consultant to review the Firm’s pricing procedures. Based on our independent review of the record, we sustain FINRA’s findings of violation and the sanctions it imposed.³

It is well-established that the markup or markdown in a retail securities transaction is the difference between the price at which the firm either sells the security to the customer (for markups) or buys the securities from the customer (for markdowns) and the prevailing market price.⁴ The prevailing market price for firms that are not market makers is generally the price the firm contemporaneously paid to acquire the security it sells to a customer (for markups) or the price the firm contemporaneously receives when it sells the security it bought from a customer (for markdowns).⁵ After calculating the relevant markup or markdown, we determine whether it is excessive by comparing it to the markups or markdowns that generally are charged in the industry for similar transactions in the same or similar securities, as shown by expert testimony or other evidence.⁶ If such evidence indicates that the markup or markdown at issue is excessive,

¹ *Dep’t of Enf’t v. J.W. Korth & Co.*, Complaint No. 2012030738501 (NAC May 29, 2019), https://www.finra.org/sites/default/files/2019-07/NAC_2012030738501_Korth_052219.pdf.

² FINRA enforces the rules of the Municipal Securities Rulemaking Board (“MSRB”) pursuant to Section 15B of the Securities Exchange Act of 1934. 15 U.S.C. § 78o-4(c)(5).

³ We deny Korth’s request that we order oral argument under Rule of Practice 451 because we do not find that our “decisional process would be significantly aided by oral argument.” 17 C.F.R. § 201.451(a); *see also Rules of Practice*, Exchange Act Release No. 35833 (June 9, 1995), 60 Fed. Reg. 32,738, 32,779 (June 23, 1995) (explaining that generally we do not grant oral argument in appeals from the actions of self-regulatory organizations).

⁴ *See Grandon v. Merrill Lynch & Co., Inc.*, 147 F.3d 184, 189 (2d Cir. 1998) (citations omitted); *Shamrock Partners, Ltd.*, Exchange Act Release No. 40663, 1998 WL 786953, at *3 (Nov. 12, 1998).

⁵ *See Alstead, Dempsey & Co.*, Exchange Act Release No. 20825, 1984 WL 50800, at *1 (Apr. 5, 1984).

⁶ *See, e.g., Anthony A. Grey*, Exchange Act Release No. 75839, 2015 WL 5172955, at *12 (Sept. 3, 2015) (finding markups between 5.36% and 19.12% to be excessive in light of expert testimony “that, under standard industry practice, three percent is generally the maximum permissible markup on municipal securities”); *Mark David Anderson*, Exchange Act Release No.

the burden shifts to the applicant to demonstrate that under the circumstances the markup or markdown was nonetheless reasonable.⁷ Because each case turns on its own facts, there is no fixed percentage at which markups are deemed to be per se excessive.⁸

The markups and markdowns at issue here all exceeded 3%, and the expert testimony that FINRA adduced established that for each transaction at issue the markups and markdowns exceeded the levels normally charged for similar transactions in the securities at issue. Korth did not introduce any expert testimony of its own to show that the markups and markdowns were nonetheless reasonable under the circumstances. Although Korth otherwise attempted to justify its pricing, the record establishes that neither the services it provided its customers nor market conditions justified the markups and markdowns that it charged. As a result, we sustain FINRA's finding that Korth's pricing was unreasonable. Because we find the sanctions FINRA imposed to be neither excessive nor oppressive, we also sustain the sanctions.

I. Background

A. FINRA found that Korth charged excessive markups and markdowns in 51 retail transactions.

FINRA found that Korth's municipal bond markups violated MSRB Rules G-17 and G-30, which require dealers to trade with retail customers at prices that are "fair" and "reasonably related to the prevailing market price at the time . . ."⁹ FINRA also found that Korth's corporate bond markups and markdowns violated NASD Rule 2440 and IM-2440, which required all transactions between member firms and customers to be conducted at prices that are "fair" and "reasonably related to the current market price of the security."¹⁰ FINRA further

48352, 2003 WL 21953883, at *7 (Aug. 15, 2003) (finding, based on expert testimony, that the markups "were at least two to three times greater than prevailing industry practice"); *F.B. Horner & Assocs., Inc.*, Exchange Act Release No. 30884, 1992 WL 160028, at *3 & n.11 (July 2, 1992) (stating that "expert testimony is generally very helpful when the question to be resolved is the proper pricing of debt securities"), *aff'd*, 994 F.2d 61 (2d Cir. 1993) (per curiam).

⁷ See *Donald T. Sheldon*, Exchange Act Release No. 31475, 1992 WL 353048, at *12 (Nov. 18, 1992), *aff'd* 45 F.3d 1515 (11th Cir. 1995).

⁸ *Inv. Planning, Inc.*, Exchange Act Release No. 32687, 1993 WL 289728, at *1 (July 28, 1993).

⁹ MSRB Rule G-17; MRSB Rule G-30; MSRB Manual (CCH) ¶ 3646, p. 5159 (1989).

¹⁰ On May 21, 2014, FINRA adopted new FINRA Rule 2121, replacing NASD Rule 2440 and IM-2440. See *Notice of Filing and Immediate Effectiveness of a Proposed Rule Change*, Exchange Act Release No. 72208, 2014 WL 2120449, at *4 (May 21, 2014). Because the conduct at issue here occurred before that date, the NASD Rules in effect at the time apply.

found that this conduct also violated FINRA Rule 2010.¹¹ Korth does not dispute that it purchased (in the case of markups) or sold (in the case of markdowns) the securities at issue in inter-dealer transactions at the prices, dates, and times FINRA found.

In determining that Korth charged customers unfair markups and markdowns, FINRA conducted a two-step analysis. First, it determined whether the Firm’s purchase price (in the case of markups) or sale price (in the case of markdowns) in the inter-dealer transactions was the best measure of the prevailing market price upon which to calculate the resulting markups and markdowns. Second, it determined whether those markups and markdowns were excessive based on relevant precedent and industry standards. For the transactions that it found to be violations, FINRA concluded that the record supported the use of contemporaneous purchases or sales in inter-dealer transactions as the prevailing market price and established that the resulting markups and markdowns were unfair in violation of the applicable rules.

- 1. FINRA used Korth’s contemporaneous purchase or sale price as the prevailing market price.**
 - a. FINRA relied on Commission precedent and expert testimony to conclude that Korth’s contemporaneous purchase or sale price was the best evidence of the prevailing market price for the relevant transactions.**

It is well-established that the markup on a security is the difference between the price charged to the customer and the prevailing market price, and that the markdown on a security is the difference between the price paid to the customer and the prevailing market price.¹² In determining the prevailing market price here, FINRA followed authority establishing that, absent countervailing evidence, the prevailing market price is the price at which dealers trade with one another—the current inter-dealer market.¹³ We have held that a dealer’s contemporaneous purchase or sale price in inter-dealer transactions is the best evidence of the current market because prices paid or received for a security by a dealer in actual transactions closely related in time to its sales or purchases are normally a highly reliable indication of the prevailing market.¹⁴

¹¹ See FINRA Rule 2010 (prohibiting conduct inconsistent with just and equitable principles of trade); see also, e.g., *Bruce Zipper*, Exchange Act Release No. 90737, 2020 WL 7496222, at *11 (Dec. 21, 2020) (stating that it is a “long-standing and judicially-recognized policy” that a “violation of another FINRA rule . . . itself constitutes a violation of FINRA Rule 2010”).

¹² See *supra* note 4.

