UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 77396 / March 17, 2016

Admin. Proc. File No. 3-15869

In the Matter of the Application of

THE DRATEL GROUP, INC.
and
WILLIAM M. DRATEL

for Review of Action Taken by

FINRA

OPINION OF THE COMMISSION

REGISTERED SECURITIES ASSOCIATION – REVIEW OF DISCIPLINARY PROCEEDINGS

Grounds for Remedial Action

Fraud

Recordkeeping Violations

Conduct Inconsistent with Just and Equitable Principles of Trade

Former member firm and its principal engaged in a fraudulent cherry-picking scheme, falsified and backdated order tickets, time stamped blank order tickets, failed to identify customer names on order tickets before execution, and discarded order tickets. *Held*, FINRA's findings of violations and imposition of sanctions are *sustained*.

APPEARANCES:

William M. Dratel, pro se.

Alan Lawhead and *Andrew J. Love*, for FINRA.

Appeal filed: May 12, 2014
Last brief received: August 22, 2014

I. Introduction

The Dratel Group, Inc. ("DGI"), a former FINRA member firm, and William M. Dratel ("Dratel"), DGI's principal and a formerly registered person (collectively, "Applicants"), appeal from a FINRA disciplinary action that found, in part, that Applicants engaged in a fraudulent trade allocation scheme known as "cherry picking," falsified and backdated order tickets, time stamped blank order tickets, and failed to identify customer names on order tickets until after execution.[1] For these violations, FINRA expelled DGI from its membership; barred Dratel in all capacities; and ordered Dratel to disgorge $489,000, plus interest, and to pay certain costs.[2]

The charges against Applicants stem from Dratel's use of omnibus firm accounts to day and overnight trade for both himself and his customers from October 2005 through December

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[1] Dratel entered the securities industry in September 1977 and, with his father and another business partner, founded DGI as a registered broker-dealer in 1980. Dratel became DGI's sole owner in August 1999 and began operating, managing, and supervising all aspects of DGI's business, including acting as the firm's sole broker for its customer accounts. Dratel was DGI's Chief Compliance Officer, Anti-Money Laundering Compliance Officer, and Financial Operations Officer. He was registered with FINRA as a General Securities Representative, General Securities Principal, and Financial and Operations Principal, but neither DGI nor Dratel are currently registered. DGI began operating under a waiver of the two-principal requirement in 2002. *See* NASD Rule 1021(e) (requiring members, other than sole proprietorships, to have "at least two officers or partners who are registered as principals with respect to each aspect of the member's investment banking and securities business"); NASD Rule 9610 (providing a means for applicants to request a waiver or exemption from the two-principal requirement).

[2] FINRA also found that Applicants failed to establish, maintain, and enforce supervisory procedures adequate to prevent post-execution allocation of trades and ensure timely and accurate completion of customer order tickets and that they failed to update certain customer account information periodically. DGI also opened new customer accounts without requiring customers to show photographic identification and failed to independently test its anti-money laundering program. We do not address these findings because FINRA did not impose sanctions for these violations. *See Dep't of Enforcement v. The Dratel Group, Inc.*, Complaint No. 2008012925001, 2014 WL 1803377, at *31 (May 2, 2014). Under Exchange Act Section 19(e), we review only final disciplinary sanctions imposed by self-regulatory organizations. *See* 15 U.S.C. § 78s(e)(1) (providing that the Commission shall review an action in which a self-regulatory organization, such as FINRA, imposes "any final disciplinary sanction" on any member or person associated with a member if an aggrieved person timely files an application for review).

In addition, Applicants did not challenge these findings in their application for review or their opening brief—their challenges appear in their reply brief. Under Commission Rule of Practice 450(b), reply briefs must be confined to matters in opposition briefs of other parties, and as such, we do not consider these arguments.

2006.[3] Dratel purchased securities (or initiated short positions) in the omnibus accounts, but waited to allocate those trades until after he saw how they performed. Applicants directed a higher proportion of profitable trades to Dratel's personal account and a smaller proportion of profitable trades to customers' accounts—thereby "cherry picking" the best trades for Dratel. Applicants furthered this scheme by failing to keep accurate and current records of their trades. We find that, by engaging in this conduct, Applicants willfully violated the antifraud and recordkeeping provisions of the federal securities laws and NASD Conduct Rules and that FINRA's imposition of sanctions is neither excessive nor oppressive.[4] Our findings are based on an independent review of the record.

II. Facts

Cherry picking is a practice in which securities professionals allocate profitable trades to a preferred account (like their own) and less profitable or unprofitable trades to a non-preferred account (like a customer's). To cherry pick a trade, a securities professional typically originates the trade in an omnibus firm account, without identifying the underlying customer or proprietary account for which the trade was placed, and then allocates the trade to an account after observing how that transaction performed. By directing the more profitable trades toward preferred accounts, a securities professional is effectively stealing from one customer to enrich himself or other preferred customers.[5]

Determining whether cherry picking has occurred often requires drawing inferences from a pattern of behavior, irregularities, and trading data. Cherry picking is difficult to detect. By self-dealing occasionally and skimming small amounts of customer profits, disadvantaged customers continue to earn an overall profit (although less of one), making it easier to avoid regulatory or customer scrutiny.

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3 For simplicity, this opinion occasionally refers to day and overnight trades as "day trades."

4 On July 26, 2007, the Commission approved a proposed rule change filed by NASD to amend NASD's Restated Certificate of Incorporation to reflect its name change to Financial Industry Regulatory Authority, Inc., or FINRA, in connection with the consolidation of NASD and the member-regulation, enforcement, and arbitration functions of the New York Stock Exchange. *See* Securities Exchange Act Release No. 56146, 2007 WL 5185331 (July 26, 2007). Because the conduct at issue occurred before this date, NASD Conduct Rules apply to this case.

5 Alex Raskolnikov, *Irredeemably Inefficient Acts: A Threat to Markets, Firms, and the FISC*, 102 GEO. L.J. 1133, 1152 (2014) ("Cherry-picking—a broker's trading alongside her customers while taking advantage of the cheapest execution prices and burdening the customers with the least favorable ones—comes close to outright theft.").

A. Beginning in October 2005, the proportion of profitable trades in Dratel's own account increased substantially while the proportion of profitable trades in certain discretionary accounts fell.

During the relevant period, Dratel was DGI's sole owner and broker. He placed trades in both his personal and customer accounts, including about seventy customer accounts over which he had discretionary trading authority.[6] Although the majority of Dratel's trades for customers were long-term investments, Dratel day and overnight traded in about forty of the customer accounts over which he had discretionary authority, and the majority of the trades in Dratel's personal account were day trades. At issue here are the twenty-five discretionary accounts in which Dratel day and overnight traded most actively (the "Discretionary Customers").[7] Many of these Discretionary Customers were Dratel's friends or family and were long-term DGI customers.

Dratel's general practice was to place all trades through two omnibus firm accounts.[8] Dratel, working in DGI's East Hampton, New York office, initiated all day and overnight trades by calling or sending a fax to one of two staff members who worked in DGI's Manhattan office. He provided the stock's name and quantity to trade, which the staff then entered into a system maintained by DGI's clearing broker, Oppenheimer & Co., called the Order Management System ("OMS").[9] Some of these day and overnight trades were for a single account (either his or a customer's) and some were "bunched" trades that Dratel placed for multiple accounts simultaneously, including his personal account and customer accounts.

The Manhattan staff member who worked as DGI's sales assistant had primary responsibility for entering trades into OMS. After she entered the trades into OMS, she typically called Dratel to give him the price and order identification number as trades were executed. Dratel then used this information to complete a paper OMS order ticket that reflected the order's entry and execution time. The OMS ticket reflected only the purchase or sale in the firm's

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[6] Dratel had one regular trading account and several individual retirement accounts at DGI. The trading at issue here occurred primarily in Dratel's regular trading account.

[7] FINRA excluded the other fifteen discretionary accounts from its analysis because Dratel day traded only one or two times during the relevant period.

[8] Dratel used one of two firm omnibus accounts: an "Average Price Listed Account," which he used for securities listed on the New York Stock Exchange, and an "OTC Principal Account," which he used for Nasdaq or over-the-counter securities. Broker-dealers often use average price accounts as a way to buy or sell large amounts of a given security for their customers in small increments throughout a trading session. The broker-dealer then typically transfers the accumulated long or short position to one or more individual accounts at a volume-weighted average price.

[9] An introducing broker, like DGI, deals directly with the public and originates customer accounts, and a clearing broker, like Oppenheimer, handles the mechanics of clearance and settlement of trades in those accounts. *See VanCook v. SEC*, 653 F.3d 130, 133 (2d Cir. 2011).

omnibus accounts and did not reflect the account to which the trade ultimately would be allocated.

DGI used a separate Oppenheimer system, called FiNet, to allocate trades from the omnibus accounts to customer accounts. Dratel testified that for trades involving only his account or a single customer account, his long-standing practice was to time stamp blank paper FiNet order tickets at the same time that he time stamped the paper OMS tickets. Then, sometime later in the day, he faxed a completed FiNet ticket showing the account allocation to the staff in the Manhattan office. For trades involving multiple accounts, Dratel instructed the staff in Manhattan to time-stamp a blank FiNet ticket at the same time that he placed the initial OMS order, but to wait to complete the FiNet ticket until he sent them allocation instructions.[10] The staff entered the allocation information from the paper FiNet tickets into the FiNet system. The FiNet system did not automatically record the time that a trade was entered into it, meaning that DGI staff could enter allocations anytime the system was open, including after the market had closed.[11] Oppenheimer used the information in FiNet to generate trade confirmations for DGI and its customers.

Dratel admitted that he sometimes waited until four or five o'clock before transmitting allocation instructions to the staff in the Manhattan office. The sales assistant testified that Dratel generally provided her with allocation instructions after a trade had been executed, and often provided her those instructions near or after the close of the market. The allocation instructions that Applicants produced during FINRA's investigation reflect this practice. Applicants produced allocation instructions for approximately half of Dratel's day trades, and all of these instructions had been faxed to DGI's Manhattan office *after* Dratel had closed the particular trade position.

