BEFORE THE NATIONAL ADJUDICATORY COUNCIL

FINANCIAL INDUSTRY REGULATORY AUTHORITY

In the Matter of Department of Enforcement, Complainant, vs. Andrew Gonchar Staten Island, NY, and Polyvios Polyviou Upper Saddle River, NJ, Respondents.	DECISION Complaint No. CAF040058 Dated: August 26, 2008

Registered representatives fraudulently interpositioned a third party between their member firm and 71 retail customers in 142 trades and charged the customers fraudulently excessive mark-ups that they failed to disclose to the customers. Held, findings and sanctions affirmed (with a minor modification).

Appearances

For the Complainant: Philip Berkowitz, Esq., Leo Orenstein, Esq., Financial Industry Regulatory Authority Department of Enforcement.

For the Respondents: Martin Kaplan, Esq., Melvyn Falis, Esq., Brian D. Graifman, Esq., Gusrae, Kaplan, Bruno & Nusbaum.

Decision

Pursuant to NASD Rule 9311, Andrew Gonchar ("Gonchar") and Polyvios Polyviou ("Polyviou") appeal a Hearing Panel's October 26, 2006 decision, which found that, in 142 sales to 71 retail customers, the respondents fraudulently interposed a third party between their member firm and the customers and charged the customers fraudulently excessive mark-ups that they did not disclose. The Hearing Panel barred Gonchar and Polyviou in all capacities and fined

each of them $115,000. After a thorough review of the record, we affirm the Hearing Panel's findings and sanctions (with one minor adjustment).[1]

I. Background

Gonchar entered the securities industry in 1988 and joined CIBC World Markets Corp. ("CIBC" or "the Firm") where he was registered as a general securities representative in October 1996. He left CIBC in February 2002 and is not currently working in the securities industry. Polyviou also entered the securities industry in 1988. He was associated with CIBC as a general securities representative from October 1996 through February 2002 and is not currently working in the securities industry.

In 1988, Gonchar and Polyviou formed a partnership, which they maintained at several firms that they subsequently joined. CIBC hired Gonchar and Polyviou as a team. At CIBC, they shared an office and a registered representative number. Although they maintained separate customer lists, they serviced each other's clients as necessary and shared all remuneration equally on every trade.

II. Procedural History

FINRA's Department of Enforcement ("Enforcement") filed the complaint in this matter in August 2004.

Causes one through four of the complaint alleged, and the Hearing Panel found, that between August 2000 and January 2002, Gonchar and Polyviou fraudulently interpositioned the account of Avalon Asset Management, Inc. ("Avalon") between CIBC and 71 retail clients in 142 convertible bond transactions and charged the customers fraudulently excessive mark-ups that Gonchar and Polyviou did not disclose to their customers. The Hearing Panel found that Gonchar and Polyviou violated Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act"), Rule 10b-5 thereunder, and NASD Rules 2110, 2120, 2320, and 2440. The Hearing Panel barred Gonchar and Polyviou in all capacities, fined each $115,000, and imposed costs.

This appeal followed.

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[1] As of July 30, 2007, NASD consolidated with the member firm regulation functions of the NYSE and began operating as the Financial Industry Regulatory Authority ("FINRA"). References in this decision to FINRA shall include, by reference and where appropriate, references to NASD.

III. Facts

A. Convertible Bond Trading at CIBC

All of the trades at issue, like the majority of Gonchar's and Polyviou's business, involved sales of convertible bonds to retail clients.[2] A convertible bond, like a straight bond, provides the investor with a fixed interest payment and a return of principal, but also includes a right to exchange the bond for the common stock of the issuer at a conversion price or conversion ratio per bond as stated in the indenture.[3] During the relevant period, CIBC's convertible bond trading desk engaged in proprietary trading of convertible bonds and bought convertible bonds from and sold them to institutional and retail clients. CIBC did not make a market in the five convertible bonds that are at issue in this case: Juniper Networks, Inc. ("JNI"), Redback Networks, Inc. ("RNI"), Protein Design Labs, Inc. ("PDLI"), Enzon, Inc. ("EI") and Cell Therapeutics, Inc. ("CTI"). At the time, the market for these bonds was not transparent. Convertible bonds were not listed on any exchange and transactions involving these bonds were not reported. CIBC's convertible bond traders used computerized models to determine the theoretical prices of various bonds.[4]

When Gonchar and Polyviou initially joined CIBC, they obtained convertible bond prices from the convertible bond trading desk. Retail trades constituted approximately one-tenth of one percent of the trading on CIBC's convertible bond trading desk, and Gonchar and Polyviou felt

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[2] Gonchar estimated that, during the relevant period, 35 to 45 percent of respondents' business involved convertible bond sales and that compensation on convertible bond trades accounted for approximately 60 percent of their income.

[3] Convertible bonds generally have a par value of $1,000 per bond like most bonds, but a lower coupon rate and yield than the coupon rate and yield of a nonconvertible bond similar in rating and remaining maturity because of the value of the conversion feature. Convertible bonds are usually subordinated debentures, and senior creditors, such as other bondholders and any bank lender, have priority in bankruptcy or insolvency. As a result, a convertible bond may have a lower credit rating than a nonconvertible bond of the same issuer. Many convertible bond issuers are smaller companies whose common stock is considered speculative. Typically, the price of a convertible bond rises with the price of the underlying common stock, although usually to a lesser degree. Intra-day changes in the prices of convertible bonds often are attributable to intra-day changes in the prices of the underlying securities. Changes in interest rates and changes in the volatility of the stock price also affect convertible bond pricing. *See* Frank J. Fabozzi, *The Handbook of Fixed Income Securities* 1103-1126 (McGraw-Hill 6th ed. 2001)(1983); Nicholas G. Apostolou, *Keys to Investing in Corporate Bonds* 35-38 (Barron's Educational Series, Inc. 1990).