¹³ See *supra* note 5.

¹⁴ *First Honolulu Sec., Inc.*, Exchange Act Release No. 32933, 1993 WL 380039, at *2 (Sept. 21, 1993).

And we have looked to a dealer's inter-dealer purchases or sales occurring within five business days of the retail transaction at issue for determining the prevailing market price.¹⁵

To reach its conclusion that Korth's contemporaneous purchase or sale price in inter-dealer transactions was the best measure of the prevailing market price, FINRA relied on two expert reports that its Department of Enforcement introduced: one by Charles Paviolitis relating to the municipal bond transactions, and a second by Vikram Kapoor relating to the corporate bond transactions. Both of Enforcement's experts noted that Korth's related inter-dealer purchases (in the case of markups) or sales (in the case of markdowns) all occurred within five business days of its transactions with retail customers, with the majority occurring within a few hours and several involving simultaneous purchases and sales. Both further observed, based on their review of trading data over a two-month period surrounding the transactions at issue, that there were no inter-dealer trades between the purchase and sale transactions at issue. They explained further that there were no other inter-dealer transactions during the time of the transactions at issue that would support using a measure of the prevailing market price other than Korth's contemporaneous purchases or sales. Korth failed to introduce any expert reports or other countervailing evidence to show that its contemporaneous purchase or sale price in inter-dealer transactions was not the best measure of the prevailing market price.

Both FINRA's hearing panel and its National Adjudicatory Council ("NAC"), sitting in review of the hearing panel's decision, independently reviewed the trading data, carefully analyzed each of the transactions at issue, and ultimately concurred with the experts' conclusions that Korth's contemporaneous purchase or sale price was the best measure of the prevailing market price. In support of this determination, the NAC noted that, "with respect to the municipal bond transactions, most of Korth's purchases occurred only one to two days prior to its sales to customers and that no intervening inter-dealer trades occurred." With respect to the corporate bond transactions, it noted that "all of the trades occurred on the same day as the Firm's sales to its customers," or its purchases from customers in the case of the four markdowns.

For example, Korth purchased 280,000 bonds offered by Colorado Public Radio at a price of \$88.711, on January 28, 2010, at 3:50 PM, and sold those bonds in several transactions within a short time (two at 4:10 PM the same day, three the following business day around 10:30 AM, and the final transaction the business day after that) at a price of \$92.00—resulting in a markup of 3.71%. There were no inter-dealer transactions in the bonds between Korth's inter-dealer purchase and its customer sales. The only inter-dealer transaction in the bond within one

¹⁵ See e.g., *LSCO Sec., Inc.*, Exchange Act Release No. 28994, 1991 WL 296502, at *2 (Mar. 21, 1991) ("[A]bsent some showing of a change in the prevailing market, a dealer's inter-dealer cost may be used to establish market price for a period up to five business days from the date of the dealer's purchase."); *Nicholas A. Codispoti*, Exchange Act Release No. 24946, 1987 WL 755546, at *1 (Sept. 29, 1987) (finding that "prices that [firm] paid other dealers for the bonds within five or less business days of its sales" was best measure of prevailing market price).

week of Korth's inter-dealer purchase was another firm's purchase at 3:28 PM, 22 minutes before Korth's purchase, of 530,000 bonds at a price of \$87.75—which, had it been used instead of Korth's contemporaneous purchase price as the prevailing market price, would have resulted in a finding that Korth had charged an even larger markup of 4.84%.¹⁶

b. FINRA rejected Korth's arguments that quotations were the best evidence of the prevailing market price for the relevant transactions.

For approximately half of the transactions at issue, Korth did not challenge the use of its contemporaneous purchase or sale price in inter-dealer transactions to calculate the markups or markdowns. For the other transactions involving markups, Korth argued that the “best contemporaneous offer is a reliable indicator of prevailing market price” and should have been used to calculate the markups instead of the Firm's contemporaneous purchase price. But the hearing panel found that Korth “failed to submit documentation demonstrating that the market for the securities was best-represented by inter-dealer quotations rather than its own contemporaneous costs.” And the NAC cited Commission precedent holding that quotation evidence is not a reliable indicator of the prevailing market price because “quotations only propose a transaction; they do not reflect the actual result of a completed arms-length sale.”¹⁷ The NAC also cited Commission precedent holding that “quotations that are not validated by comparison with actual inter-dealer transactions should not be relied on to establish prevailing market price in determining an appropriate retail markup.”¹⁸

The NAC also relied on the experts' conclusion that using Korth's proposed quotation-based method of calculating markups would be inconsistent with industry practice and result in excessive pricing. Paviolitis stated that the Firm's use of quotations was “an extreme departure from the methodology universally employed by other dealers.” Kapoor agreed that a quotation-based method was “not a good proxy for prevailing market price” because “[r]esearch has established that transactions in OTC markets such as those for corporate bonds do not necessarily take place at the prevailing bid and ask quote, and that the differences can be significant.”

The NAC similarly rejected Korth's argument that it was permitted to base its retail pricing on quotations because it was a market maker for certain of these securities. “[W]here a market maker is involved, markups may be computed on the basis of the contemporaneous prices charged by the firm or other market makers in actual sales to other dealers or, if no such prices

¹⁶ The other firm quickly sold the bonds it purchased to a customer at a 1.1% markup.

¹⁷ NAC Decision, *supra* note 1, at 17 (quoting *Alstead*, 1984 WL 50800, at *2).

¹⁸ *Id.* (quoting *Dennis Todd Lloyd Gordon*, Exchange Act Release No. 57655, 2008 WL 1697151, at *11 (Apr. 11, 2008)).

are available, on the basis of representative asked quotations.”¹⁹ But The NAC found that the Firm introduced no evidence showing that it met the statutory definition of a “market maker.”²⁰

2. FINRA found the markups and markdowns to be excessive.

After determining that Korth’s contemporaneous purchase or sale prices in inter-dealer transactions were the appropriate basis for calculating the markups and markdowns, and considering the evidence in the record, the NAC found that the markups or markdowns exceeding 3% on the corporate bonds and some of the municipal bonds, and 3.5% for the other municipal bonds, were excessive. The record evidence included the relevant trade data as well as the nature of the bonds, their maturity and yield, issue size, and liquidity. The evidence also included the opinions of the two expert witnesses, Paviolitis and Kapoor.

Paviolitis opined that the industry norm for markups on transactions similar to the municipal bond sales at issue was 0.25-3%.²¹ Paviolitis also opined that Korth’s policy of permitting markups on such sales of up to 3.9% was “inconsistent with the custom and practice in the municipal bond market during the relevant period of time.”

Kapoor opined that 3% was the maximum appropriate markup or markdown for the corporate bonds. According to Kapoor, Korth “had a statistically significant higher markup on the securities at issue than the highest markup of the other dealers” in the same security.

For example, in two of the corporate bond transactions, Korth charged customers a 5.3% markup on bonds that it bought and sold within two hours. During the period from one month before to one month after these transactions, Kapoor found that the highest markup on the bond charged by any other dealer was 3.85%, and the average markup charged by other dealers for all transactions in the bond during that time period was 0.70%. In another example, involving four

¹⁹ *Alstead*, 1984 WL 50800, at *2; *see also Grandon*, 147 F.3d at 189 (stating that “when the dealer is a marketmaker . . . ‘the contemporaneous cost rule may not be appropriate’”) (citing Louis Loss & Joel Seligman, *Fundamentals of Securities Regulation*, 883-84 (3d ed. 1995)).