In the first nine months of 2005, the proportion of profitable day and overnight trades in the Discretionary Customer accounts and Dratel's own account was 46% and 40%, respectively. Beginning in October 2005, the success rate of the day and overnight trades in the two types of accounts was no longer consistent. From October 2005 to December 2006, only 28% of the day and overnight trades in the Discretionary Customers' accounts were profitable, while 83% of the trades in Dratel's account were profitable.

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[10] The sales assistant also time stamped blank FiNet order tickets after completing the OMS tickets. Based on her training by two other DGI employees, she would ensure that both tickets had the same time stamp by rolling back the firm's time-stamp machine to match the time on the FiNet ticket to the time on the previously stamped OMS order ticket. Although the two employees both denied telling the sales assistant to roll back the time stamp, the Hearing Panel found the sales assistant's account to be "very credible," noting that, "[u]nlike [the other two employees], [the sales assistant] was not a long-time employee of DGI. Further, she appeared to have no animosity toward Dratel." We find no evidence in the record that provides a basis for overturning this finding. *See infra* note 34 (noting that we generally accord deference to the fact finder's credibility determinations).

[11] FiNet remained open for several hours after the market closed.

Dratel day and overnight traded the same stock, on the same day, for both himself and his Discretionary Customers 27 times in 2006. Dratel received a greater profit or smaller loss than his customers did in 21 out of 27 (78%) of those cases.

B. The higher proportion of profitable trades in Dratel's personal account coincided with an increase in his day-trading activity despite his reduced buying power.

The higher proportion of profitable trades in Dratel's own account in late 2005 and 2006, and the decrease in the proportion of profitable trades in the Discretionary Customers' accounts, coincided with an increase in Dratel's day-trading activity despite a smaller amount of equity, or buying power, in his personal account. Beginning in October 2005, Dratel increased the number of day and overnight trades he placed for both his Discretionary Customers' accounts and his own account.

Between January and September 2005, Dratel executed an average of 19.2 day and overnight trades per month in the Discretionary Customers' accounts and an average of 2.7 day and overnight trades per month in his own account. In contrast, between October 1, 2005, and December 31, 2006, Dratel executed an average of 82.9 day and overnight trades per month in his Discretionary Customers' accounts—an increase of more than 330% over the first nine months of 2005. He executed an average of 33.4 day and overnight trades per month in his own account—an increase of more than 1,130% over the first nine months of 2005. In 2006 alone, Dratel executed approximately 1,200 day and overnight trades in the Discretionary Customers' accounts and approximately 501 day and overnight trades for his personal account. By comparison, between 1999 and 2004, the highest volume of day trades in the Discretionary Customers' accounts was in 2001, when Dratel made 410 day trades, and the highest number of day trades in his personal account was in 2002, when Dratel made 411 day trades.

This increased trading volume in Dratel's own account occurred despite a drop in the equity in that account. Although Dratel had less buying power in his account, Dratel leveraged the buying power of his customers' accounts by placing his trades through the firm's omnibus accounts. As a result, Dratel placed more trades with less of his own money at risk. Between 1999 and 2002, Dratel's personal account traded at a little more than three times equity.[12] In 2003, Dratel's personal account traded at approximately five and a half times equity, and his

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[12] Between 1999 and 2002, the average equity in Dratel's personal account was approximately $510,364 per month, while the monthly average purchase volume was approximately $1,614,376 (thus he was trading at a little more than three times equity).

account traded at a little more than one times equity in 2004.[13] But in 2006, Dratel's account traded at approximately 71 times equity.[14]

In 2006, Dratel conducted his personal trades through the omnibus accounts, although it would have been more cost effective to initiate orders through his personal account.[15] Dratel did not disclose to customers that he was directing a higher proportion of profitable trades away from their accounts to benefit himself. In fact, Dratel testified that, unless it "came up," he did not disclose to his customers that he was trading for both his own and customers' accounts at the same time, or that he waited until after trades were executed before allocating these trades between his own account and customers' accounts.

Further, Dratel testified that he did not think day trading for himself and his customers through the same omnibus account, at the same time, created an issue because he "knew exactly who was . . . buying what." But Dratel acknowledged at the hearing that his personal trades in the same stocks as his customers created at least "the appearance of conflict and makes for all sorts of problems." Dratel relied on the fact that his customers trusted him. As he put it at the hearing, "[m]y customers trust me. That's why they give me discretion."

C. The increased proportion of profitable trades in Dratel's own account occurred after he experienced financial difficulties.

The increased proportion of profitable trades in Dratel's own account followed financial losses that he suffered starting in the early 2000s. In 2002 and 2003, Dratel realized total investment losses of $34,439 in his personal trading account and $252,173 in his IRA accounts.

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[13] In 2003, Dratel's average monthly account equity was approximately $132,325, with an average monthly purchase volume of $733,084 (thus trading at approximately five and one-half times equity). In 2004, Dratel's average monthly account equity was approximately $152,203, with an average monthly purchase volume of approximately $177,664 (a little more than one times equity).

[14] In the last three months of 2005, Dratel's average monthly account equity dropped to approximately $60,718, while his average monthly purchase volume rose to approximately $921,568 (approximately 15 times equity). And in 2006, Dratel's average monthly account equity was approximately $27,867 per month, while his average monthly purchase volume was $1,990,678 (approximately 71 times equity).

[15] Dratel claimed that routing his personal trades through the omnibus accounts saved him money. During FINRA's investigation, Dratel stated he used the omnibus accounts because they were "the simplest and most cost effective way" to trade, claiming that Oppenheimer charged DGI twice as much for trades placed through personal accounts (such as Dratel's or a customer's) as it did for trades placed through the omnibus accounts. At the hearing, Dratel admitted that he had no evidence to support this assertion. He also admitted at the hearing that he would have saved money by using the omnibus accounts only if he had placed bunched orders of more than four trades. Because he executed significantly more single orders than bunched trades for himself in 2006, he acknowledged that it would have been more cost effective for him to initiate orders through his own account.

Between 2004 and 2005, Dratel lost another $144,981 in his personal account and $115,509 in his IRA accounts. In addition to settling two customer arbitrations in 2002 and 2005, paying the customers a total of $233,000, Dratel also personally compensated certain DGI customers for $156,000 in trading losses between 2004 and 2005.[16]

In 2005, Dratel refinanced an approximately $4.2 million mortgage on his home with an interest-only loan. Later that year, he put his home on the market and purchased a less expensive one. He testified that he was having difficulty selling his first home and needed "a chunk of money" to purchase the second. Dratel then borrowed $434,000 from a customer, despite Dratel's acknowledgement that his firm's internal procedures barred him from doing so. Dratel ultimately was unable to sell the first home, and the bank foreclosed on it in 2008.[17]

D. FINRA investigated an increase in the number of "as of" trades at DGI and discovered numerous record-keeping inconsistencies.

In 2006, FINRA received a report indicating a significant increase in the number of "as-of trades" that DGI executed relative to its peer firms.[18] An "as-of trade" typically refers to a trade executed to correct a trading error that occurred on an earlier "as-of" date.[19]

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16 Dratel described these payments as covering "egregious" losses that he felt were the result of his own bad investment decisions. Dratel made the payments by engaging in cross-trades between his personal account and the customers' accounts. He purchased poorly performing securities from customers at an above-market price (thus covering at least part of the customers' losses) and then sold the securities from his own account into the market (often for a significant personal loss). Dratel did not disclose these trades to his customers.

17 Applicants dispute that Dratel suffered financial hardships in 2005 and 2006, but the only support for this argument is a citation to Dratel's cursory and self-serving testimony that he was not suffering financial problems during that time.

18 FINRA maintained a surveillance system in which clearing firms provided information about broker-dealers' cancelled and as-of trades. According to Applicants, the firm would use as-of trades for trades that were, for whatever reason, not entered into FiNet on the day the trade was executed. Dratel testified that, when this happened, DGI would enter the trade into FiNet the next date, but with the indication that the trade was executed "as-of" the earlier, intended date. On appeal, Applicants argue that FINRA failed to prove that they used the "as-of" trades to perpetuate their fraud. Although "[t]he use of an arbitrary 'as of' date for the purpose of creating the appearance that a transaction had occurred on a specific date, in order to disguise or hide rule violations, is an improper practice," our findings of violations do not rely on Applicants' use of as-of trades. *Kirk A. Knapp*, Exchange Act Release No. 31556, 1992 WL 365568, at *3 n.17 (Dec. 3, 1992).

19 *See, e.g.*, *SEC v. Durgarian*, 477 F. Supp. 2d 342, 352 (D. Mass. 2007) (stating that mutual fund company had a policy of allowing "as of" trades to correct trading errors); *Knapp*, 1992 WL 36556, at *3 n.17 (observing that, "[i]n common industry usage, an 'as of' trade is the correction of an error or oversight which actually occurred on the 'as of' date").

FINRA initiated an examination to investigate the increase. During the exam, FINRA's lead examiner uncovered faxes indicating that Applicants had delayed the allocation of trades.[20] In one case, she found order tickets in DGI's files for the purchase and sale of Sun Microsystems through an omnibus account that had time stamps of January 13, 2006, at 3:10 and 3:12 p.m. But the allocation instructions for those trades indicated that they were not faxed to the Manhattan office until four days later, with a notation that the trades should be entered "as of" the earlier, January 13, date. The time stamps on the physical FiNet order tickets were manually altered to reflect the January 13 trade date, with a time stamp of 9:12 a.m., which made it appear as if the allocations were made six hours *before* the initial trades were placed.

FINRA's examination also uncovered order tickets that were never time stamped. When FINRA asked Applicants to provide more information about their trades,[21] Applicants produced tickets for the same trades, now time stamped and written in different handwriting. In another instance, FINRA examiners found a ticket during their on-site examination for trades in IFS AB stock that had no time stamp; Dratel later produced a ticket for the same trade with a time stamp, for the correct time of the trade, but in different handwriting and with the wrong trade date. In another instance, Dratel executed a cross-trade between customers on January 18, 2006. For that trade, one customer's order ticket is time stamped 2:22 p.m., while the order ticket for the other side of the cross-trade is stamped 12:22 p.m. Dratel testified that he had told his staff to stamp the tickets 2:22 p.m. (when he claimed to have done the cross-trade), but said he did not know what caused the discrepancy.