[4] To use the models, the traders at CIBC input information about the convertible bond that they were pricing, such as maturity date, the price of the underlying stock, the conversion price or conversion ratio, the coupon rate, and the yield and volatility of the underlying stock price.

that CIBC's convertible bond traders were more responsive to CIBC's institutional convertible bond salespeople. In February 2000, CIBC created a retail liaison position on the convertible bond trading desk. The first person to fill that position (and the person in that position during the relevant time) was a former CIBC sales assistant, Debora Frank ("Frank").[5]

As part of Frank's role as retail liaison on CIBC's convertible bond trading desk, she provided Gonchar, Polyviou, and other retail salespeople with convertible bond prices daily.[6] Generally, Gonchar and Polyviou contacted Frank at the start of the trading day to obtain price levels on specific convertible bonds. Frank provided them with price levels that she obtained from traders on the convertible bond desk. Frank testified that these prices were not considered firm quotes. Instead, they were price levels or indications of where the trader was willing to purchase or sell bonds based on the underlying stock prices. With respect to the five bonds at issue, Frank obtained price levels for JNI from trader Timothy Reilly ("Reilly") and price levels for RNI, PDLI, CTI, and EI from trader Kevin Lowe ("Lowe"). Throughout the trading day, Frank provided Gonchar and Polyviou with updated prices that she obtained either from the traders or by using a computerized model available to her at her desk. In order to obtain a price via the computerized model at Frank's desk, Frank had to input the trading price of the underlying stock, which she generally obtained from Gonchar or Polyviou.[7]

Gonchar, Polyviou, and other retail convertible bond salespeople also placed their trades with Frank. CIBC sometimes maintained an inventory in certain convertible bonds. If Gonchar, Polyviou, or another salesperson sought to purchase convertible bonds that CIBC held in inventory, Frank executed the trade with the trading desk. If CIBC did not hold a bond in inventory, Frank obtained prices and purchased bonds from brokers' brokers through CIBC's

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[5] Gonchar testified that, before Frank assumed the position of retail liaison, CIBC's convertible bond traders never answered his calls or responded to his messages, and they failed to provide him with prices comparable to the prices that salespeople at other firms obtained from their convertible bond trading desks.

[6] Frank testified that she was not treated well on the convertible bond desk because she supported retail rather than institutional salespeople. She stated that she liked Gonchar and Polyviou because they treated her with respect. After Frank left CIBC, Gonchar and Polyviou helped her to secure employment trading convertible bonds at other firms, and Gonchar and Polyviou remained customers of Frank's and were responsible for more than half of her business while she remained associated with other member firms. Frank is no longer working in the securities industry.

[7] Frank conveyed to Gonchar and Polyviou convertible bond prices "versus" (i.e., based on) the price of the underlying stock. For example, "PDLI 30, 106-1/2, 107-1/2" meant that CIBC was willing to buy PDLI bonds from a retail customer at $106.50 per bond and sell to retail customers at $107.50 per bond based on the underlying stock price of $30 per share.

convertible bond trading desk.[8] Additionally, at respondents' request, she also sometimes executed cross trades to effect convertible bond transactions for Gonchar and Polyviou, regardless of whether CIBC held the bonds in inventory.[9]

CIBC utilized an electronic system to input convertible bond trades. The system generated electronic order tickets; CIBC did not utilize paper order tickets for convertible bond transactions. For each convertible bond trade, Frank was required to enter into the electronic order entry system: the name of the security, the price, the quantity, the mark-up or mark-down, and the customer account number. Ideally, Frank would have input the information into the computer system at the time of the trade, but she did not. Instead, Frank maintained notes on paper throughout the day and input the information into the system when she had time or at the end of the day.[10] As such, CIBC's records regarding the times of the Firm's retail trades were not accurate.

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[8] CIBC maintained a real-time inventory system that enabled convertible bond traders to monitor activity in their trading accounts on a real-time basis. Frank, however, did not have access to the system.

[9] A cross trade is a sale from one customer account to another customer account. Frank testified that, when she began as retail liaison, she was uncomfortable executing cross trades without approval from the trading desk because she considered pricing on cross trades to be in a "grey area." She stated that, as her level of comfort increased, she executed cross trades without first consulting with the trading desk. She stated that she never denied a salesperson's request to execute a cross trade because it was up to the salespeople to decide whether to do a cross trade. Frank further testified that the convertible bond trading desk had no involvement in setting prices for cross trades, and the evidence suggested that CIBC's trading desk did not even see cross trades that Frank executed. (Frank testified that cross trades appeared on both her screen and the trader's screen. The Hearing Panel did not credit Frank's testimony, which was contradicted by Reilly, a CIBC convertible bond trader whose testimony the Hearing Panel did credit.)