²⁰ *See* Exchange Act Section 3(a)(38), 15 U.S.C. § 78c(a)(38) (defining a “market maker” as “any dealer who, with respect to a security, holds himself out (by entering quotations in an inter-dealer communications system or otherwise) as being willing to buy and sell such security for his own account on a regular or continuous basis”). Korth further justified its use of quotations by claiming that it acted as a “position trader” on several of these trades. But it did not cite any authority to support this claim or introduce any evidence to establish its factual assertion.

²¹ In a footnote, the NAC noted that Paviolitis further opined that the markups at issue should not have exceeded 2%. The NAC rejected this conclusion. Based on the case law, the NAC concluded that 3% reflected an appropriate “maximum markup on debt securities.” *See* NAC Decision at 11 & n.15 (citing *Grey*, 2015 WL 5172955, at *9 (recognizing that markups on municipal securities exceeding 3% are generally excessive); *Anderson*, 2003 WL 21953883, at *9 (recognizing that markups on debt securities of 3% to 3.5% may be excessive)).

other corporate bond transactions, Kapoor found that Korth's markdowns were between 0.97-2.01% higher than the highest markdown on the bonds at issue charged by any other dealer for the period between one month before and one month after Korth's transaction, and were also 2.47-2.9% higher than the average markdown charged by other dealers during such period.

Based on the experts' testimony, as well as the NAC's own review of the transactions at issue, the NAC concluded that Enforcement had established a prima facie case that the markups on 38 municipal bond transactions that exceeded either 3% or 3.5% and the markups or markdowns on 13 corporate bond transactions that exceeded 3% were excessive. The NAC therefore shifted the burden to Korth to present evidence demonstrating the fairness of the Firm's pricing when it exceeded those levels.²² Although Korth argued that such burden shifting is impermissible in the absence of a showing that the markups and markdowns exceeded 5% (invoking the level at which markups on equities are generally presumed to be excessive), the NAC cited Commission precedent for shifting the burden at much lower levels.²³ The NAC then found that Korth did not demonstrate the fairness of its pricing.²⁴

a. FINRA found that Korth's customer service did not justify its pricing.

The NAC rejected Korth's efforts to justify its pricing by claiming that it provided extraordinary customer service. James Korth, the Firm's managing partner who was responsible for reviewing the Firm's pricing, testified in investigative testimony that the Firm had earlier set a limit of 3.5% for its markups and markdowns but raised that limit to 3.9% in February 2009 because "we were losing money." He explained that "[w]e do a lot of investigation on every trade we do, and we have people who are doing all the work behind these representatives, and we need to make more money" In an email announcing the change, the Firm advised its staff:

While our costs have basically stayed the same, the market environment has created a slowdown in our trading volume. Therefore, the average cost per ticket has risen for us. While we must obviously adhere to the FINRA 2440 markup

²² See *supra* note 7

²³ See, e.g., *Anderson*, 2003 WL 21953883, at *7 (shifting the burden where markups on the municipal securities at issue were as low as 1.42%); *First Honolulu*, 1993 WL 380039, at *4 & n.23 (finding that NASD appropriately shifted the burden where evidence showed that applicant charged markups of 3.58% on municipal bond transactions).

²⁴ FINRA declined to find violations for certain of the charged markups due to special circumstances surrounding those transactions. For example, with respect to one transaction involving a 3.71% markup, FINRA noted that an inter-dealer transaction occurred within two days of Korth's customer sale at a significantly higher price than Korth's inter-dealer purchase price a few days earlier, which FINRA found suggested "that the market was moving upward." Accordingly, FINRA calculated Korth's markup using the later inter-dealer price (instead of Korth's contemporaneous purchase price) as the prevailing market price, which approach reduced the markup percentage to 2.79%, a level that FINRA found to be "fair and reasonable." FINRA dismissed allegations of excessive markups with respect to 11 of the 62 charged trades.

rule (5% guideline as it's known), and the FINRA Fair Dealing Rule, we have decided to allow markups of up to a 3.9% limit as opposed to our standard 3.5%. This doesn't mean that every trade should be marked at 3.9% because in many cases that would not be warranted. Please use your best judgment.

The Firm's written supervisory procedures further provided that, for municipal securities, various factors should be considered in setting prices, including the expenses involved in the transaction, and the availability, maturity, and yield of the security.

FINRA recognized that extraordinary customer service and related additional expenses incurred by a dealer (as well as other factors) may justify charges above the levels it generally considered unfair here, but found that Korth failed to present the requisite evidence to support its claims. Korth waived an in-person hearing, and the hearing panel considered the matter on the written record, including the parties' briefs and the two expert reports. In its decision, the hearing panel concluded that "Korth [had] not proffered sufficient evidence to support its contention that it invested significant time and energy into each of the bond sales at issue."

On appeal, the NAC allowed Korth to supplement the record with approximately 500 pages of documentation to support its claim of fair pricing. The NAC permitted Korth to introduce this evidence to the extent it "existed contemporaneous with the bond transactions at issue in an effort to justify its markups and markdowns." The evidence included financial statements, auditors reports, newspaper articles, bond offering documents, Shop-4-Bond tickets, emails and instant messages discussing particular bonds, and screenshots of comparable bonds. The NAC found that this evidence "demonstrate[d] that the Firm engaged in due diligence, as it was required to do, [but] . . . failed to show that its services were any different from those provided by other broker-dealers that recommend fixed-income securities to their customers."

b. FINRA found that market conditions did not justify Korth's pricing.

FINRA also rejected Korth's related claim that changes in market conditions justified its pricing. For example, Korth purchased 300,000 bonds issued by the Tennessee Energy Acquisition Corp. in two transactions on April 21, 2009, at an average buy trade price of \$87.1396 per bond. Korth then sold 235,000 of the bonds to customers in six transactions the following day at markups ranging from 4.12% to 4.80%. In a seventh transaction, Korth sold 55,000 of the bonds to a customer on April 23, 2009, and charged a 5.58% markup on that transaction.

With respect to the seventh transaction, Korth argued that the Firm held the bonds for two nights and "that the inter-dealer market changed during that period." Korth submitted evidence showing that the inter-dealer price for a separate tranche of the bonds at issue, with a different CUSIP number, had increased late in the day on April 22 from approximately \$81.43 to approximately \$84.145. But Korth did not introduce evidence that pricing with respect to this other tranche was comparable to pricing of the tranche at issue in the charged transactions. And, even assuming the other tranche was comparable, the prices for this other tranche were both substantially lower than Korth's purchase price and the marked-up prices at which it sold the

bonds at issue. The hearing panel found that the evidence the Firm submitted did not establish a change in the market for the bonds Korth purchased on April 21 and sold on April 23.

The hearing panel engaged in a similar analysis in determining that other transactions also involved excessive markups. For example, Korth purchased 45,000 municipal bonds issued by the New Jersey Economic Development Authority in an inter-dealer transaction on June 10, 2009, at 4:10 PM, and sold them to a customer six minutes later at a 3.89% markup. In addition to noting the short period of time that Korth held the bonds, the hearing panel pointed out that “at a similar time on the same day as this trade, another firm purchased 10,000 bonds at a higher price, yet sold them to a customer at a price lower than” Korth’s. Similarly, Korth purchased 100,000 municipal bonds issued by a Maryland state agency from another dealer on March 2, 2010, and sold them to a customer one hour later at a 5.87% markup. The hearing panel found “no evidence that the market moved during” the short period between Korth’s purchase and sale.