III. Procedural History

In May 2010, FINRA's Department of Enforcement filed a complaint against Applicants, alleging, among other things, that Applicants executed a fraudulent trade allocation scheme and falsified and backdated order tickets to further their cherry-picking scheme. After holding a hearing, a hearing panel found Applicants liable for the alleged violations. One member of the hearing panel partially dissented, finding that "there was no direct evidence of cherry-picking" and that the Department of Enforcement's "entire case was circumstantial and built exclusively on the statistical unlikelihood of Dratel's day trading success being attributable to anything other than cherry-picking."[22] The statistical evidence, the dissenting member concluded, was based on an arbitrary and unrepresentative sample of Applicants' overall trades. The dissenting member also found no evidence that Dratel personally altered order tickets, or directed anyone else to do

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[20] The hearing panel found that FINRA's lead examiner "was credible and thorough in her review of [Applicants'] records." Applicants take issue with this conclusion, but we see no reason to overturn it because the record evidence supports the FINRA examiner's descriptions of Applicants' trading records. *See infra* note 34 (noting that we generally accord deference to the fact finder's credibility determinations).

[21] Applicants were required to provide information or documents in the investigation pursuant to NASD Rule 8210.

[22] The dissenting member agreed with the majority's finding of record-keeping violations not related to Dratel's cherry picking, but because he dissented from the majority's fraud findings, he recommended imposing lesser sanctions.

so, and that it was “not clear that allocations were made (as opposed to transmitted) after the fact.”

Applicants appealed the hearing panel’s decision to FINRA’s National Adjudicatory Council. The NAC affirmed the hearing panel’s findings and rejected the dissenting hearing panel member’s conclusion that the Department of Enforcement had used arbitrary and unrepresentative data to support its allegations. The NAC found that Dratel’s lower success rate before 2006, as compared to his Discretionary Customers, did “not counteract the extreme nature of the reversal that occurred in 2006 and the extent of the differences in 2006 between the performance of day and overnight trading in Dratel’s personal account and day and overnight trading in the [customers’] accounts, particularly given that Dratel and the customers often traded the same or similar securities.”

The NAC found Applicants’ misconduct was “highly egregious, pervasive, [and] premeditated” and affirmed the hearing panel’s decision to bar Dratel in all capacities and order him to disgorge $489,000, plus pre-judgment interest, and to pay certain costs. The NAC increased the sanction against DGI from a day-trading bar to a full expulsion from membership, but declined to impose any fines against either Dratel or DGI because it had imposed a bar and expulsion, respectively. This appeal followed.[23]

IV. Analysis

We base our findings on an independent review of the record and apply the preponderance of the evidence standard for self-regulatory organization disciplinary actions.[24] Pursuant to Exchange Act Section 19(e)(1), we determine whether Applicants engaged in the conduct found by FINRA, whether that conduct violated the relevant provisions, and whether those provisions are, and were applied in a manner, consistent with the purposes of the Exchange Act.[25]

A. Applicants engaged in an unlawful cherry-picking scheme.

The record contains sufficient evidence to find that Applicants cherry picked profitable trades away from their Discretionary Customers during the relevant period. First, the increased proportion of profitable day and overnight trades in Dratel’s own account in 2006, and corresponding decrease in the proportion of profitable trades in Discretionary Customers’ accounts, is a statistically significant departure from prior trading periods. Second, the record supports a finding that Dratel allocated trades after they had been executed, and falsified and backdated trade tickets to make it appear as if the allocations occurred when the trades were

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23 Only the NAC’s decision is before us on appeal. *See Philippe N. Keyes*, Exchange Act Release No. 54723, 2006 WL 3313843, at *6 (Nov. 8, 2006 (“[I]t is the decision of the NAC, not the decision of the Hearing Panel, that is the final action of NASD which is subject to Commission review.”).

24 *See David M. Levine*, Exchange Act Release No. 48760, 2003 WL 22570694, at *9 n.42 (Nov. 7, 2003) (citing *Seaton v. SEC*, 670 F.2d 309, 311 (D.C. Cir. 1982) (upholding preponderance of evidence standard in SRO disciplinary proceeding)).

25 15 U.S.C. § 78s(e)(1).

placed. Third, the record evidence does not demonstrate an explanation, other than cherry picking, for the increased proportion of profitable trades in Dratel's own account. As a whole, the circumstantial and indirect evidence in the record establishes by a preponderance of the evidence that Dratel cherry picked profitable trades away from his customers to benefit himself. Neither chance, faulty statistics, nor trading strategy provides a persuasive alternative explanation for the shifts in success rates and late allocation of trades.

The increase in Dratel's rate of profitable trades in his personal account during the relevant period and the decrease in the rate of profitable trades in the Discretionary Customers' accounts during the same period cannot be explained by chance alone. The proportion of profitable trades in Dratel's own account had been slightly lower during the first nine months of 2005 than the proportion of profitable trades in the Discretionary Customers' accounts (40% of Dratel's own trades were profitable versus 46% of the Discretionary Customers' trades). In comparison, from October 2005 through December 2006, Dratel's success rate when trading for his own accounts was 83%, while his success rate when trading for the Discretionary Customers' accounts was 28%.[26]

This is striking because the proportion of profitable day and overnight trades when the trades in both Dratel's own account and the Discretionary Customers' accounts are combined is consistent and stable in both periods. For all day and overnight trades placed in both Dratel's own account *and* the Discretionary Customers' accounts, the aggregate proportion of profitable trades in the first nine months of 2005 was approximately 45%, and the aggregate proportion of profitable trades from October 2005 through December 2006 was approximately 44%. Although the aggregate proportion of profitable day and overnight trades during the two periods was essentially the same, from October 2005 through December 2006, the trades that Dratel allocated to his own account were much more likely to be profitable than the trades that he allocated to the Discretionary Customers' accounts. The statistical probability that chance caused the difference between Dratel's own success rate and his Discretionary Customers' success rate from October 2005 through December 2006 was effectively zero.

We reject Applicants' argument that the statistical evidence on which FINRA relied was an arbitrary and unrepresentative sample of Applicants' trades and order tickets.[27] Applicants

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26 In its complaint, FINRA's Department of Enforcement alleged that Applicants' misconduct occurred from October 2005 through December 2006, but the hearing panel and the NAC limited their fraud findings to 2006. As part of our review, however, we examined all of the trades and statistics that were part of the record. Our discussion therefore includes statistics concerning trades over a longer period of time. The hearing panel and the NAC both found all other violations to have occurred from October 2005 through December 2006.

27 A two-proportion z-test is a hypothesis test to determine whether the difference between two ratios is statistically significant. This test requires there to be a "null hypothesis" and an "alternative hypothesis." The "null hypothesis" is the hypothesis that the observed results are caused solely by chance. The "alternative hypothesis" is the hypothesis that the observed results are from some non-random cause. The "z score" or "z statistic" indicates how many standard deviations the alternative hypothesis results are from those of the null hypothesis. A z-statistic of 1.96 (or -1.96) indicates a result that is approximately two standard deviations away from the

(continued…)

fault FINRA for focusing on day and overnight trades that represented a tiny fraction of the overall trading activity during the relevant period.[28] The analysis's focus on day and overnight trades was reasonable because Dratel testified that he engaged in "purely day trading" when trading for his own account. The long-term trades FINRA excluded from its analysis were

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(…continued)

expected result, and anything above that number in absolute value is generally considered statistically significant. The z-statistic can be expressed as a "p-value," which is the probability that the difference between the null hypothesis and Dratel's actual trade results occurred by chance. The larger the z-score, the smaller the p-value, and a p-value smaller than 5% is generally considered statistically significant. *See SEC v. Selden*, 632 F. Supp. 2d 91, 94 (D. Mass. 2009) ("A p value of 0.05 or less (indicating a 95% level of certainty that the observed effect was not randomly induced) is generally accepted as showing a statistically-significant effect."); FEDERAL JUDICIAL CENTER, REFERENCE MANUAL ON SCIENTIFIC EVIDENCE 250 (3d ed. 2000) ("Large p-values indicate that a disparity can easily be explained by the play of chance: The data fall within the range likely to be produced by chance variation. On the other hand, if p is very small, something other than chance must be involved: The data are far away from the values expected under the null hypothesis.").

In this case, the null hypothesis was that Dratel would achieve the same trading results (namely achieve the same ratio of profitable trades in his personal account to the profitable trades in the Discretionary Customers' accounts) simply by chance. The alternative hypothesis was that this ratio was a result of some non-random cause, *e.g.*, cherry picking by Applicants.

The Z statistic for Dratel's trading activity, from October 2005 through December 2006, was 20.39— highly statistically significant. The associated p-value indicates that there is effectively zero probability of his trading results being the result of chance. By comparison, in the nine months before Dratel's cherry-picking scheme began in late 2005, the z-statistic was 0.53 with a p-value of 59%, meaning there was no statistically significant difference between Dratel's success when trading for his own account or for his customers' accounts during that time.

Applicants argue that FINRA failed to show that this increased success rate was more than what occurred at some other time in Dratel's trading history. It may be that Dratel had a higher proportion of successful trades at some other time in his trading career, but Applicants point to no evidence of this. Even if this were true, we still find for all the reasons discussed herein that FINRA provided ample evidence to conclude that Dratel's increased success rate during the relevant time is best explained by Applicants' cherry picking trades.

[28] Dratel argues, for instance, that FINRA focused on the twenty-seven trades where he traded the same stock on the same day as his customers, which he claims represent fewer than 1.6% of all trades at issue during the relevant time. This is not an accurate comparison, however, because FINRA looked at *all* of Dratel's day and overnight trades in his and the Discretionary Customers' accounts, not just the twenty-seven instances where Dratel traded the same stock on the same day as his customers—and this larger pool of trades represents approximately 31% of all trades at issue.

allocated exclusively to customer accounts; analyzing them for cherry picking would be to no end, since there are no long-term trades that Dratel allocated to his personal accounts. To test for cherry picking here, it was necessary to compare the performance of similar trades across personal and customer accounts.