[10] Frank testified that her telephone rang continuously throughout the day and that other individuals on the convertible bond desk were unwilling to answer her phone. Gonchar and Polyviou testified that, prior to the terrorist attacks of September 11, 2001, when Frank, Gonchar and Polyviou were located in the World Trade Center, Gonchar and Polyviou completed paper order tickets that they time stamped and sent to Frank by runner to enable her to enter the trades into CIBC's electronic system. Gonchar and Polyviou contended that, during part of the time period after September 11, they continued to send paper order tickets to Frank via runner even though they were located in a different building than Frank. Although Gonchar and Polyviou produced copies of paper order tickets for trades other than the trades at issue, they were unable to produce any for the trades at issue. Gonchar and Polyviou argue that, when they left CIBC, they left their paper order tickets behind and that the paper tickets would have provided accurate information as to the times of the trades. CIBC was unaware that Gonchar and Polyviou had utilized paper order tickets and were unable to produce them.

Frank was responsible for a facilitation account known as "the 128 Account."[11] CIBC did not allow Frank to maintain inventory in the 128 Account, hold positions overnight, or take risk positions. The sole purpose of the 128 Account was to facilitate order flow between the Firm and its retail customers in riskless principal transactions and to capture compensation in the form of mark-ups and mark-downs. Peter Barnes ("Barnes"), the head of compliance for CIBC's convertible bond trading desk, reviewed the 128 Account daily to ensure that it was flat at the end of the day, but did not otherwise monitor trading activity in the account during the trading day.[12]

CIBC prohibited mark-ups and mark-downs in excess of three percent on retail purchases or sales of convertible bonds. Gonchar testified that initially when he and Polyvou joined CIBC, the Firm limited the total mark-up/mark-down for both sides of a cross trade to five percent. CIBC later reduced that limit to four percent total for both sides of a cross trade.

B. CIBC Customer Avalon

Avalon was one of Gonchar and Polyviou's most active convertible bond customers. AC, a former colleague of Gonchar and Polyviou at CIBC, used Avalon as his personal trading vehicle.[13] In addition to the account that Avalon maintained at CIBC, it maintained numerous

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[11] For trades that were not cross trades, Frank would confirm a price with a trader and then execute a retail purchase by transferring the bonds by journal entry from the trading account into the 128 Account and selling the bonds to the customer from the 128 Account after adding a mark-up that was determined by the salesperson. For cross trades, Frank purchased from one customer into the 128 Account and sold to the second customer from the 128 Account. On the cross trades at issue in this case, Frank added a mark-down in an amount specified by Gonchar or Polyviou on the 128 Account purchase and a mark-up also in an amount specified by Gonchar or Polyviou on the 128 Account sale.

[12] On April 8, 2004, FINRA settled an action against CIBC. FINRA found that CIBC: failed to register Frank as a Series 55 equity trader limited representative, failed to supervise respondents' and the trading desk's trading of convertible bonds, and charged retail customers unfair and excessive prices as a result of respondents' interpositioning scheme. CIBC agreed to a censure, a $75,000 fine, and an order to pay restitution to injured customers of $154,700 plus $50,600 in interest. (Before settling, CIBC had already paid injured customers an additional sum of $300,000.) On July 30, 2004, FINRA settled an action against Frank. FINRA censured Frank and fined her $10,000 for executing trades with brokers' brokers without being registered as a Series 55 equity trader limited representative.

[13] AC is no longer within FINRA's jurisdiction, so he could not be compelled to testify, and he refused respondents' request that he appear voluntarily.

brokerage accounts with other brokerage firms.[14] Gonchar testified that, in addition to convertible bond trading, Avalon was very interested in purchasing shares in any initial or secondary offerings that CIBC allocated to Gonchar and Polyviou. Gonchar testified that 85 percent of the time, he and Polyviou allocated their shares in initial and secondary offerings to Avalon over other customers.

C. CIBC's Recordings of Gonchar's and Polyviou's Telephone Conversations with Frank

CIBC recorded all of Frank's telephone conversations on the convertible bond trading desk. In January 2002, an exception report prompted CIBC's compliance department to examine respondents' convertible bond trades and ultimately to review recorded conversations between Gonchar, Polyviou, and Frank. CIBC recycled the tapes used to make the recordings on the convertible bond desk every 15 days, so recordings of trading days prior to January 4, 2002 were destroyed. The record contains recordings for only eight of the 72 trading days at issue (January 4, 7, 8, 14, 15, 16, 17, and 29, 2002).

A pattern emerged from the recordings for these eight days: Gonchar purchased bonds through Frank in the morning without identifying the purchasing customer. Sometime thereafter, Gonchar informed Frank that he intended to cross the bonds before the end of the day, and he would give Frank the high stock price of the day to obtain price levels for the cross trades and then ask to execute the cross trade one point above the level.[15] Polyviou later called with account numbers (for Avalon, as the original purchaser, and for the purchasing retail customers in the cross trade), and Frank executed the cross trades.