With respect to four of the corporate bond transactions, Korth charged markdowns ranging from 3.57% to 3.75% on transactions in which the Firm’s purchase of the bonds from a customer and its inter-dealer sale were simultaneous. Considering the simultaneous sale and purchase transactions, the hearing panel found that Korth “did not present any evidence to substantiate a change in the market, a change in ratings, additional services that the Firm provided, or other circumstances that would justify markdowns in excess of three percent.”

B. FINRA sanctioned Korth for charging its customers excessive markups and markdowns.

For the violations of MSRB Rules G-17 and G-30, NASD Rule 2440 and IM-2440, and FINRA Rule 2010, the hearing panel censured Korth, ordered it to pay restitution plus prejudgment interest, and required it to retain an independent consultant to review its pricing procedures. The NAC sustained the violations and the sanctions imposed. This appeal followed.

II. Analysis

We review FINRA’s disciplinary action to determine: (1) whether Applicants engaged in the conduct FINRA found; (2) whether that conduct violated the provisions specified in FINRA’s determination; and (3) whether those provisions are, and were applied in a manner, consistent with the purposes of the Exchange Act.²⁵ We base our findings on an independent review of the record and apply a preponderance of the evidence standard.²⁶

²⁵ 15 U.S.C. § 78s(e)(1).

²⁶ See *Richard G. Cody*, Exchange Act Release No. 64565, 2011 WL 2098202, at *9 & n.7 (May 27, 2011), *aff’d*, 693 F.3d 251 (1st Cir. 2012).

A. The record demonstrates that FINRA’s findings of liability should be sustained.

1. Korth charged its retail customers markups and markdowns greater than 3%, and in some cases greater than 5%, on municipal and corporate bond transactions.

The record establishes that Korth engaged in the conduct FINRA found. Undisputed evidence shows that Korth engaged in the transactions at issue on the dates and at the times detailed in the NAC’s opinion and at the prices the NAC used to calculate the markups or markdowns. The transactions with retail customers all occurred within five business days—and most occurred within hours—of the Firm’s related inter-dealer trade. Thus, the record supports FINRA’s finding that, based on the Firm’s contemporaneous purchase or sale price, Korth charged the markups and markdowns detailed in the NAC’s opinion. Of the 38 municipal bond transactions that FINRA found to be violations, 7 involved markups exceeding 5%; 12 involved markups exceeding 4%; 17 involved markups exceeding 3.5%; and 2 involved markups between 3-3.5%. For the corporate bond transactions at issue, 3 involved markups exceeding 5%; 8 (including the four markdown transactions) involved markups or markdowns between 3.5-4%; and the remaining 2 involved markups between 3-3.5%.

2. Korth’s markups and markdowns were excessive and violated MSRB Rules G-17 and G-30, NASD Rule 2440 and IM-2440, and FINRA Rule 2010.

The record also establishes that Korth’s markups and markdowns were excessive and violated the rules FINRA found Korth to have violated.

a. Contemporaneous purchase or sale prices were the best measure of prevailing market price.

As discussed above, for all 51 transactions at issue, Korth’s inter-dealer purchase or sale and its sale or purchase of the same security to or from a retail customer occurred within five days of each other. As a result, the inter-dealer trades were appropriate bases to calculate the resulting markups and markdowns in this case.²⁷ Korth, despite ample opportunity, failed to present countervailing evidence of the prevailing market price; indeed, the record showed that there were no inter-dealer trades between those FINRA used to establish the Firm’s contemporaneous purchase or sale price and the retail trades at issue here.

FINRA properly rejected Korth’s claim that it was entitled to base its pricing on quotations. As discussed above, we have held that quotation evidence is a “less reliable measure

²⁷ See *supra* notes 9-15; *Orkin v. SEC*, 31 F.3d 1056, 1063 (11th Cir. 1994) (“The general rule is that in the absence of countervailing evidence, the best evidence of prevailing market price is the dealer’s contemporaneous cost . . .”) (citing *F.B. Horner & Assocs. v. SEC*, 994 F.2d 61, 63 (2d Cir. 1993) and *Barnett v. United States*, 319 F.3d 340, 344 (8th Cir. 1963)); see also, e.g., *Lehl v. SEC*, 90 F.3d 1483, 1488 (10th Cir. 1996) (same).

of the market” than the applicant’s contemporaneous purchase or sale price in an inter-dealer transaction because “[b]y their very nature, quotations only propose a transaction; they do not reflect the actual result of a completed arms-length sale.”²⁸ We have also held that “quotations that are not validated by comparison with actual inter-dealer transactions should not be relied on to establish the prevailing market price, in determining an appropriate retail markup.”²⁹ The two expert witnesses confirmed that quotations were not a good proxy for the prevailing market price here. And Korth’s claimed reliance on quotations also conflicted with its written supervisory procedures. Those procedures, while silent as to municipal bonds, specified that markups or markdowns on corporate bonds “must be calculated from the prevailing market price of the security,” which would be “commonly obtained from” the Firm’s contemporaneous purchase or sale prices when such evidence existed. Such evidence existed for all of the transactions at issue here. In any case, Korth did not show that using quotations to establish the prevailing market price would have produced markups or markdowns that would have been deemed fair and reasonable.

Nor did Korth substantiate its claim that unusual market conditions, resulting from the 2008-2009 financial crisis or otherwise, justified a measure of the prevailing market price other than contemporaneous purchase or sale price. As we have observed, the financial crisis “did not unseat contemporaneous cost as the appropriate measure of prevailing market price.”³⁰ Rather, we have stated that the financial crisis instead “bolstered contemporaneous cost as the best evidence of prevailing market price, since interdealer trades provided the only objective measure at a time when the assumptions underlying external models were suspect.”³¹

b. Korth’s markups were excessive, unfair, and unreasonable.

As discussed above, MSRB Rules G-17 and G-30 required dealers to trade with retail customers at prices that are “fair” and “reasonably related to the prevailing market price at the

²⁸ *D.E. Wine Invs., Inc.*, Exchange Act Release No. 39517, 1998 WL 1819, at *4 (Jan. 6, 1998) (citing *Alstead*, 1984 WL 50800, at *2); *see also First Indep. Grp. v. SEC*, 37 F.3d 30, 32 (2d Cir. 1994) (“In this case, petitioners’ countervailing evidence consisted not of actual sales, but rather of quotations from other dealers. Quotations, however, are generally not a reliable indicator of the prevailing market price. Quotations only propose transactions and do not represent completed arms-length sales.”); *Orkin*, 31 F.3d at 1064 (“Nevertheless, the use of quotations to establish the prevailing market price, as urged by Orkin in this case, is widely recognized as problematic. As an initial matter, quotations merely propose a transaction, they do not represent an actual sale.”) (internal citations omitted).

²⁹ *Gordon*, 2008 WL 1697151, at *11.

³⁰ *Grey*, 2015 WL 5172955, at *6 (stating that the financial crisis did not “alter the fundamental concept that the *market* dictates prevailing market price”) (emphasis in original).

³¹ *Id.*

time.”³² NASD Rule 2440 and IM-2440 required all transactions between member firms and customers to be conducted at prices that are “fair” and “reasonably related to the current market price of the security.”³³ The evidence supports FINRA’s findings that the markups and markdowns Korth charged were excessive, unfair and unreasonable in violation of these rules.

i. The markups and markdowns Korth charged its customers were excessive when compared to industry norms.