Applicants also fault FINRA for excluding the fifteen customer accounts from its analysis that contained only one or two day and overnight trades during the relevant period. FINRA's exclusion of the fifteen customer accounts, however, does not affect the persuasiveness of its statistical evidence. If FINRA had included in its analysis two day and overnight trades in each of the fifteen customer accounts, and we assume that all of those trades were profitable for customers during the relevant period, there would not be a significant change in the proportion of profitable trades in Dratel's account versus the Discretionary Customers' accounts. And the probability of that success occurring by chance would still be effectively zero.

Finally, Applicants fault FINRA for failing to explain its rationale for calculating Dratel's success rate on a per-customer basis instead of a per-stock basis. FINRA expressly considered this issue and concluded that Applicants' preferred methodology of using a per-stock calculation did not provide an accurate comparison between Dratel's success rate and that of his customers. By considering multiple transactions in the same security as a single trade, FINRA observed, Applicants' approach would effectively hide those occasions where Dratel made multiple trades in a given security during the day, and later allocated the better trades to himself.[29] Ultimately, it is appropriate to use a per-customer analysis, and Dratel offers no authority suggesting such an approach is invalid or improper.[30]

Besides challenging the statistical evidence, Applicants argue that the higher proportion of profitable trades in Dratel's account was the result of Dratel's use of a more aggressive trading strategy for himself than for his customers. This is not supported by his testimony or any other record evidence.

Dratel testified that he "always" or "usually" used a more aggressive day-trading strategy for himself. He claimed this difference in strategy was "part of [his] fiduciary duty . . . not to put

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[29] To illustrate the difference, assume, *arguendo*, that Dratel purchased a stock twice in a given day (first at $9 per share and later at $10) and that he then sold all of those shares on the same day at $9.50, allocating the winning trade (purchased at $9) to his own account and the losing trade (purchased at $10) to a customer's account. Analyzing these transactions on a per customer basis, as FINRA did, would show these differing outcomes. But analyzing the transactions on a per stock basis, as Applicants suggest, would result in only a single data point, which would show that neither a winning nor a losing trade took place because the stock's average purchase price would equal its sale price ($9.50)—thus hiding Dratel's profit and his customer's loss. *SEC v. K.W. Brown & Co.*, 555 F. Supp. 2d 1275, 1299 (S.D. Fla. 2007) (finding evidence of cherry picking by analyzing trades on a per customer basis).

[30] Applicants argue that FINRA failed to show that this increased trading volume was greater than any other increase between 1999 and 2004, but Applicants themselves introduced an exhibit showing that Dratel's trading volume in 2006 was significantly higher than in any other year between 1999 and 2004.

the customers at a greater risk than they need to be." But that testimony was contradicted by his other hearing testimony and his earlier investigation testimony.

At the hearing, he admitted that he held a higher percentage of his customers' "day-trade positions" overnight than he did in his own account—and acknowledged that holding these positions overnight was riskier than ending the day flat.[31] Further, Dratel conceded that he used the same trading strategy for himself and his customers on the occasions when he traded the same stock, on the same day, for both accounts. And in his investigative testimony he said that he "day trade[d] the same way for everyone. . . . Day trading is day trading" and that there was "[u]sually no difference" between how he selected stocks for himself and for customers, although he was also "sure" there were times when "the customers had the riskier [stock].

The actual trading activity also contradicts Dratel's claim. He traded the same stock on the same day twenty-seven times in 2006. And despite using the same trading strategy for those stocks, Dratel received a greater profit or smaller loss than his customers in twenty-one of the twenty-seven trades (78%).[32]

Applicants also claim that their increased proportion of profitable trades (and their customers' corresponding decreased proportion of profitable trades) can be explained by Dratel's use of an online subscription service called TheFlyOnTheWall.com ("TheFly"). Dratel testified that he began to use TheFly in 2004. When asked to explain why, during 2006, the recommendations from TheFly were more profitable for himself than his customers, Dratel claimed that 2006 was a year with "less volatility of the customers' stocks, even though the stocks were volatile, I would also try to buy the customers the ones with the better recommendations." Dratel's explanations about his trading strategy, however, do not explain the dramatic change in the proportion of profitable trades between his and his customers' accounts during the relevant period. As a result, we are not persuaded by Applicants' claims that the changes in success rate were the result of trading strategy.[33]

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[31] Dratel held approximately 27% (323 of 1,164 trades) of his customers' day-trade positions overnight, while he held only 5% (21 of 423 trades) of his own day-trade positions overnight. *See also Day Trading: Your Dollars at Risk*, at 1, *available at* http://www.sec.gov/investor/pubs/daytips.htm ("True day traders do not own any stocks overnight because of the extreme risk that prices will change radically from one day to the next, leading to large losses.").

[32] Applicants contend that this difference in profits "was because Dratel charged himself slightly less commission on these trades," but provide no citation to the record supporting this claim. *See* 17 C.F.R. § 201.450(b) (requiring that all exceptions to the findings or conclusions under review "shall be supported by citation to the relevant portions of the record, including references to the specific pages relied upon").

[33] *K.W. Brown*, 555 F. Supp. 2d at 1304 (finding that defendants engaged in cherry picking where the disparity between the success of their and their customers' trades, "cannot be explained through market forces and . . . is more likely than not . . . caused from cherry picking").

Dratel claims that he made his allocation decision when he initiated his day and overnight trades (and thus did not cherry pick). But the only evidence supporting his claim is his own testimony, which the hearing panel did not credit. We agree that his testimony is not credible.[34] Dratel testified that he recorded all allocation decisions as he made them on a sheet of paper (for multiple customer orders) or on an order ticket (for single customer orders). But when asked whether he ever produced the allocation sheets to FINRA, Dratel responded, "No, because I never keep them." He explained that he "d[id]n't run [his] business that way, as just a data collection center." Dratel similarly admitted that DGI did not number or code its order tickets (on which he recorded single-trade allocations) and that he therefore could have discarded a ticket before the trade was entered in FiNet, and created a new one, without anyone knowing that another ticket had existed, and had been replaced or discarded. There was, in other words, no evidence to corroborate Dratel's claims about how he actually allocated the trades. There was, however, significant documentary evidence, discussed above—including falsified tickets, backdated tickets, and allocation instructions that were faxed post-execution[35]—all of which suggests he allocated trades after they were executed.[36]

The statistical and documentary evidence supports FINRA's finding by a preponderance of the evidence that Applicants cherry picked profitable trades away from the Discretionary Customers' accounts. Dratel has also offered no persuasive alternative to FINRA's findings. Although the burden of proving that Applicants engaged in violative conduct rests with FINRA, Applicants bore the burden of producing evidence to support their claimed factual defenses to the

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[34] "We generally accord considerable weight and deference to the fact finder's credibility determination." *Mitchell H. Fillet*, Exchange Act Release No. 75054, 2015 WL 3397780, at *8 (May 27, 2015) (finding no reason to depart from a FINRA hearing panel's credibility determination); *cf. Rita J. McConville*, Exchange Act Release No. 51950, 2005 WL 1560276, at *6 n.21 (June 30, 2005) (observing in an administrative proceeding that the credibility determination of an initial fact finder "is entitled to considerable weight and deference because it is based on hearing the witnesses' testimony and observing their demeanor"), *petition denied*, 465 F.3d 780 (7th Cir. 2006)).

[35] Applicants argue that FINRA failed to produce original copies of the faxes admitted as exhibits during trial, contending that FINRA failed to establish that the "fax [marks on DGI's records] were genuine and unaltered." Applicants have not presented evidence that the documents were altered by FINRA, such as their own original records from which these documents were copied.

[36] DGI's supervisory procedures also required that Dratel, as the designated sales supervisor, ensure that all "employee or employee-related orders are so designated on the order ticket." But Dratel admitted that none of the OMS order tickets for his trades contained any indication that the trade was for him. Rather, the tickets stated only that they were for DGI's omnibus account. DGI's procedures similarly required that "each [Registered Representative] effecting a trade for any discretionary account must designate the account number prior to entering any order." Dratel admitted that he did not provide account numbers on order tickets before executing trades through DGI's omnibus accounts.

charged conduct.[37] Applicants had ample opportunity to offer their own expert analysis or other countervailing evidence about why Dratel's rate of profitable trades in his personal account during the relevant period and the decrease in the Discretionary Customers' rate of profitable trades during the same period was not due to cherry picking. Instead, Applicants provided unpersuasive explanations—which without adequate supporting evidence amounts to little more than assertions—for Dratel's trading success that, as we explain above, do not outweigh FINRA's evidence of cherry picking.

B. Applicants' Cherry-Picking Scheme Violated The Antifraud Provisions of The Securities Laws.

We sustain FINRA's finding that Applicants violated Exchange Act Section 10(b), Exchange Act Rule 10b-5, and NASD Rule 2120 by engaging in an unlawful cherry-picking scheme. Section 10(b) makes it "unlawful for any person directly or indirectly . . . to use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention of" Commission rules.[38] Rule 10b-5 implements the Commission's authority under Section 10(b) through three subsections that are "mutually supporting rather than mutually exclusive."[39]

The first subsection, Rule 10b-5(a), prohibits "directly or indirectly . . . employ[ing] any device, scheme, or artifice to defraud."[40] The second subsection, Rule 10b-5(b), prohibits "directly or indirectly . . . mak[ing] any untrue statement of a material fact or [omitting] to state a material fact necessary in order to make the statements made . . . not misleading."[41] The third, Rule 10b-5(c), prohibits "directly or indirectly . . . engag[ing] in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person."[42] Liability

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37 *See, e.g.*, *Atlanta-One, Inc. v. SEC*, 100 F.3d 105, 109–10 (9th Cir. 1996) (finding that NASD had not impermissibly shifted the burden of proof when it asked respondent during the hearing process to explain certain commissions that were alleged to have been excessive); *Kirlin Sec., Inc.*, Exchange Act Release No. 61135, 2009 WL 4731652, at *13 n.87 (Dec. 10, 2009) ("As always, the burden of proving that an applicant engaged in conduct violating [FINRA rules] rests with FINRA; however, as we have stated previously, the applicant bears the burden of producing evidence to support his claimed defenses." (citing *James M. Bowen*, Exchange Act Release No. 34195, 1994 WL 268834, at *2 (June 10, 1994) (affirming violation for failure to pay arbitration award timely where applicant "produced no documents, letters, or witnesses to corroborate his assertions" about having conducted good faith negotiations with arbitration counterparty))).