D. Enforcement's Interpositioning Theory and Mark-up Calculations

Enforcement argued that, in 142 transactions on 72 days between August 2000 and January 2002, Gonchar and Polyviou used the 128 Account as a de facto trading account. On each trading day at issue, Gonchar and Polyviou bought convertible bonds early in the day in the 128 Account purportedly for a customer who they did not identify. Later in the day, after they located a retail customer to purchase the same bonds, they identified Avalon to Frank as the customer who had purchased the bonds earlier that day, then executed cross sales (based on the high stock price of the day) between Avalon and the purchasing retail customers through the 128 Account. By conducting the retail sale as a cross trade, Gonchar and Polyviou were able to execute the trades away from CIBC's trading desk. In each instance, Avalon paid a mark-up on

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[14] Eric Zuckerman ("Zuckerman"), AC's former partner, testified that AC left the securities business in late 1999 and began conducting his personal trading through Avalon. Zuckerman characterized AC as a sophisticated and aggressive trader and a day trader.

[15] Gonchar and Polyviou testified that CIBC allowed them to price cross trades 2.5 to five points above or below the levels that Frank quoted them. Frank stated that CIBC granted her discretion to price convertible bonds one to two points above or below the levels that she obtained from her computerized model.

its initial purchase and a mark-down on its sale back to the 128 Account. The retail customers paid mark-ups on their purchases from the 128 Account. On 16 of the 72 days, Avalon also traded back and forth with itself through the 128 Account before the respondents eventually sold the bonds to retail customers. In each instance in which Avalon bought and sold the same bonds through the 128 Account, Avalon paid a mark-down on each sale and a mark-up on each purchase. In all 142 transactions, the retail customers paid more for the bonds than Avalon paid on the same day, regardless of market movement in the underlying stock. Additionally, despite paying mark-ups and mark-downs on each leg of the trades, Avalon suffered a net loss on only one trading day of $125 and profited on 69 of the 72 trading days. Avalon remained as Gonchar's and Polyviou's client after they left CIBC, but did not place additional convertible bond trades with them.

To calculate mark-ups on the 142 retail sales, Enforcement used as the prevailing market price the price per bond that respondents paid to purchase the bonds that were held in the 128 Account purportedly for Avalon (before mark-ups). Based on this calculation, Enforcement determined that respondents charged their customers mark-ups (above the price that Avalon received earlier in the day) between five percent and 12 percent, with a few mark-ups as low as 3.5 percent and some as high as 23.9 percent. Gonchar and Polyviou did not tell the ultimate retail customers that the convertible bonds that they purchased were purchased from another customer in a cross trade, and the mark-ups disclosed to the customers on the Firm's confirmations were based on the price of the cross trade between Avalon and the ultimate retail customer, not on Avalon's purchase price. Enforcement calculated the difference and determined that the undisclosed portion of the mark-ups ranged predominantly from $1,000 to $4,000 per customer trade.

IV. Discussion

After a thorough review of the record, we affirm the Hearing Panel's findings of violation as follows: Gonchar and Polyviou fraudulently interpositioned Avalon between CIBC and 71 retail clients in 142 transactions, thereby denying the customers best execution, in violation of NASD Rules 2110, 2120 and 2320, Section 10(b) of the Exchange Act, and Exchange Act Rule 10b-5 (causes one and two); and Gonchar and Polyviou charged the same 71 customers fraudulently excessive and undisclosed mark-ups in the same 142 trades, in violation of NASD Rules 2110, 2120 and 2440, Section 10(b) of the Exchange Act, and Exchange Act Rule 10b-5 (causes three and four).

A. Fraudulent Interpositioning

FINRA's best execution rule, NASD Rule 2320, prohibits member firms and their associated persons from interjecting a third party between the member and the best available market except in cases where the member can demonstrate that, at the time of the transaction, the total cost to the customer was better than the prevailing inter-dealer market for the security. Once interpositioning is demonstrated, the burden of proof shifts to the broker to demonstrate that, by channeling the transaction through another account, he reduced the cost of the transaction

to the customer. *See* NASD Rule 2320(b); *Milton M. Star*, 47 S.E.C. 58, 59 (1979) (holding that, where interpositioning has occurred, the broker bears the burden of demonstrating that his action resulted in the customer being charged a price that is lower than the prevailing market price).[16]

In the trades at issue, Gonchar and Polyviou sold convertible bonds to their customers exclusively via cross trades with the Avalon account. Tape recordings of Frank's telephone conversations with Gonchar and Polyviou demonstrate that Gonchar and Polyviou would purchase the bonds in the morning without identifying a customer and then later claim the purchase for the Avalon account. On the 72 days at issue, after buying the bonds in the morning, and sometimes selling the bonds back and forth between Avalon's account and the 128 Account throughout the day, Gonchar and Polyviou would execute cross trades from the Avalon account (through the 128 Account) to retail customers using the high stock price of the day as a basis for obtaining a "price level" from Frank. Gonchar and Polyviou generally added at least one point to the price suggested by Frank and added a mark-up in its sales of the convertible bonds to retail customers. In every instance, respondents' ultimate retail customers paid more for the bonds than Avalon paid on the same day.