The record establishes that Korth charged markups on the municipal bond transactions between 3.10% and 8.33%, and markups or markdowns on the corporate bond transactions between 3.24% and 5.56%. As discussed above, Paviolitis opined that the industry norm for markups on transactions similar to the municipal bond sales at issue was 0.25-3%. Kapoor opined that 3% was the maximum appropriate markup or markdown for the corporate bonds. Korth introduced no expert testimony refuting those opinions.

In addition to the expert testimony, the members of the hearing panel considered their own industry experience in evaluating the relevant factors under MSRB and FINRA rules, such as the bonds’ maturity, yield, and liquidity. Based on the evidence and that experience, the hearing panel found that substantial evidence supported the conclusion that the markups and markdowns were excessive. Our review of the record indicates that the hearing panel, which held that several of the markups alleged to be excessive were not violations, conducted a thorough and fair review of each of the trades at issue and that its findings of violation, which were wholly adopted by the NAC, are each supported by the evidence in the record.³⁴

We recognize that FINRA’s markup policy, NASD IM-2440-1, provided that a markup over five percent is generally considered excessive (the “5% Policy”). But a five percent markup serves merely as an outside limit for securities transactions in general.³⁵ We have “made clear that no particular percentage provides a safe harbor.”³⁶

³² See *supra* note 9 and accompanying text.

³³ See *supra* note 10 and accompanying text.

³⁴ See generally *William K. Cantrell*, Exchange Act Release No. 38570, 1997 WL 219926, at *3 (May 5, 1997) (“Where an issue involves an NASD panel’s collective experience and its knowledge of trade practice in the securities industry, we give substantial weight to the determination of that issue by the panel.”); *Hamilton Bohner, Inc.*, Exchange Act Release No. 27232, 1989 WL 992313, at *5 (Sept. 8, 1989) (making similar statement in a markup case); *cf. Cody*, 693 F.3d at 258 (stating that a “panel comprised of those experienced in the industry” is less in need of expert testimony “than an ordinary judge or jury”).

³⁵ *Inv. Planning*, 1993 WL 289728, at *2.

³⁶ *First Honolulu*, 1993 WL 380039, at *2.

As an initial matter, we note that seven of the municipal bond transactions and three of the corporate bond transactions at issue involved markups exceeding 5%. In any case, we have recognized that the “fact that a markup of more than five percent is generally considered excessive does not mean that markups of five percent or less are automatically deemed fair.”³⁷ The 5% Policy itself states that it is only a guide and that a markup of less than five percent may be considered unfair and unreasonable.³⁸ And we have held that, although the 5% Policy applies to transactions in both debt and equity securities, markups on debt securities “usually are smaller than those on equity securities.”³⁹ We have said it is “well-settled” that markups and markdowns on municipal securities may be excessive even when they are substantially below 5%.⁴⁰ We have also rejected the view that markups under 4% on transactions in corporate and municipal bonds are necessarily fair.⁴¹ Almost 30 years ago, we stated that markups on bonds above 3% may be considered excessive.⁴² Indeed, we have observed that markups on municipal securities are often as low as one or two percent in securities that trade frequently.⁴³

In this case, several of the transactions involved markups above 5%. With respect to the transactions that involved markups above 4%, we have held previously that such markups for the types of securities at issue here “represent extraordinary charges for ordinary transactions.”⁴⁴ And with respect to the transactions that involved markups above 3%, unrefuted expert testimony established that such markups were excessive. As a result, we believe that FINRA properly shifted the burden to Korth to present evidence demonstrating the fairness of the Firm’s

³⁷ *Gordon*, 2008 WL 1697151, at *11 n.60.

³⁸ NASD IM-2440-1(a)(1).

³⁹ *First Honolulu*, 1993 WL 380039, at *3 & n.14 (citing *Zero Coupon Securities*, Exchange Act Release No. 24368, 1987 WL 756237, at *3 (Apr. 21, 1987)). *See also Anderson*, 2003 WL 21953883, at *6 (observing that a “significantly lower markup is customarily charged in the sale of debt securities than in transactions of the same size involving common stock”).

⁴⁰ *Anderson*, 2003 WL 21953883, at *6.

⁴¹ *Inv. Planning*, 1993 WL 289728, at *1 & n.5.

⁴² *See First Honolulu*, 1993 WL 380039, at *3 (finding that markups between 3.26% and 4% on municipal debt securities “may well have been unfair” but declining to find violations because “NASD introduced no evidence that would establish the unfairness of markups at these levels”) *Thomas F. White & Co., Inc.*, Exchange Act Release No. 33477, 1994 WL 17044, at *2 & n.7 (Jan. 14, 1994) (clarifying that although markups below 5% were not at issue, the Commission did not “intend to suggest that markups under 5% [on corporate bonds] may not be unfair”).

⁴³ *Anderson*, 2003 WL 21953883, at *6 (citing *Staten Secs. Corp.*, Exchange Act Release No. 18628, 1982 WL 32503, at *2 & n.9 (Apr. 9, 1982)); *see also id.* at *2, 7, 9 (imposing liability for markups on bonds as low as 1.42% because they deviated from industry norms).

⁴⁴ *Inv. Planning*, 1993 WL 289728, at *1. Markdowns generally are lower than markups. *See Anderson*, 2003 WL 21953883, at *6.

pricing.⁴⁵ Once Enforcement established “a *prima facie* case that [Korth’s] prices were not reasonably related to the prevailing market price,” then “the burden of going forward shifted to [Korth] ‘to explain why, notwithstanding the evidence to the contrary, this pricing was fair.’”⁴⁶ The record establishes that Korth did not satisfy its burden.

ii. Korth failed to meet its burden to show that the markups and markdowns it charged were fair and reasonable and not excessive.

Korth argued that it provided “special services” to its customers that justified its pricing. But, to justify prices that deviate significantly from the prevailing market price, an applicant must present adequate documentation explaining why it was necessary for it to charge those prices.⁴⁷ We agree with FINRA that Korth failed to do so.

Korth’s evidentiary submissions include offering documents for the bonds, internal Firm communications, and news articles. But this evidence showed only that the Firm conducted basic due diligence such as reviewing offering documents or investigating the pricing of comparable securities.⁴⁸ Here, the evidence “does not establish any advantage that customers gained from applicants’ services or advice that would justify the high markups charged.”⁴⁹

⁴⁵ See *supra* notes 22-23.

⁴⁶ *Anderson*, 2003 WL 21953883, at *7 (citing *Sheldon*, *supra* note 7, and quoting *Richard R. Perkins*, Exchange Act Release No. 32188, 1993 WL 128738, at *2 & n.16 (Apr. 21, 1993)); *First Honolulu*, 1993 WL 380039, at *4 & n.23 (“The NASD, as proponent of the issue, had the burden of introducing *prima facie* evidence of the excessiveness of the markups Once the NASD presented evidence of the [excessive] markups, the burden shifted to Applicants to refute this evidence.”); see also *Anderson*, 2003 WL 21953883, at *7 & n.41 (“We do not mean to suggest that the burden of proof shifts but merely that the experts’ testimony regarding industry practice had the effect of placing with Anderson the burden of producing evidence to support his claim that his pricing was not excessive. As we made clear in *Sheldon*, the ultimate burden of persuasion remains with the Division.”).

⁴⁷ *Robert Marcus Lane*, Exchange Act Release No. 74269, 2015 WL 627346, at *8 & n.41 (Feb. 13, 2015).