38 15 U.S.C. § 78j(b).

39 *Cady, Roberts & Co.*, Exchange Act Release No. 6668, 1961 WL 60638, at *4 (Nov. 8, 1961).

40 17 C.F.R. § 240.10b-5(a).

41 *Id.* § 240.10b-5(b).

42 *Id.* § 240.10b-5(c).

under each subsection requires a showing of scienter, "a mental state embracing intent to deceive, manipulate, or defraud."[43]

NASD Rule 2120, in place at the time of the conduct, similarly prohibited members from "effect[ing] any transaction in, or induc[ing] the purchase or sale of, any security by means of any manipulative, deceptive or other fraudulent device or contrivance."[44]

We conclude that Applicants violated Exchange Act Section 10(b), Rule 10b-5, and NASD Rule 2120 because their cherry picking was a deceptive "device, scheme [and] artifice to defraud"[45] and a deceptive act, practice, and course of business which operated as a "fraud or deceit"[46] on their customers.[47] It is "well-settled" that "a discretionary account automatically

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43 *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12 (1976). Scienter may be established through a heightened showing of recklessness. *Rockies Fund, Inc. v. SEC*, 428 F.3d 1088, 1093 (D.C. Cir. 2005). This has been "defined as . . . an extreme departure from the standards of ordinary care, and which presents a danger of misleading buyers or sellers that is either known to the [actor] or is so obvious that the actor must have been aware of it." *David Henry Disraeli*, Exchange Act Release No. 57027, 2007 WL 4481515, at *5 (Dec. 21, 2007); *accord SEC v. Ficken*, 546 F.3d 45, 47–48 (1st Cir. 2008) (finding that Section 10(b) and Rule 10b–5 require "a high degree of recklessness" (quotations omitted)); *Rockies Fund*, 428 F.3d at 1093 (finding that Rule 10b-5 requires a showing of extreme recklessness).

44 NASD Rule 2120 is now FINRA Rule 2020. *See Notice of Filing of a Proposed Rule Change*, Exchange Act Release No. 58095, 2008 WL 2971979, at *3 (July 3, 2008) (observing FINRA's belief that transferring NASD Rule 2120 into the Consolidated FINRA Rulebook as FINRA Rule 2020 with no changes was consistent with the provisions of Exchange Act Section 15A(b)(6), which requires that FINRA's rules be designed to prevent fraudulent and manipulative acts and practices and to protect investors and the public interest), *Rule Change Approved Without Modification*, 2008 WL 4468749 (Sept. 25, 2008).

45 17 C.F.R. § 240.10b-5(a).

46 *Id.* § 240.10b-5(c).

47 *Cf. K.W. Brown*, 555 F. Supp. 2d at 1304 (finding that, "by its very nature," a cherry-picking scheme operated as a fraud in violation Rule 10b-5(a) and (c)). FINRA found that Applicants willfully violated the antifraud and recordkeeping provisions, noting that such a finding gives rise to a statutory disqualification under Exchange Act Section 3(a)(39)(F). *See* 15 U.S.C. § 78c(a)(39)(F) (stating that a person is subject to a statutory disqualification if, among other things, he has committed any act enumerated in Exchange Act Section 15(b)(4)(D), 15 U.S.C. § 78o(b)(4)(D), which refers, among other things, to willful violations of the Exchange Act). Under Article III, § 3, of FINRA's By-Laws, a person subject to a statutory disqualification cannot become or remain associated with a FINRA member unless the disqualified person's member firm applies for and is granted, in FINRA's discretion, relief from the statutory disqualification. *See Joseph S. Amundsen*, Exchange Act Release No. 69406, 2013 WL 1683914, at *1 n.4 (Apr. 18, 2013).

(continued…)

implies a general fiduciary duty between a broker and customer."[48] And a fiduciary has "an affirmative duty of . . . full and fair disclosure of all material facts."[49] Nondisclosure in breach of a fiduciary duty "satisfies section 10(b)'s requirement . . . [of] a 'deceptive device or contrivance.'"[50] Dratel breached his fiduciary duty by failing to disclose that he was cherry picking trades for his own personal benefit.[51] As FINRA concluded, "[a] reasonable investor surely would find material Dratel's subordination of discretionary customers' interests to his personal interests." Accordingly, Applicants' conduct was deceptive within the meaning of Section 10(b).

Having found that Applicants acted deceptively, we also find that they employed a device, scheme, or artifice to defraud in violation of Rule 10b-5(a) and engaged in an act, practice, or course of business that operated as a fraud in violation of Rule 10b-5(c). Each cherry-picked trade was a device Applicants used to defraud a customer of profits. The series of cherry-picked trades constituted an over-arching scheme to defraud the Discretionary Customers by stealing profits on select trades in a way that would be difficult to detect. The Applicants used the falsified and backdated FiNet tickets as artifices to defraud and make their cherry-

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(…continued)

Because we find that Applicants acted with scienter in violating the antifraud provisions, and because Dratel admitted to time stamping blank order tickets (and directing his staff to do the same) and to adding customer names to order tickets after execution, we agree with FINRA that Applicants acted willfully. *Cf. Robert D. Tucker,* Exchange Act Release No. 68210, 2012 WL 5462896, at *10 (Nov. 9, 2012) (stating that a willful violation under the federal securities laws simply means "'that the person charged with the duty knows what he is doing.'" (quoting *Wonsover v. SEC,* 205 F.3d 408,414 (D.C. Cir. 2000))).

[48] *United States v. Wolfson*, 642 F.3d 293, 295 (2d Cir. 2011); *accord United States v. Skelly*, 442 F.3d 94, 98 (2d Cir. 2006); *United States v. Szur*, 289 F.3d 200, 208 (2d Cir. 2002).

[49] *Geman v. SEC*, 334 F.3d 1183, 1189 (10th Cir. 2003) (quotation omitted); *see also Paulson Inv. Co., Inc.*, Exchange Act Release No. 19603, 47 SEC 886, 1983 WL 32198, at *2 (Mar. 16, 1983) (quoting *Chasins v. Smith, Barney & Co., Inc.*, 438 F.2d 1167, 1172 (2d Cir. 1970) (finding a Rule 10b-5 violation where firm failed to disclose that its buy recommendations "could have been motivated by its own market position rather than the intrinsic desirability of the securities for [its customers]")).

[50] *United States v. O'Hagan*, 521 U.S. 642, 653 (1997); *see also United States v. Finnerty*, 533 F.3d 143, 148 (2d Cir. 2008) (holding that deception "irreducibly entails some act that gives the victim a false impression" such as "a false statement, breach of a duty to disclose, or deceptive communicative conduct"); *see generally Stoneridge Inv. Partners, LLC v. Scientific-Atlanta*, 128 S. Ct. 761, 769 (2008) ("Conduct itself can be deceptive.").

[51] *See Basic Inc. v. Levinson*, 485 U.S. 224, 231–32 (1988); *see also Vernazza v. SEC*, 327 F.3d 851, 859 (9th Cir. 2003) (stating that even "potential conflicts of interest are 'material' facts with respect to clients and the Commission"); *cf. K.W. Brown*, 555 F. Supp. 2d at 1305 (finding that defendants made materially false statements when failing to disclose that they were placing their interests in front of their customers by keeping profitable trades for themselves).

picking scheme successful. Applicants made it appear as if trades were allocated at the time the trade orders were placed by time stamping the paper FiNet tickets at the same time that the OMS tickets were stamped (even though Applicants delayed their completion of the allocation instructions on the FiNet tickets until after a position was closed).

Similarly, each cherry-picked trade was an act that operated as a fraud or deceit on the affected customer by depriving that customer of profits. Applicants' allocation of trades after they were able to see which trades would be profitable, followed by cherry picking, was a practice and course of business that operated as a fraud on the Discretionary Customers.

The record also supports a finding that Applicants acted with scienter. Dratel controlled all of the trading and allocation decisions. Dratel therefore knew that he was trading in the same securities as his customers and that he was favoring his own account over theirs.[52] Dratel's dramatically increased personal success rate, at the expense of his customers' success, further demonstrate that he intended to defraud his customers. Dratel also demonstrated his intent to deceive when he failed to disclose his activities to his customers and attempted to conceal his misconduct from FINRA.[53] We therefore find that Dratel acted with scienter and that, as DGI's owner and sole registered person, Dratel's actions and scienter are imputed to DGI.[54]

Applicants argue that FINRA erred in citing several cases —*James C. Dawson*,[55] *SEC v. K.W. Brown,*[56] and *SEC v. Slocum*.[57] In *Dawson*, we imposed an associational bar on an investment adviser after finding that he had been enjoined from violating the anti-fraud provisions of the securities laws as a result of his cherry-picking scheme.[58] Applicants contend that *Dawson* is distinguishable because the respondent there had established new trading accounts at the beginning of his cherry-picking scheme, while Applicants had been using the

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52 *See, e.g.*, *K.W. Brown*, 555 F. Supp. 2d at 1307 (finding scienter where "it was impossible for [defendant] not to know about the cherry-picking scheme since he was doing the actual trading that constituted the cherry[-]picking scheme").

53 *See Phillip J. Milligan*, Exchange Act Release No. 61790, 2010 WL 1143088, at *5 (Mar. 26, 2010) ("[A]ttempts to conceal misconduct indicate scienter.").

54 *See Disraeli*, 2007 WL 4481515, at *5 n.25 ("The scienter of a corporation's officers and directors establishes the scienter of the corporation for purposes of the antifraud provisions." (internal quotation marks and citation omitted)); *cf. SIG Specialists, Inc.*, Exchange Act Release No. 51867, 2005 WL 1421103, at *7 (June 17, 2005) ("It is well-established that a firm may be held accountable for the misconduct of its associated persons because it is through such persons that a firm acts.").