Respondents' trading on January 7, 2002, is illustrative of their interpositioning scheme. Before the market opened on January 7, recorded telephone conversations show that Frank provided Polyviou with a price level of 109 1/2, 110 1/2 for PDLI convertible bonds versus (i.e., based on) a stock price of $31.50 per share. At 10:11 a.m., Gonchar contacted Frank and requested a price for PDLI bonds versus a stock price of $30.50. Frank quoted 107 7/16, 108 7/16, and Gonchar directed her to buy 100 bonds. He did not identify a purchasing customer. At 10:41 a.m., Frank advised Gonchar that his order for PDLI bonds had been filled at 108 5/8 ($108.625 per bond). Gonchar still did not identify a customer. At the time, PDLI stock was trading at $30.75 per share. Although Gonchar did not then provide a customer account number for the purchase, it later was attributed to the Avalon account. At 11:22 a.m., Gonchar advised Frank that he wanted to cross the PDLI bonds. PDLI stock was then trading at $29.75, but Frank asked Gonchar what stock price he wanted to use to calculate the bond price for the trade. Gonchar responded that the high price of $31.75 was the "preference point," and Frank calculated the bond price as 110, 111 versus the stock price of $31.75 per share. The high stock price of $31.75 occurred at 9:30:34 a.m. that day. Gonchar told Frank to execute the cross trade at $112, and she did. At 3:06 p.m. that day, Polyviou contacted Frank and provided her with the customer account numbers, prices and mark-ups for the PDLI bond trades as follows: Avalon purchased 100 PDLI bonds at 108 5/8 plus a three-point mark-up (for a total of $111.625 per bond). Avalon sold 100 bonds at $112 per bond (which included a 3/8 mark-down) to the 128 Account. The 128 Account then resold the bonds to two of respondents' customers (50 bonds each) in what respondents referred to as cross trades for $112 per bond plus a 3.25 point mark-up (for a total of $115.25 per bond). In the end, respondents charged retail customers $115.25 for convertible bonds that Avalon purchased on the same day at $108.625 per bond even though the underlying stock price had declined throughout the day. Avalon's net profit was $250, and respondents each earned $1,155.63 in compensation.

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[16] A violation of NASD Rule 2320 or any FINRA rule constitutes a violation of NASD Rule 2110. *See Stephen J. Gluckman*, 54 S.E.C. 175, 185 (1999).

Respondents' back and forth trading between Avalon's account and the 128 Account before selling to retail customers is illustrated by the trading that occurred on January 3, 2001. On that day, Avalon purchased JNI bonds at $89 per bond, sold the bonds to the 128 Account for $89.50 per bond ($92.25 minus a $2.75 mark-down), repurchased them at $95 per bond ($92.25 plus a $2.75 mark-up), sold them again to the 128 Account for $95.25 per bond ($95.50 minus a $.25 mark-down), repurchased them at $98.25 per bond ($95.50 plus a $2.75 mark-up), again sold them to the 128 Account at $98.375 ($98.50 minus a $.125 mark-down), repurchased them at $101.375 per bond ($98.50 plus a $2.875 mark-up), sold them to the 128 Account at $101.50 per bond ($102.50 minus a $1 mark-down), and repurchased them at $105.50 per bond ($102.50 plus a $3 mark-up). After Avalon bought and sold the same 50 bonds five times, Gonchar and Polyviou sold the bonds in a cross trade through the 128 Account to Polyviou's client for $109.25 per bond (Avalon sold to the 128 Account for $106, and the customer purchased from the 128 Account for $109.25). On this trading day, Avalon paid $8,312.50 in compensation and made a net profit of $750. Neither respondent was able to explain Avalon's trading strategy. Between 9:30 a.m. and 1:15 p.m. on January 3, the price of JNI stock fluctuated between $98 and $112 per share, and then between 1:15 p.m. and 1:45 p.m. that day, it moved from $105 per share to $134 per share and hit a high of $136 per share at 3:43 p.m. Because Frank did not timely input trade information into CIBC's electronic system and Gonchar and Polyviou did not timely supply account numbers to Frank, it is unclear when on January 3 Avalon's purchases and sales occurred.

Gonchar's and Polyviou's customers could have purchased the same bonds, as Avalon did, from CIBC's inventory or from other dealers through CIBC's trading desk. Respondents, however, would not have been able to manipulate and increase the convertible bond prices if they had enabled their customers to purchase directly from the Firm's proprietary account or through the trading desk because a trader would have had to fill the order. By purchasing convertible bonds on each of the 72 mornings without identifying a customer, they in effect used the 128 Account as their trading account. Furthermore, by interjecting Avalon in each of the customer sales, Gonchar and Polyviou bypassed CIBC's trading desk and were able to execute the trades at higher prices as cross trades through the 128 Account. For example, on January 14, 2002, Frank contacted Gonchar at 10:16 a.m. to confirm that the trading desk had filled his order for 100 PDLI bonds at $104.25 versus a stock price of $28.25 per share. Gonchar immediately phoned back to ask about price levels for a cross trade. Without identifying the purchaser, Gonchar stated that he wanted to cross the bonds "temporarily" at a bond price based on a stock price of $29.16 per share. Frank provided Gonchar with bond price levels of 105.18, 106.18. Gonchar replied that he would cross at $107.25 "for now." Frank replied that she was "not going to write anything down ... because you want to watch and see where it is anyway." Later in the day, at 2:36 p.m., Polyviou contacted Frank to ask whether they had executed the cross trade. Both agreed that it was "still early," but Polyviou advised Frank to proceed with the cross trades at $107.25. Polyviou then attributed the original bond purchase to Avalon at a price of $104.25 plus a 2.5 point mark-up (for a total cost of $106.75). Avalon sold the bonds at $107 in a cross trade through the 128 Account. Two of respondents' customers bought 50 bonds each at $107.25 plus a 3 point mark-up (for a total price of $110.25 per bond). Respondents' sales price of $107.25 per bond was based on the high stock price of the day of $29.10 per share, which occurred at 9:39:14 a.m., even though the retail sales occurred after 2:00 p.m. (based on the timing of respondents' recorded telephone conversations with Frank) and the price of PDLI stock

had dropped to $27 per share. On this series of transactions, Avalon made a net profit of $250, and respondents each earned $1,092.50 in compensation.