⁴⁸ See *Staten*, 1982 WL 32503, at *2 (finding that the evidence did not establish that the markups were justified because the firm “incurred any unusual expense” or “expended an ‘extraordinary amount of time’” in effecting the transactions at issue).

⁴⁹ *Inv. Planning*, 1993 WL 289728, at *3 (rejecting contention that firm’s “personalized service that involved long consultations” and “research expenses” justified excessive markups); see also *First Honolulu*, 1993 WL 380039, at *4 & n.27 (rejecting argument that higher markups were justified as a result of firm spending “a great deal of effort researching these bonds and providing consequent services to the Firm’s customers” because the evidence did not show that “the research and services were unusual or beyond that which would be normal”).

Nor did market conditions justify the Firm's pricing. We agree with the NAC that Korth did not meet its burden of demonstrating a change in the market that would justify its pricing for any of the markups or markdowns found to be excessive. And, as detailed above, most of the transactions involved purchases and sales transactions occurring within hours of each other and in securities that were, according to the expert reports, relatively liquid in nature (or, where trading in a given security was relatively light, FINRA adjusted its maximum appropriate markup level from 3.0% to 3.5% or dismissed the charges as to the transaction).

In *Mark David Anderson*, we rejected the applicant's argument that "special circumstances" justified the markups because "the expert testimony regarding the liquidity of those securities and the fact that he was able to make all twelve trades for the customer within one hour indicates that the effort he made was in no way extraordinary."⁵⁰ Similarly, here the record established the liquidity of the municipal and corporate bonds at issue, that the transactions were all completed within short periods of time, and that the Firm failed to produce adequate documentation supporting its pricing. As a result, the record supports FINRA's finding that Korth failed to introduce sufficient evidence to justify the markups and markdowns at issue in the face of the uncontested evidence that the prices Korth charged were excessive in comparison to the prevailing market price. "In the final analysis, [Korth's] customers got less than they should have received, i.e., a moderate cost and a proper return on ordinary investments of a type obtainable from almost any full-service dealer."⁵¹

Based on the analysis discussed above, we sustain FINRA's findings that Korth charged its customers excessive, unfair, and unreasonable markups on the municipal bond transactions at issue here in violation of MSRB Rules G-17 and G-30 and charged its customers excessive, unfair, and unreasonable markups or markdowns on the corporate bond transactions at issue here in violation of NASD Rule 2440 and IM-2440, and FINRA Rule 2010.

3. MSRB Rules G-17 and G-30, NASD Rule 2440 and IM-2440, and FINRA Rule 2010 are, and were applied in a manner, consistent with the purposes of the Exchange Act.

MSRB Rules G-17 and G-30, NASD Rule 2440 and IM-2440, and FINRA Rule 2010 are consistent with the purposes of the Exchange Act. The Exchange Act requires that FINRA and the MSRB design its rules to "promote just and equitable principles of trade."⁵² MSRB Rules G-17 and G-30 and NASD Rule 2440 and IM-2440 promote just and equitable principles of trade by requiring member firms to charge customers a fair price. FINRA Rule 2010 promotes just and equitable principles of trade because it "protects investors and the securities industry from

⁵⁰ *Anderson*, 2003 WL 21953883, at *8.

⁵¹ *Inv. Planning*, 1993 WL 289728, at *4.

⁵² Exchange Act Section 15(b)(6), 15 U.S.C. § 78o-3(b)(6) (FINRA); Exchange Act Section 15B(b)(2)(C), 15 U.S.C. § 78o-4(b)(2)(C) (MSRB).

dishonest practices that are unfair to investors.”⁵³ Because we sustain FINRA’s finding that Korth charged its customers excessive markups and markdowns, we find that FINRA applied these rules in a manner consistent with the purposes of the Exchange Act.⁵⁴

B. Korth’s arguments on appeal lack merit.

1. Korth has failed to introduce sufficient evidence to justify measuring the prevailing market price based on quotations or to rebut the prima facie showing that the markups and markdowns it charged were excessive.

On appeal, Korth continues to argue that its contemporaneous purchase price was not an appropriate measure for certain of the trades at issue and that the markups should have been calculated based on quotations. We reject this argument because the Firm provides no evidence that these quotations were validated by contemporaneous trades or otherwise justifies their use as an alternative to the Firm’s contemporaneous purchase price (or sale price, in the case of markdowns). As discussed above, we have rejected the use of quotations as evidence of the prevailing market price in the absence of such evidence or such a justification.

Korth also continues to argue that special services it provided justified the markups and markdowns. It claims that, for each trade, it “carefully considered the relevant factors (especially the resulting yield to the customer) and provided attractive opportunities to [its] clients they may not have otherwise had.” According to Korth, it “provided [its] customers with quality investment opportunities in a challenging market at yields which were thoughtful and fair.” But Korth still fails to document any extraordinary effort it made or expense it incurred in connection with the markups and markdowns that were held to be excessive. And other than yield, Korth does not discuss any of the factors to be considered in evaluating dealers’ pricing determinations, such as the maturity and liquidity of the securities. Nor does Korth explain on appeal its basis for saying that the yields on the securities at issue were fair despite the markups and markdowns. Korth’s subjective assessment that its customers received “thoughtful and fair”

⁵³ *Notice of Filing of a Proposed Rule Change*, Exchange Act Release No. 58095, 2008 WL 2971979, at *2 (July 3, 2008); *Rule Change Approved Without Modification*, Exchange Act Release No. 58643, 2008 WL 4468749 (Sept. 25, 2008).

⁵⁴ *See Lane*, 2015 WL 627346, at *6 & n.20, *11 (finding NASD Rule 2440 and the predecessor to FINRA Rule 2010, and their application to applicants in a case involving markup violations, to be consistent with the purposes of the Exchange Act); *Grey*, 2015 WL 5172955, at *3, 8 (finding that applicant’s “excessive, unfair, and unreasonable” markups violated MSRB Rules G-17 and G-30, among other rules and statutory provisions, and that FINRA’s application of such rules was consistent with the purposes of the Exchange Act).

yields on the bonds has little if any relevance to the objective question of whether the Firm charged prices that were excessive in relation to the prevailing market price.

Although, for some of the transactions, Korth adduced evidence showing the yields of bonds Korth claimed were similar, we have rejected analogous efforts to justify excessive markups by comparing the yields customers received to general market yields for bonds claimed to be similar. In *Anderson*, for example, we found that the respondent's reliance on "general information about average yields for bonds of the same grade with similar maturities" did not justify the markups charged because such information provided insufficient data to permit a meaningful evaluation of the appropriate yields for the municipal bonds the respondent sold.⁵⁵

Korth argues further that FINRA's analysis effectively denied the Firm the option of pursuing a business model under which it would "bundle its services and receive an 'average fair profit' for serving its customers." As support, the Firm claims that "[i]n one of the [transactions] during the financial crisis [Korth] provided a customer with extensive advice [regarding] 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." Again, we have rejected this justification for charging excessive markups on specific transactions. For example, in *Staten Secs. Corp.*, we rejected an attempt to "justify . . . markups on certain sales by pointing to other transactions with the same customer in which [applicants] made little or no profit."⁵⁶ We held that the "fact that applicants may not have made a profit on one transaction cannot justify an excessive markup in an unrelated transaction with the same customer."⁵⁷ We held further that, where the firm redeemed securities for a customer and utilized the proceeds to make a new purchase, the firm was not entitled to charge more than a modest fee for doing so.⁵⁸ And, more generally, we have held that "in seeking a profit" a firm may not "pass along to the customer their expenses if the total would unreasonably exceed the prevailing wholesale price."⁵⁹

We also reject Korth's argument that we should "remove any weight" given to Paviolitis's report because Paviolitis's previous experience "included no profit and loss responsibility and was at a wholesale firm" and because the hearing panel "essentially dismissed" the report. The hearing panel did not essentially dismiss Paviolitis's report. Although the panel did not accept all of Paviolitis's conclusions, its findings were consistent with his views on the essential issues in the case such as that contemporaneous purchase price

⁵⁵ *Anderson*, 2003 WL 21953883, at *8.