55 Investment Adviser Act Release No. 3057, 2010 WL 2886183, at *1 (July 23, 2010) (barring an investment advisor who engaged in a cherry-picking scheme to divert profitable securities trades he made on behalf of a hedge fund to his personal trading account).

56 555 F. Supp. 2d at 1304 (finding defendants liable for fraudulent cherry-picking scheme).

57 334 F. Supp. 2d 144.

58 2010 WL 2886183.

same omnibus accounts for years.[59] This distinction is irrelevant. Unlike Dawson, who needed to open a new account to enable his cherry picking, Applicants already had a system in place that allowed for late allocation among accounts at the same broker. The fact that Applicants did not need to open a new account does not have any effect on their liability.[60]

In *K.W. Brown,* the court found, among other things, that defendants violated the anti-fraud provisions through their cherry-picking scheme.[61] Applicants contend unlike in their case, the customers in *K.W. Brown* experienced significant overall losses, and the defendants often got better prices than their customers, failed to identify customer allocations until after execution, and provided an inadequate explanation for using an average price account. Contrary to Applicants' argument, these facts—or ones similar to them—are present in this case.

Although Applicants' overall customer base may not have suffered losses, the Discretionary Customers suffered an aggregate net day-trading loss of $185,748 during the relevant period. Even if the Discretionary Customers had realized net day-trading profits, the Discretionary Customers would have made greater profits if Applicants had not cherry picked certain profitable trades away from their accounts. Applicants received better prices than their customers when trading the same stock, on the same day. Applicants also failed to identify customer allocations until after execution, and did not provide an adequate explanation for using the omnibus accounts for both their own and their customers' trades.

Slocum[62] also does not demand a contrary result. There, a district court found that the Commission had not proven its allegations that defendants engaged in a cherry-picking scheme. The court, based on the facts in the case before it, credited the defendants' explanations for why certain trades in their customers' accounts were less profitable, while trades in their own accounts were more profitable. Here, in contrast, the hearing panel expressly did *not* credit Applicants' explanations about their trades. And we, too, do not find Applicants' explanations credible.

Applicants argue that *Slocum* allows an inference of non-cherry picking if there is evidence their customer accounts "performed extremely well,"[63] which they allege was true for their customers between 1999 and 2006. But in *Slocum*, the Commission had relied on evidence of "hypothetical client losses," not evidence of actual customer losses on cherry picking trades.[64] Unlike in *Slocum*, statistical evidence from Applicants' *actual* day and overnight trades shows that their Discretionary Customers performed worse on those trades than Dratel during the relevant period. At no point does the court in *Slocum* establish a *per se* rule, as Applicants suggest, that overall profitability negates an inference of cherry picking.

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59 *Id.* at *1.

60 *Id.*

61 555 F. Supp. 2d at 1304.

62 334 F. Supp. 2d 144.

63 *Id*. at 173.

64 *Id.* at 169–73.

Within the context of the facts of this case, we find it compelling that there is both testimony and documentary evidence that Dratel allocated day trades after they had been completed and he knew whether the trades had been profitable. Further, Dratel's increased trading volume corresponded with a decrease in available personal equity. Similar evidence was simply not present in *Slocum*.

C. Applicants violated the recordkeeping provisions.

In carrying out their cherry-picking scheme, Applicants also violated various recordkeeping provisions. Exchange Act Section 17(a)(1)[65] requires registered brokers and dealers to make and keep records as required by Commission rules. Exchange Act Rule 17a-3(a)(6) requires broker-dealers to indicate on every brokerage order ticket the account for which an order is entered, the time the order was received, the time of entry, the time of execution (to the extent feasible), and whether the order was entered pursuant to an exercise of discretionary authority.[66] Similarly, Exchange Act Rule 17a-3(a)(7) requires broker-dealers to indicate on every proprietary order ticket the account for which an order is entered, the time the order was received (when the purchase or sale is with a customer other than a broker-dealer), the time of execution (to the extent feasible), and whether the order was entered pursuant to an exercise of discretionary authority (when the purchase or sale is with a customer other than a broker-dealer).[67]

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65 15 U.S.C § 78q(a)(1).

66 17 C.F.R. § 240.17a-3(a)(6) (requiring that a memorandum of "each brokerage order" show, among other things, "the time the order was received; the time of entry; the price at which executed; the identity of each associated person, if any, responsible for the account; . . . and, to the extent feasible, the time of execution or cancellation"); *see also Statement Regarding the Maintenance of Current Books and Records by Brokers and Dealers*, Exchange Act Release No. 10756 (April 26, 1974), 39 FR 16440, 16440 (May 9, 1974) (stating that "[b]y their nature the memoranda of brokerage and principal transactions should be prepared at the time of the transactions").

67 17 C.F.R. § 240.17a-3(a)(7) (requiring that a memorandum for "each purchase and sale for the account of the member, broker, or dealer" show, among other things, "the price and, to the extent feasible, the time of execution; and, in addition, where the purchase or sale is with a customer other than a broker or dealer, a memorandum of each order received, showing the time of receipt; the terms and conditions of the order and of any modification thereof; the account for which it was entered; the identity of each associated person, if any, responsible for the account"); *see also Statement Regarding the Maintenance of Current Books and Records by Brokers and Dealers*, Exchange Act Release No. 10756 (Apr. 26, 1974), 39 FR 16440, 16440 (May 9, 1974) (stating that "[b]y their nature the memoranda of brokerage and principal transactions should be prepared at the time of the transactions").

Implicit in these requirements is "that the records be accurate, which applies 'regardless of whether the information itself is mandated.'"[68] NASD Rule 3110(a) similarly requires that members make and preserve books, accounts, records, memoranda, and correspondence in conformity with all applicable laws, rules, and regulations, which includes Exchange Act Rules 17a-3 and 17a-4. NASD Rule 3110(j) requires that, before any customer order is executed, the name or designation of the account for which the order is to be executed must be placed on the order ticket. And NASD Rule 2110 requires the observance of high standards of commercial honor and just and equitable principles of trade. A violation of any other Commission or NASD rule constitutes a violation of NASD Rule 2110.[69] Proof of scienter is not required to establish violations of either the SEC or FINRA recordkeeping provisions.[70]

Applicants failed to meet these obligations. Applicants admit that they or their staff time stamped blank order tickets, failed to identify customers on order tickets until after execution,[71] and threw order tickets away.[72] Applicants' staff also admitted to backdating time stamps on tickets. When asked during FINRA's investigation about suspicious or questionable order tickets, Applicants also produced several obviously altered tickets that contradicted earlier tickets, and thereby providing compelling evidence that Applicants falsified order tickets to conceal their misconduct from FINRA.

On appeal, Applicants admit that their records contained errors, but describe them as mere clerical mistakes. The evidence is to the contrary. Applicants played an active and knowing role in intentionally mismarking, altering, or omitting information in records in furtherance of their scheme. Dratel admits, for example, that he purposefully left customer

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68 *Eric J. Brown*, Exchange Act Release No. 66469, 2012 WL 625874, at *11 (Feb. 27, 2012) (quoting *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, Exchange Act Release No. 33367, 1993 WL 538899 at *7 (Dec. 22, 1993)).

69 *See Stephen J. Gluckman*, Exchange Act Release No. 41628, 1999 WL 507864, at *6 (July 20, 1999) (stating that "our long-standing and judicially-recognized policy [is] that a violation of another Commission or NASD rule or regulation . . . constitutes a violation of [NASD] Conduct Rule 2110."); *see also Fillet*, 2015 WL 3397780, at *13 (observing that "providing misleading and inaccurate information to FINRA is conduct contrary to high standards of commercial honor and is inconsistent with just and equitable principles of trade").

70 *See Fillet*, 2015 WL 3397780, at *12–13 (observing that neither NASD Rule 2110 nor 3110 have scienter requirements); *Orlando Joseph Jett*, Exchange Act Release No. 49366, 2004 WL 2809317, at *23 (Mar. 5, 2004) (finding that scienter is not required to establish a primary violation of Exchange Act Section 17(a)(1) or the rules thereunder).

71 We note that FINRA Rule 4515.01, which is based on NYSE Rule Interpretation 410/02, permits investment advisers to allocate orders by noon of the next business day following the trading session. DGI was not registered as an investment adviser.

72 Although the NAC decision did not discuss Exchange Act Rule 17a-4 violations, NASD Rule 3110(a) requires members to make *and preserve* books and records in conformity with all applicable laws, rules, and regulations, including Exchange Act Rule 17a-4.

names and account numbers blank when time stamping FiNet order tickets and completed the information later. Dratel also admitted to directing his staff to throw order tickets away, and Applicants' staff admitted to rolling back the time stamp machine so that time stamps on FiNet tickets matched time stamps on OMS tickets. Although Applicants claim that they did not know DGI staff was rolling back the time stamp machine or making other mistakes, the hearing panel did not find Dratel's testimony on this issue to be credible, and we see no basis to disagree with that finding.

Accordingly, DGI violated Exchange Act Section 17(a)(1), Exchange Act Rules 17a-3(a)(6) and (7), and Applicants violated NASD Rule 3110.[73] Because Dratel handled all of DGI's trading, and completed or directed DGI staff to complete all of the firm's order tickets, Dratel also caused DGI's recordkeeping violations.[74] By violating these recordkeeping provisions, Applicants also violated NASD Rule 2110.

V. 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.[75] As part of this review, we consider any aggravating or mitigating factors presented[76] and whether the sanctions that FINRA imposed are remedial and not punitive.[77] Though not bound by FINRA's Sanction Guidelines, we use them as a benchmark for our review under Exchange Act Section 19(e)(2).[78] Here, we sustain FINRA's decision to bar Dratel in all capacities; expel DGI from membership; and order Dratel to pay disgorgement, interest, and certain costs.

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73 NASD Rule 115 made NASD's rules, including the books and records requirements, equally applicable to "[FINRA] members and persons associated with a member," such as Dratel. NASD Rule 115; *see also Edward S. Brokaw*, Exchange Act Release No. 70883, 2013 WL 6044123, at *16 (Nov. 15, 2013).