The Commission has stressed "the importance of a broker's ... obligation to get the best price for his customers, an obligation that is vital to the broker-customer relationship." *Voss & Co*, 48 S.E.C. 39, 40-41 (1984). Here, Gonchar and Polyviou interjected Avalon between CIBC and 71 retail customers in 142 retail transactions. This type of interpositioning designed to benefit themselves at the expense of their customers was a breach of Gonchar's and Polyviou's obligations to their customers and a violation of NASD Rules 2320 and 2110. *See Fin. Programs, Inc.*, 45 S.E.C. 718, 720 n.10 (1975) (finding that interpositioning is a breach of fiduciary duty).[17]

We also find that Gonchar's and Polyviou's actions were fraudulent. *See Dist. Bus. Conduct Comm. v. Johansen*, Complaint No. C8A940073, 1997 NASD Discip. LEXIS 54, at *23 (NASD NBCC Sept. 18, 1997) (finding that interpositioning scheme was fraudulent). Section 10(b) of the Exchange Act, 15 U.S.C. 78j(b), forbids any person from using or employing, in connection with the purchase or sale of any security, any manipulative or deceptive device or contrivance. Exchange Act Rule 10b-5 prohibits "any device, scheme, or artifice to defraud" or any practice "which operates or would operate as a fraud or deceit upon any person." 17 C.F.R. §240.10b-5(a) and (c). NASD Rule 2120, FINRA's antifraud rule, parallels Exchange Act Rule 10b-5, and provides that no member shall effect any transactions, or induce the purchase or sale of any security, by means of any manipulative, deceptive or fraudulent device. In order to establish liability under Section 10(b) and NASD Rule 2120, it is necessary that Enforcement prove that Gonchar and Polyviou acted with scienter (i.e., intentionally made a material misrepresentation or omission or used a fraudulent device in connection with the purchase or sale of a security).[18] *See Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 (1976) (defining scienter as an "intent to deceive, manipulate or defraud").

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[17] The Hearing Panel also found that Frank participated in Gonchar's and Polyviou's interpositioning scheme. Although Frank is not a party to this proceeding, we agree that Gonchar and Polyviou would not have been able to carry out their fraudulent scheme without Frank's assistance. The Hearing Panel listened to the recorded conversations between Frank, Gonchar and Polyviou, and found that she exhibited a deferential tone that was absent in her conversations with other retail convertible bond salespeople. Frank testified that she did not know if she had ever refused Gonchar's and Polyviou's price recommendations, and the record shows that Gonchar and Polyviou interpositioned Avalon only on days when Frank was in the office, never when she was absent.

[18] Violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder also must involve the respondent's use of any means or instruments of transportation or communication in interstate commerce, or the mails, or any facility of any national securities exchange. Respondents do not dispute that they communicated with customers through the use of telephone lines and the U.S. mail service, thereby satisfying this requirement. *SEC v. Hasho*, 784 F. Supp. 1059, 1106 (S.D.N.Y. 1992).

We find that Gonchar and Polyviou intentionally interposed Avalon's account between retail customers and the best available market. The fact that Gonchar and Polyviou followed a similar trading pattern on each of the 72 days at issue supports our conclusion that they acted intentionally. Gonchar and Polyviou devised a plan whereby they made short-term purchases of convertible bonds in the 128 Account each morning that they later attributed to the Avalon account. With Frank's assistance, they executed the initial bond purchases without identifying Avalon as the purchasing customer until later in the day when they had already located a buyer ready to purchase in a cross trade and only after they had determined the high stock price of the day. This trading pattern was consistent on all 72 trading days.

As further evidence of Gonchar's and Polyviou's intent, we note that they concealed their conduct from the trading desk by executing cross trades and by using the 128 Account as a de facto trading account. CIBC's trading desk did not become involved in executing cross trades, and the Firm allowed Frank to execute cross trades virtually unsupervised. Additionally, Gonchar and Polyviou knew that the only oversight of the 128 Account that CIBC conducted was at the end of the day to ensure that Frank was not holding inventory overnight. Gonchar and Polyviou seized on the opportunity caused by CIBC's supervisory gaps by utilizing the 128 Account to hold short-term bond purchases until they were ready to attribute them to Avalon, and by using the Avalon account to execute cross trades with customers.

As additional proof of the intentional nature of Gonchar's and Polyviou's actions, we note that, by interpositioning Avalon between CIBC and other retail customers, they derived significant profits for themselves and CIBC. While Avalon generally broke even or profited minimally on the 142 transactions at issue (and suffered a loss on only two transactions), Gonchar and Polyviou generated compensation of $534,965 on the same 142 transactions. On those trades, Gonchar and Polyviou each earned a total of $114,024.81. Gonchar and Polyviou intentionally marked the bonds up on each intervening sale from the 128 Account to Avalon and marked them down on each intervening purchase by the 128 Account from Avalon, and systematically increased the price paid by the ultimate retail customers in the cross trades taking place later in the day. By utilizing the 128 Account in this manner, Gonchar and Polyviou ensured that they (and CIBC) reaped the maximum benefit and retail customers paid more than they should have paid.