⁵⁶ *Staten*, 1982 WL 32503, at *2.

⁵⁷ *Id.*; see also, e.g., *Inv. Planning*, 1993 WL 289728, at *8 ("[T]he price charged in each transaction must be fair. Accordingly, a lack of profit on some transactions for a customer cannot justify excessive markups on others."); *W.H. Whelen & Co.*, Exchange Act Release No. 28390, 1990 WL 312067, at *3 (Aug. 28, 1990) (stating that "the price charged in each individual sale to a customer must be fair and reasonable").

⁵⁸ *Staten*, 1982 WL 32503, at *2.

⁵⁹ *Inv. Planning*, 1993 WL 289728, at *3.

was the best measure of the prevailing market price and that there was a “generally recognized 3% threshold” on municipal bond transactions at the time of these transactions.

The record reveals no basis to reject Paviolitis’s testimony on these issues. Korth did not introduce expert testimony of its own or cross-examine Paviolitis. Korth fails to explain why Paviolitis’s lack of retail industry experience undermined his asserted expertise, especially in light of his 38 years of experience in the municipal bond industry.

2. FINRA properly found that markups and markdowns below 5% were excessive.

Korth argues that FINRA erred in finding markups and markdowns below 5% excessive when FINRA’s “written rules for markups set a 5.0% guideline.” But, as discussed above, both we and FINRA have made clear that the 5% Policy does not provide a numerical safe harbor. Indeed, we have found markups on debt securities excessive despite being substantially below 5% while observing that such charges will reach 5% in only “the most exceptional cases.”⁶⁰

Korth also contends that it had “explained [its] markup policies and business plan to examiners years before” the period at issue and “had specific written policies reviewed by both FINRA and the SEC during the period of the trades in question,” yet received “no specific guidance that charges more than 3% would be presumed excessive.” The record does not indicate what regulators reviewed and what, if anything, they told Korth in response. In any case, we have held that regulatory staff have “no duty to analyze and render an opinion on the particulars of the firm’s markups, and [their] failure to do so does not provide a defense.”⁶¹

We also reject Korth’s request that, in connection with this proceeding, we order a broad “review of FINRA’s approach to markup enforcement” and issue a “directive to FINRA to create a better format for its mark-up enforcement procedures.” Korth has not supported its claim of unclear or unequal enforcement of pricing violations that “has left dealers wary and uncertain” and that “negatively affects the securities prices of US citizens.” Even had it, the broad review

⁶⁰ *First Honolulu*, 1993 WL 380039, at *3 (finding that markups between 3.26% and 4% on municipal debt securities “may well have been unfair” and stating that “although some markups on municipal bonds may reach 5%, that figure might be acceptable in only the most exceptional cases”); *accord Inv. Planning*, 1993 WL 289728, at *2 (markups over 4% were excessive).

⁶¹ *Inv. Planning*, 1993 WL 289728, at *4 & n.28 (citing *Apex Fin. Corp.*, Exchange Act Release No. 16749, 1980 WL 29925, at *2 (Apr. 16, 1980)); *cf. Rita H. Malm*, Exchange Act Release No. 35000, 1994 WL 665963, at *8 & n.40 (Nov. 23, 1994) (rejecting contention that “because the NASD noted no markup, pricing or other ‘exceptions’ during its audit . . . NASD was subsequently precluded from bringing markup or supervisory charges”).

of FINRA's enforcement program that Korth requests is "beyond the scope of our authority in a proceeding to review FINRA disciplinary action pursuant to Exchange Act Section 19(e)."⁶²

3. FINRA provided Korth with a fair proceeding.

Korth claims that the proceeding was unfair because a motion it filed before the NAC to remand the case to the hearing panel for consideration of the additional evidence it adduced before the NAC was denied on unspecified "nebulous grounds." According to Korth, Enforcement fought "tooth and nail" to prevent it from introducing the additional evidence. But, as discussed above, the NAC permitted Korth to belatedly introduce the evidence before it. Given that it did so and considered that evidence itself, we see no error in its refusal to order a remand at that point. We also see no prejudice to Korth given that we have considered the additional evidence and found that it does not justify Korth's pricing.

Although Korth argues that the NAC "essentially ignored all the Additional Evidence and dismissed it with a broad brush," we do not agree. As discussed above, the record indicates that the NAC engaged in a careful, thorough, and fair review of the evidence in this case, including the supporting evidence Korth introduced belatedly. As just mentioned, we agree with the NAC's findings that the additional evidence Korth submitted did not justify its pricing. That evidence showed only that the Firm conducted basic due diligence such as reviewing offering documents or investigating the pricing of comparable securities. The evidence did not establish that Korth engaged in any special services that would justify the markups and markdowns at issue in the face of the evidence that those prices were excessive.⁶³

Korth claims that, before the NAC, its chief compliance officer "essentially received a 'gag order' and was not allowed to speak" and thus "no rebuttal of FINRA's position was ever made." The record does not support this claim. Rather, the record establishes that Korth chose to have its managing partner make its opening argument before the NAC and then leave the hearing, with the chief compliance officer as its sole remaining representative.

Enforcement objected to the chief compliance officer's appearance on the ground that FINRA rules do not permit new testimony before the NAC. Indeed, FINRA Rule 9346 expressly limits the NAC's "scope of review" to the existing "record [and] any oral argument" before the NAC. The NAC therefore sustained Enforcement's objection, stating that it would not permit

⁶² See, e.g., *John Joseph Plunkett*, Exchange Act Release No. 73124, 2014 WL 4593195, at *7 & n.33 (Sept. 16, 2014) (rejecting request for remedies exceeding authority under Section 19(e)).

⁶³ See *supra* notes 47-51; see also *Kirk L. Ferguson*, Exchange Act Release No. 34621, 1994 WL 482332, at *4 (Aug. 31, 1994) ("Ferguson fails to present any other countervailing evidence in the form of other factors or special services to persuade us that these transactions do not involve excessive markups."); cf. *Anderson*, 2003 WL 21953883, at *4 & n.21 (noting that expert witness reviewed respondent's investigative testimony to see if respondent "did something special" for the customers to "justify his markups" but "found no such justification").

the chief compliance officer “to do a formal rebuttal to Enforcement’s argument in the sense of, you know, a rebuttal. We’ll think of it as a speech.”

Nevertheless, the NAC asked the chief compliance officer a number of questions “so [the NAC] c[ould] better understand and ascertain things that are most relevant in our view to deciding this case.” In response to such questions, the chief compliance officer responded extensively and was granted considerable latitude to defend Korth’s pricing. At one point during such questioning, the chief compliance officer expressed hesitance to answer in detail because he was “going to go onto the rebuttal things.” One of the members of the NAC encouraged the chief compliance officer to expand on his answer, notwithstanding the NAC’s earlier ruling, saying: “[t]ake it easy. I appreciate your respect of our previous . . . warning [that no new testimony was permitted before the NAC]. But at the same time we are trying to understand. And . . . this is your last chance [to explain the markups and markdowns at issue].” Korth does not explain, nor do we see, how it was prejudiced by the NAC’s refusal to allow the chief compliance officer to make a formal rebuttal statement under the circumstances.