74 *K.W. Brown*, 2012 WL 625874, at *11 (observing that a person "can be a cause of a broker-dealer's violations of the books and records provisions 'if he was responsible for an act or omission that he knew or should have known would contribute to the violation.'" (quoting *Stephen J. Horning*, Exchange Act Release No. 56886, 2007 WL 4236161, at *12 (Dec. 3, 2007), *aff'd*, 570 F.3d 337 (D.C. Cir. 2009))).

75 15 U.S.C. § 78s(e)(2). Applicants do not allege, and the record does not show, that the FINRA rules at issue are, or that FINRA's application of them was, inconsistent with the Exchange Act. Nor do Applicants allege, nor does the record show, that FINRA's sanctions in this case imposed an undue burden on competition.

76 *See Saad v. SEC*, 718 F.3d 904, 906 (D.C. Cir. 2013); *PAZ Sec., Inc. v. SEC*, 494 F.3d 1059, 1064–65 (D.C. Cir. 2007).

77 *See PAZ*, 494 F.3d at 1065.

78 *Capwest Sec., Inc.*, Exchange Act Release No. 71340, 2014 WL 198188, at *9 (Jan. 17, 2014) (citation omitted). FINRA adopted the Sanction Guidelines to ensure "greater

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A. FINRA's expulsion of DGI and bar of Dratel in all capacities was neither excessive nor oppressive.

FINRA's Sanction Guidelines recommend that adjudicators consider barring an individual and expelling a firm for egregious cases of fraud.[79] The Guidelines similarly recommend a possible bar and expulsion for egregious violations of the recordkeeping provisions.[80] The sanctions that FINRA imposed fit within these recommendations and, for the reasons below, are neither excessive nor oppressive.

Applicants' violations were egregious. Their customers, many of whom were friends, family, and long-term customers, entrusted Applicants with discretion and authority over their accounts. Dratel knew this discretionary authority created a fiduciary duty between himself and his customers.[81] Rather than acting in good faith towards their customers, Applicants stole from them by surreptitiously directing more profitable trades to themselves.[82] By arguing that their violations represented only a small fraction of their overall trading activity, Applicants seem to imply that their violations were not widespread. But Applicants' cherry picking occurred over the course of at least twelve months, and involved a significant number of day and overnight trades.

Several other aggravating factors also weigh in favor of a bar. First, Applicants' violations demonstrated a high degree of scienter.[83] Their cherry-picking scheme was done in a calculating manner, as it "required specific preparation and the deliberate allocation of a disproportionate number of profitable trades to [his] own account."[84] Dratel carried out this calculated scheme to defraud his customers of profits and enrich himself. Dratel also admitted that he knowingly withheld material information about the cherry picking from his customers. And Applicants' recordkeeping violations were intentional, as Dratel admitted that he purposefully stamped blank order tickets, waited to complete order tickets, and directed his staff

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consistency, uniformity, and fairness in the sanctions that are imposed for violations." *Richard A. Neaton*, Exchange Act Release 65598, 2011 WL 5001956, at *12 n.38 (Oct. 20, 2011).

79 *FINRA Sanction Guidelines*, at 88 (2013) (hereafter "*Guidelines*").

80 See Guidelines, at 29.

81 *See United States v. Skelly*, 442 F.3d 94, 98 (2d Cir. 2006) (stating that a fiduciary duty "[m]ost commonly . . . exists in situations in which a broker has discretionary authority over the customer's account").

82 *See, e.g., Dawson*, 2010 WL 2886183, at *3 (finding applicant's allocation of profitable trades to himself and losing trades to his customers to be egregious misconduct that warranted a bar); *see also Guidelines*, at 7 (Principal Consideration No. 18) (stating that adjudicators should consider the character of transactions at issue).

83 *See Guidelines*, at 7 (Principal Consideration No. 13) (stating that adjudicators should consider whether respondents' misconduct was intentional, reckless, or negligent).

84 *Dawson*, 2010 WL 2886183, at *5.

to throw tickets away. Second, Applicants intentionally sought to mislead their regulator by producing altered order tickets in the course of the investigation. This conduct both demonstrates the extent to which Applicants were willing to go to avoid detection and undermines FINRA's ability to regulate its members.[85] In fact, Applicants' production of false records to FINRA would warrant a bar and expulsion by itself.[86]

Third, the breadth of Applicants' misconduct is an aggravating factor. Their actions involved multiple violations, affected twenty-five different customer accounts, and occurred over the course of at least a year.[87] Their recurrent actions exposed the Discretionary Customers to the potential for significant, ongoing losses, while earning illicit profits for themselves.[88]

Fourth, Applicants' recordkeeping violations demonstrate an inability or unwillingness to follow other regulatory requirements. Applicants characterize their recordkeeping violations as mere "clerical mistakes" and claim that the evidence shows "an astonishingly good record of accuracy by Dratel's staff." To the contrary, the evidence shows an institutional failure to maintain accurate records. Dratel admitted, among other things, that he (or his staff, at his direction) regularly stamped blank tickets, waited to complete those tickets until after trades were completed, and threw records away. Dratel also was dismissive toward his regulatory obligations, testifying that he did not keep records of his allocation instructions because he did not run his business "as just a data collection center."

Finally, Applicants' misconduct fits within a broader pattern of noncompliance.[89] In November 2003, for example, DGI settled a disciplinary matter in which FINRA found that DGI

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85 *See, e.g., John Edward Mullins*, Exchange Act Release No. 66373, 2012 WL 423413, at *18 (Feb. 10, 2012) (affirming bar by considering aggravating factors, including that applicant sought to conceal his conduct); *Guidelines*, at 6 (Principal Consideration No. 10) (stating that adjudicators should consider whether respondents attempted to conceal their misconduct).

86 *Cf. Geoffrey Ortiz*, Exchange Act Release No. 58416, 2008 WL 3891311, at *9 (Aug. 22, 2008) (finding that a bar was appropriate where applicant provided false information to NASD during an investigation, which "'mislead[s] NASD and can conceal wrongdoing' and thereby 'subvert[s]' NASD's ability to perform its regulatory function and protect the public interest" (quoting *Michael A. Rooms*, Exchange Act Release No. 51467, 2005 WL 742738, at *5 (Apr. 1, 2005), *aff'd*, 444 F.3d 1208 (10th Cir. 2006))).

87 *See Guidelines*, at 6 (Principal Consideration Nos. 8, 9) (stating that adjudicators should consider whether respondents engaged in numerous acts or a pattern of misconduct and whether the misconduct occurred over an extended period).

88 *See William J. Murphy*, Exchange Act Release No. 69923, 2013 WL 3327752, at *24 (July 2, 2013) (affirming FINRA's imposition of a bar where applicant's misconduct "benefitted himself while injuring his customers"); *Guidelines*, at 6–7 (Principal Consideration Nos. 11, 17) (stating that adjudicators should consider whether respondents' misconduct resulted in customer harm and the potential for gain for the respondents).

89 *John Joseph Plunkett*, Exchange Act Release No. 69766, 2013 WL 2898033, at *12 (June 14, 2013) (observing that "FINRA routinely considers an applicant's disciplinary history in

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had failed to report equity transactions timely, failed to disclose required information accurately, failed to report time on order tickets completely, and failed to prepare certain order tickets properly.[90] In July 2006, Applicants settled a disciplinary matter in which FINRA found that they had failed to timely report two customer complaints that they subsequently settled, failed to amend and update Dratel's Form U4, and failed to timely obtain an opinion of counsel concerning a lawsuit that could have had a material impact on DGI's net capital computation.[91] Finally, in May 2015 FINRA found that Applicants committed numerous rule violations related to the disclosure of liens and judgments, creation and preservation of order memoranda, maintenance of books and records, and other fundamental regulatory requirements.[92]

Applicants argue that their disciplinary history is misleading and that neither of the two settled proceedings "represent more than 10% of the complainant's damage request" and that "these were suits brought for their nuisance value and nothing more." Applicants further contend that the two settlements "had nothing to do with customers whatsoever" and that they were "technical in nature." Even if Applicants settled the two proceedings for reasons of efficiency, they are part of Applicants' disciplinary history, which "provides evidence of whether an applicant's misconduct is isolated, the sincerity of the applicant's assurance that he will not commit future violations and/or the egregiousness of the applicant's misconduct."[93] Applicants' settled matters ultimately are part of a pattern of regulatory failures that raise serious concerns about Applicants' ability to comply with their obligations in the future.[94] Even ignoring the two

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determining the appropriate sanction"); *Guidelines*, at 2 (General Principle No. 2) (stating that "[a]djudicators should always consider a respondent's disciplinary history in determining sanctions" and observing that "[a]n important objective of the disciplinary process is to deter and prevent future misconduct by imposing progressively escalating sanctions on recidivists … including barring registered persons and expelling firms"); *Guidelines*, at 6 (Principal Consideration No. 1) (stating that adjudicators should consider "[t]he respondent's relevant disciplinary history" and citing General Principle No. 2).

90 *The Dratel Group, Inc.*, NASD Case No. CLI030027 (Nov. 25, 2003).

91 *The Dratel Group, Inc.*, NASD Case No. 2005001123301 (July 24, 2006).

92 *Dep't of Enforcement v. The Dratel Group, Inc.*, FINRA Discip. Proc. No. 2009016317701, 2015 FINRA Discip. LEXIS 10, at *63–64 (May 6, 2015) (suspending Dratel for twenty-five business days, jointly and severally fining Applicants $31,000, fining Dratel an additional $5,000, fining the firm an additional $2,500, and ordering Applicants to pay certain fees and costs).

93 *Consolidated Inv. Servs., Inc.*, Exchange Act Release No. 36687, 1996 SEC LEXIS 83, at *24 (Jan. 5, 1996); *accord Midas Sec., LLC*, Exchange Act Release No. 66200, 2012 WL 169138, at *16 (Jan. 20, 2012).

94 *See, e.g.*, *North Woodward Fin. Corp.*, Exchange Act Release No. 74913, 2015 WL 2151765, at *13 (May 8, 2015) (affirming FINRA's imposition of a bar and expulsion where FINRA found applicants' disciplinary history, including a settled matter, to be an aggravating factor).

settled matters, FINRA's 2015 decision alone is evidence of Applicants' inability to comply with their regulatory obligations.