Gonchar and Polyviou also intentionally concealed from their customers that they were interposing Avalon between the retail customers and the best available market. *See Robert L. Ridenour*, Initial Decision Rel. No. 18, 1991 SEC LEXIS 691, at *10 (Apr. 9, 1991), *notice of final decision*, Exchange Act Rel. No. 29184, 1991 SEC LEXIS 881 (May 9, 1991) (finding the failure to disclose interpositioning between customers and the fair market to be a material omission); *Johansen*, 1997 NASD Discip. LEXIS 54, at *23 (holding that interpositioning would have been material to retail investors and should have been disclosed). Gonchar's and Polyviou's customers lacked the market information that Gonchar and Polyviou possessed as registered representatives who specialized in convertible bond sales. The customers therefore relied on Gonchar and Polyviou to obtain the best reasonably available prices. Gonchar and Polyviou knew the true market prices, but chose instead to interpose Avalon ahead of the customers and also to use an incorrect stock price – the high stock price of the day – which both had the effect of increasing the convertible bond prices paid by the customers without the customers' knowledge. Respondents' deceit is further evidence of their malevolent intent.

As early as 1942, the Commission has held that interpositioning violates the antifraud provisions of the federal securities laws. *See W.K. Archer & Co.*, 11 S.E.C. 635, 642 (1942), *aff'd*, 133 F.2d 795 (8th Cir. 1943). Interpositioning that results in customers' paying higher prices is "inconsistent with a broker's obligation to obtain the best prices for his or her customers." *H.C. Keister & Co.*, 43 S.E.C. 164, 168-169 (1966). Gonchar's and Polyviou's willingness to exploit their customers to exact inflated profits by the use of an interpositioning scheme is, in our view, evidence of their fraudulent intent. *See Donald T. Sheldon*, 51 S.E.C. 59, 78 (1992) (holding that interpositioning of favored accounts between the dealer and non-favored accounts demonstrated scienter), *aff'd*, 45 F.3d 1515 (11th Cir. 1995); *Edward Sinclair*, 44 S.E.C. 523, 527 (1971) (holding that interpositioning is violative of the antifraud provisions of the federal securities laws and that even disclosure of the interpositioning does not obviate its fraudulent character).

Citing to a criminal fraud case, *U.S. v. Finnerty*, 474 F. Supp. 2d 530 (S.D.N.Y. 2007), *aff'd*, 533 F.3d 143 (2d Cir. 2008), respondents argue that the NAC should reverse the Hearing Panel's finding of fraud because Enforcement failed to prove the expectations of respondents' customers. The defendant in *Finnerty* was a New York Stock Exchange specialist who repeatedly traded for his firm's proprietary account ahead of public orders in violation of NYSE rules. We find several reasons why *Finnerty* does not apply in this case.

First, in a FINRA disciplinary action, Enforcement need not show customer reliance to prove fraud. *Cf. SEC v. Feminella*, 947 F. Supp. 722, 728 n.2 (S.D.N.Y. 1996) (holding that the Commission need not show justifiable reliance upon a misrepresentation or other fraudulent device to prove fraud); *Wall St. West, Inc.*, 47 S.E.C. 677, 679 (1981), *aff'd*, 718 F.2d 973 (10th Cir. 1983) (holding that, in FINRA and SEC actions for violations of Rule 10b-5, Enforcement need not show customer reliance). As discussed above, Gonchar's and Polyviou's interpositioning was material information that they hid from their customers. Here, Enforcement proved the required elements to uphold a finding of fraud.

Second, Gonchar and Polyviou were acting as agents for their customers' orders which triggered duties that these registered representatives owed directly to their customers. Unlike the NYSE specialist in *Finnerty*, who operated as a market maker, Gonchar and Polyviou had a duty to provide their customers with best execution. "Sales of securities by broker-dealers to their customers carry with them an implied representation that the prices charged in those transactions are reasonably related to the prices charged in an open and competitive market." *SEC v. First Jersey Sec., Inc.*, 101 F.3d 1450, 1469 (2d Cir. 1996); *see also Newton v. Merrill, Lynch, Pierce, Fenner & Smith, Inc.*, 135 F.3d 266, 270 (3d Cir. 1998) ("The duty of best execution thus requires that a broker-dealer seek to obtain for its customer orders the most favorable terms reasonably available under the circumstances."). As registered representatives subject to FINRA's rules, Gonchar and Polyviou had an affirmative obligation, independent of their

customers' expectations, to provide prices that were consistent with their implied representations.[19]