II. Sanctions

Exchange Act Section 19(e)(2) directs us to sustain FINRA’s sanctions 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.⁶⁴ FINRA censured the Firm and ordered it to pay restitution and to retain an independent consultant. We sustain the sanctions as consistent with the statutory requirements.

In assessing the appropriate sanctions to impose on Korth, FINRA looked to its Sanction Guidelines. Although the Commission is not bound by FINRA’s Sanction Guidelines, we use them as a benchmark in conducting our review under Exchange Act Section 19(e)(2).⁶⁵ For excessive markups, the Guidelines recommend a fine of \$5,000 to \$73,000, plus the gross amount of the excessive markups, as well as a suspension for up to 30 days.⁶⁶ In cases of excessive markups involving intentional or reckless misconduct or where aggravating factors predominate, the Guidelines recommend considering a suspension of up to two years or a bar.⁶⁷

Here, the NAC considered the presence of mitigating factors and determined to impose a censure rather than a fine or suspension. Specifically, consistent with Korth’s argument that the transactions at issue represented a relatively small subset of its total customer transactions during the relevant period, the NAC found that “the Firm’s conduct was aberrant and did not exhibit a

⁶⁴ 15 U.S.C. § 78s(e)(2). Korth does not allege, and the record does not show, that FINRA’s sanctions imposed an undue burden on competition.

⁶⁵ *John Joseph Plunkett*, Exchange Act Release No. 69766, 2013 WL 2898033, at *11 (June 14, 2013).

⁶⁶ See FINRA Sanction Guidelines, at 91 (Apr. 2017).

⁶⁷ *Id.*

pattern of charging excessive markups.” The NAC also found that “the Firm’s misconduct was not intentional or reckless, but rather the Firm attempted, albeit unsuccessfully in some instances, to calculate fair markups,” and the hearing panel found that Korth “had in place a policy for determining markups that it openly explained to FINRA and reliably implemented,” and “employed multiple layers of oversight for its pricing practices.” Nonetheless, Korth charged customers excessive, unfair, and unreasonable markups or markdowns in violation of FINRA and MSRB rules on 51 transactions over a two-and-a-half-year period. We agree with the NAC that the facts and circumstances of this matter “support a sanction lower than that recommended by the Guidelines” and that a censure “is appropriately remedial under these facts and circumstances.” Accordingly, we find the censure not excessive or oppressive.⁶⁸

Throughout its briefing, Korth objects to FINRA’s reliance on authority in markup and markdown cases where “dealers . . . acted egregiously, or were self-dealing or otherwise fraudulently dealing with securities” and argues that we “should disregard all these cases.” But, as discussed above, the relevant precedent establishes that Korth charged its customers excessive markups and markdowns in violation of the relevant rules, and the NAC considered that Korth did not act egregiously and the other mitigating factors in the record in censuring Korth rather than imposing a suspension or bar. We find no error in the NAC’s determination.

We also sustain the NAC’s order that Korth pay restitution, plus prejudgment interest, to the overcharged customers. The Guidelines recommend imposing restitution “to restore the status quo ante where a victim otherwise would unjustly suffer loss.”⁶⁹ Korth claims that its customers “generally benefitted handsomely from [Korth’s] work and received no harm whatsoever.” But the record establishes that customers were overcharged in 51 transactions. Whatever “general benefit[]” the customers Korth overcharged may have gained from their relationship with Korth, the question is whether Korth’s misconduct with respect to the particular trades at issue justifies restitution for the amounts they were overcharged in those trades. We agree with FINRA that it does. Restitution is appropriate where, as here, “identifiable person[s] . . . [have] suffered a quantifiable loss proximately caused by a respondent’s misconduct.”⁷⁰

⁶⁸ See *Philip L. Spartis*, Exchange Act Release No. 64489, 2011 WL 1825026, at * (May 13, 2011) (finding that “the censures will serve to alert the public . . . of the unacceptability of Applicants’ conduct” and “encourag[e] other member firms and their associated persons to” adhere to the requirements of the rule violated in the case); cf. *Investors Research Corp. v. SEC*, 628 F.2d 168, 174, 179 (D.C. Cir. 1980) (affirming a censure where it was “the lightest administrative sanction available” and the Commission determined in light of circumstances mitigating the violations “that its remedial purpose would be sufficiently advanced by censure”).

⁶⁹ FINRA Sanction Guidelines, at 4.

⁷⁰ *Newport Coast Secs, Inc.*, Exchange Act Release No. 88548, 2020 WL 1659292, at *15 & n.109 (Apr. 3, 2020) (citing FINRA Sanction Guidelines, at 4 (General Principle No. 5) (stating that, “[w]here appropriate to remediate misconduct, Adjudicators should order restitution”)); *Fuad Ahmed*, Exchange Act Release No. 81759, 2017 WL 4335036, at *26 (Sept. 28, 2017) (affirming FINRA’s order of restitution to “redress [] the harm Respondents caused”));

We further sustain the NAC's order that Korth retain an independent consultant with experience in establishing pricing procedures for sales and purchases of debt securities for the limited purpose of reviewing the Firm's pricing procedures. Such a requirement is consistent with the Guidelines. With specific reference to pricing policies, the Guidelines recommend sanctions that "demonstrate[] corrective action with respect to the firm's markup/markdown policy."⁷¹ Korth argues that it should not be required to hire such a consultant because its business has "evolved" since the relevant period and it has "essentially ended its small trade research business and in most cases does not charge markups in excess of 2.5% [and] indeed [its] average markup is much lower." But the NAC's order is appropriate to address and remedy the specific violations here. We agree with the NAC that an independent consultant "will assist the Firm going forward and help ensure that it remains compliant with MSRB and FINRA rules" and will "not charge prices in excess of what is fair and reasonable." This sanction is not excessive or oppressive and is consistent with remedial measures taken in other cases.⁷²

An appropriate order will issue.⁷³

By the Commission (Chair GENSLER and Commissioners PEIRCE, LEE, and CRENSHAW).

Vanessa A. Countryman
Secretary

Shamrock Partners, 1998 WL 786953, at *6 (finding that restitution of the total amount of excessive markdowns was appropriate, even where applicant had not benefitted from certain of the markdowns, because "[t]he fact that the firm lost money on subsequent transactions does not change the unfairness of the markdowns").

⁷¹ See FINRA Sanction Guidelines, at 91.

⁷² See, e.g., *ACAP Fin., Inc.*, Exchange Act Release No. 70046, 2013 WL 3864512, at *13 & n.115 (July 26, 2013) (requiring firm to "retain a qualified independent consultant to design and/or implement procedures for improved future compliance with regulatory requirements"), *petition denied*, 783 F.3d 763 (10th Cir. 2015).

⁷³ We have considered all of the parties' contentions. We have rejected or sustained them to the extent that they are inconsistent or in accord with the views expressed in this opinion.

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 94581 / April 1, 2022

Admin. Proc. File No. 3-19206

In the Matter of the Application of
J.W. KORTH & COMPANY, LP
For Review of Disciplinary Action Taken By
FINRA

ORDER SUSTAINING DISCIPLINARY ACTION

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

ORDERED that the disciplinary action taken by FINRA against J.W. Korth & Company, LP, is hereby sustained.

By the Commission.

Vanessa A. Countryman
Secretary