We also find no mitigating factors that weighed against the imposition of a bar. The number of cherry-picked trades or percentage of trades that Applicants cherry picked is not a mitigating factor. As FINRA correctly observed, Applicants must "comply with [FINRA's] high standards of conduct at all times."[95] And defrauding customers, no matter the frequency, may warrant the imposition of severe sanctions.[96]

The letters and testimony that Applicants submitted from their customers are not mitigating evidence. As we have repeatedly held, "we look beyond the interests of particular investors in assessing the need for sanctions, to the protection of investors generally."[97] Although the customers opined about what they believe to be Dratel's general honesty and integrity, none of the customers indicated that they fully comprehended the seriousness of the misconduct at issue.[98]

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95 *Rooms v. SEC*, 444 F.3d 1208, 1214 (10th Cir. 2006); *see also Donner Corp. Int'l*, Exchange Act Release No. 55313, 2007 WL 516282, at *11 (Feb. 20, 2007) (finding that respondent's "compliance with the law in some instances does not excuse its [other violations]"); *Robert Fitzpatrick*, Exchange Act Release No. 44956, 2001 WL 1251680, at *6 (Oct. 19, 2001) (finding that NASD "correctly ruled that prompt compliance with some requests for information does not excuse dilatory compliance with other requests").

96 *See Keith Springer*, Exchange Act Release No. 45439, 2002 WL 220611, at *8 (Feb. 13, 2002) (finding that fraud violations "go[] to the heart of the duties owed by a securities professional to his investor clients"); *Marshall E. Melton*, Advisers Act Release No. 9865, 2003 WL 21729839, at *9 (July 25, 2003) (holding that "[c]onduct that violates the antifraud provisions of the federal securities laws is especially serious and subject to the severest of sanctions").

97 *Dawson*, 2010 WL 2886183, at *4; *see also Arthur Lipper Corp.*, Exchange Act Release No. 11773, 1975 WL 163472, at *15 (Oct. 24, 1975) (stating that "we must weigh the effect of our action or inaction on the welfare of investors as a class and on standards of conduct in the securities business generally").

98 *See Dawson*, 2010 WL 2886183, at *4 (rejecting respondent's reliance on client letters where it was "not clear from the letters that all of these clients fully comprehend the gravamen of the misconduct at issue").

Applicants' also suggest that that FINRA exhibited prejudice and vindictiveness by not considering what Applicants alleged was their favorable relationship with their customers. Applicants emphasize their efforts to cover their customers' losses in 2004 and 2005 with cross trades, and claim that FINRA wrongly labeled these actions as a "negative." FINRA reasonably considered Dratel's cross trades, correctly noting that the trades partly explained why his customers had not suffered greater losses in 2004 and 2005, but reasonably found, as we do, that the cross trades also contributed to Dratel's increasingly strained financial situation and motive to recoup his losses by cherry picking.

We reject Applicants' argument that a bar and expulsion are inappropriately severe relative to other cases. Applicants contrast their misconduct to other firms that they allege, without citation, "are all still free to do business with customers after having ***admitted to cheating their customers out of hundreds and hundreds of billions of dollars***." (Emphasis in original). These unsupported references to other cases do not provide a basis for concluding that FINRA's sanctions were inappropriate.[99]

For these reasons, we find that Applicants pose a serious threat to investors, warranting their bar and expulsion.[100] These sanctions serve the remedial goals of general and specific deterrence, encouraging Applicants and other securities professionals to comply with their regulatory obligations.[101] We accordingly find that FINRA's imposition of sanctions is neither excessive nor oppressive and serves the public interest and protects investors.

B. FINRA's disgorgement is neither excessive nor oppressive.

We also affirm FINRA's $489,000 disgorgement order. FINRA's Guidelines state that disgorgement generally should be ordered where, as here, the respondents had substantial ill-gotten gains.[102] We have held that FINRA, in cases involving misconduct, may require respondents to disgorge their entire financial benefit.[103] Determining the amount of that

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99 *See* 17 C.F.R. § 201.450(b) (requiring that all exceptions to the findings or conclusions under review "shall be supported by . . . concise argument including citation of such statutes, decisions and other authorities as may be relevant").

100 *See, e.g.*, *Mission Sec. Corp.*, Exchange Act Release No. 63453, 2010 WL 5092727, at *14 (Dec. 7, 2010) (holding that "applicants' demonstrated lack of fitness to be in the securities industry . . . supports the remedial purpose to be served by [a bar and expulsion]"); *Dawson*, 2010 WL 2886183, at *6 (finding respondent's lack of appreciation for the wrongful nature of his misconduct indicative of a potential for recurrence).

101 *See PAZ Sec.*, 494 F.3d at 1066 ("'[G]eneral deterrence is not, by itself, sufficient justification for expulsion or suspension . . . [but] may be considered as part of the overall remedial inquiry.'" (quoting *McCarthy v. SEC*, 406 F.3d 179, 189 (2d Cir. 2005))); *see, e.g.*, *Arthur Lipper*, 1975 WL 163472, at *15 (finding that a bar was "necessary to provide the deterrent effect" because "to be truly remedial, [the proceedings] must have a deterrent effect on other investment company managers who may be tempted to enrich themselves at the expense of their beneficiaries").

102 *See Guidelines*, at 10 (Technical Matters); *see also Michael David Sweeney*, Exchange Act Release No. 29884, 1991 WL 716756, at *5 (Oct. 30, 1991) ("[D]isgorgement is intended to force wrongdoers to give up the amount by which they were unjustly enriched.").

103 *See, e.g.*, *Anthony A. Grey*, Exchange Act Release No. 75839, 2015 WL 5172955, at *12 (Sept. 3, 2015) (citing *Guidelines*, at 5 ("In cases in which the record demonstrates that the respondent obtained a financial benefit from his or her misconduct, where appropriate to remediate misconduct, Adjudicators may require the disgorgement of such ill-gotten gains by fining away the amount of some or all of the financial benefit derived, directly or indirectly.")).

disgorgement "does not require precision."[104] Rather, "calculating disgorgement must recognize that separating legal from illegal profits exactly may at times be a near-impossible task."[105] The amount of disgorgement therefore needs to be only "a reasonable approximation" of the ill-gotten gains causally connected to the violation.[106]

Dratel acknowledges that he generated profits of approximately $489,000 in his personal account through day and overnight trading in 2006. Although some of those profits may have flowed from legal trades, some of the profits also flowed directly from Dratel's illegal cherry picking. It is nearly impossible to separate the two because of the deceptive nature of Dratel's misconduct, including his failure to maintain accurate records, his falsification of documents, and his use of inaccurate date and time stamps on trade tickets.[107] In those circumstances, we find that Dratel's 2006 day-trading profits are a reasonable approximation of his unjust enrichment. Dratel does not challenge that calculation on appeal, and therefore failed to meet his burden of showing that the amount of disgorgement is not a reasonable approximation.[108] We

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[104] *K. W. Brown*, 555 F. Supp. 2d at 1312.

[105] *SEC v. First City Fin. Corp., Ltd.*, 890 F.2d 1215, 1231 (D.C. Cir. 1989).

[106] *Id*.

[107] *See, e.g.*, *supra* note 5and accompanying text (discussing the difficulty of detecting cherry picking); *First City Fin. Corp.*, 890 F.2d at 1231 (holding that "disgorgement need only be a reasonable approximation of profits causally connected to the violation" and any risk of uncertainty in calculating disgorgement is borne by the wrongdoer that created that uncertainty); *SEC v. Balboa*, No. 11 Civ. 8731(PAC), 2015 WL 4092328, at *4 (S.D.N.Y. July 6, 2015) (ordering disgorgement of commissions where defendant's illegal conduct "directly created" the uncertainty of distinguishing between legally and illegally derived profits); *Guy P. Riordan*, Exchange Act Release No. 61153, 2009 WL 4731397, at *21 (Dec. 11, 2009) (ordering disgorgement in kickback scheme despite fact that "it was not possible to separate out individual transactions awarded to Riordan and conclude that they were not obtained by the kickback scheme simply because they were not linked to specific kickbacks"), *petition denied*, 627 F.3d 1230 (Dec. 28, 2010).

[108] *See Zacharias v. SEC*, 569 F.3d 458, 472–73 (D.C. Cir. 2009) (observing that, where disgorgement cannot be exact, the "well-established principle is that the burden of uncertainty in calculating ill-gotten gains falls on the wrongdoers who created that uncertainty"); *SEC v. Lorin*, 76 F.3d 458, 462 (2d Cir. 2006) (holding that "[w]here disgorgement calculations cannot be exact, 'any risk of uncertainty . . . should fall on the wrongdoer whose illegal conduct created that uncertainty'" (quoting *SEC v. Patel*, 61 F.3d 137, 140 (2d Cir. 1995))).

therefore find that FINRA's order for Dratel to disgorge his $489,000 in profits, plus prejudgment interest,[109] is neither excessive nor oppressive and serves the remedial purpose of depriving him of the benefit of his misconduct.[110]

An appropriate order will issue.[111]

By the Commission (Chair WHITE and Commissioners STEIN and PIWOWAR).

Brent J. Fields
Secretary

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[109] *See Terence Michael Coxon*, Exchange Act Release No. 48385, 2003 WL 21991359, at *14 (Aug. 21, 2003) ("[E]xcept in the most unique and compelling circumstances, prejudgment interest should be awarded on disgorgement, among other things, in order to deny a wrongdoer the equivalent of an interest free loan from the wrongdoer's victims."), *aff'd*, 137 F. App'x 975 (9th Cir. 2005).

[110] *Cf. Sweeney*, 1991 WL 716756, at *5 ("[D]isgorgement is intended to force wrongdoers to give up the amount by which they were unjustly enriched."). Applicants do not challenge FINRA's order that they pay costs totaling $18,611.60, which we also sustain.

[111] 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. 77396 / March 17, 2016

Admin. Proc. File No. 3-15869

In the Matter of the Application of

THE DRATEL GROUP, INC.
and
WILLIAM M. DRATEL

for Review of 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 The Dratel Group, Inc., and William M. Dratel, and the assessment of costs imposed, is sustained.

By the Commission.

Brent J. Fields
Secretary