Respondents also argue that the Hearing Panel erred in holding Enforcement to the preponderance of the evidence standard of proof. They argue that the Hearing Panel should have utilized a clear and convincing standard of proof because the evidence in the case is predominantly circumstantial, respondents were barred from the industry, and the complaint alleged fraud. Respondents rely on a 1996 decision from the United States District Court for the Southern District of New York, *SEC v. Moran*, in which the court applied a preponderance of the evidence standard in an SEC enforcement action for violations of Section 10(b) of the Exchange Act. *SEC v. Moran*, 922 F. Supp. 867 (S.D.N.Y 1996). The *Moran* court held that reliance on circumstantial evidence does not necessitate the use of the clear and convincing standard of proof, but also stated in dicta that when the loss of livelihood is a potential outcome of a regulatory action, the court should consider using the clear and convincing standard. *Id.* at 890.[20] The *Moran* court cited to *Collins Securities Corp. v. SEC*, a 1977 D.C. Circuit decision that held that the court should use the clear and convincing standard when loss of livelihood could result from the court's determination. *Collins Sec. Corp. v. SEC*, 562 F.2d 820, 824-826 (D.C. Cir. 1977). The Supreme Court, however, overruled *Collins* in 1981 in *Steadman v. SEC*, 450 U.S. 91 (1981). In *Steadman*, the Supreme Court upheld a Commission order barring Steadman and held that the preponderance of the evidence standard of proof is the appropriate standard in Commission actions involving violations of the antifraud provisions of the federal securities laws. 450 U.S. at 96. The NAC subsequently has applied the preponderance of the evidence standard to FINRA disciplinary actions, including in cases involving antifraud violations and imposing bars. *See, e.g., Jay Michael Fertman*, 51 S.E.C. 943, 949 (1994); *Dist. Bus. Conduct Comm. v. Bruno*, Complaint No. C10970007, 1998 NASD Discip. LEXIS 51, at *8-9 (NASD NAC July 8, 1998); *Sandra K. Simpson*, Exchange Act Rel. No. 45923, 2002 SEC LEXIS 1278, *57-58 (May 14, 2002). We thus reject respondents' argument and find that the Hearing Panel properly applied the preponderance of the evidence standard.

Respondents also argue that the Hearing Panel erred in finding respondents equally culpable. Although Gonchar does not admit to wrongdoing, he does not deny executing the

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[19] Additionally, the court in *Finnerty* concluded that a lay jury, without securities expertise, could not have reached its verdict without speculating absent evidence of customer expectations. *Finnerty*, 474 F. Supp. 2d at 539-540. This case, however, was decided by specialized adjudicators who understood a registered person's role in the securities industry and his duty to provide customers with best execution. Finally, even if we were to apply the *Finnerty* court's reasoning, Enforcement has produced ample evidence that the customers at issue here expected best execution and did not intend for respondents to interpose a favored customer between them and CIBC. The record includes five customer declarations in which the customers state that they were unaware that they had purchased convertible bonds in cross trades or that another account had been interposed between CIBC and their accounts.

[20] In *Moran*, the Commission did not seek to bar Moran from the securities industry, so the issue did not arise in that case. *Id.*

trades at issue. Respondents contend that Gonchar, not Polyviou, took the lead in respondents' trading activity and that Polyviou performed mainly administrative functions and "merely solicited some of the customers to purchase in the cross trades." We affirm the Hearing Panel's finding that Polyviou is equally responsible with Gonchar.

As the Hearing Panel noted, although Gonchar and Polyviou had distinct customer lists, they serviced each other's customers when necessary and they shared all compensation. Gonchar and Polyviou shared an office and worked always as a team. The victimized customers belonged to both Gonchar and Polyviou, and recorded telephone conversations demonstrate that Gonchar and Polyviou interacted interchangeably with Frank. The recordings demonstrated that Polyviou had morning conversations with Frank about convertible bond price levels and afternoon conversations in which he provided Frank with account information for both the buy side and sell side of cross trades. The recordings even included a conversation between Frank, Gonchar, and Polyviou in which the three discussed using the high stock price of the day as a basis for pricing respondents' cross trades. Another recording showed that, after CIBC commenced its investigation of Gonchar's and Polyviou's trading activities, Frank, Gonchar, and Polyviou discussed their strategy of executing cross trades together. Furthermore, Frank testified that Polyviou called her to provide mark-ups and account numbers and that Polyviou did not always have to identify the bond purchased or sold because both he and Frank were already familiar with all of the trades that Gonchar had executed earlier in the day. Frank also stated that both Gonchar and Polyviou wanted to use the high stock price of the day to calculate bond prices for their trades. We find that the evidence is sufficient to hold Polyviou equally responsible with Gonchar for the trades at issue in this case.

* * * *

We find that Gonchar and Polyviou fraudulently interpositioned Avalon between 71 of their retail customers and CIBC in 142 transactions, in violation of Section 10(b) of the Exchange Act, Exchange Act Rule 10b-5, and NASD Rules 2110, 2120 and 2320, as alleged in causes one and two of the complaint.

B. Fraudulently Excessive Mark-ups

FINRA's rules obligate member firms to deal fairly with customers. NASD Rule 2440 states that member firms shall buy securities from and sell securities to members of the public at prices that are fair, taking into consideration all relevant circumstances. Generally, mark-ups in excess of five percent above the prevailing market price for a security are considered excessive and unfair. IM-2440-1 (Mark-Up Policy); *NASD Notice to Members 92-16* (Apr. 1992), 1992 NASD LEXIS 47, at *6-7.[21] Furthermore, when debt securities are involved, a fair mark-up generally is less than what is considered fair for equity securities and well below five percent.

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[21] IM-2440-1 states that it is a violation of NASD Rules 2110 and 2440 for a member firm "to enter into any transaction with a customer in any security at any price not reasonably related to the current market price."

See Inv. Planning, Inc., 51 S.E.C. 592, 594 (1993) ("[D]ebt securities markups normally are lower than those for equities ...."); *F.B. Horner & Assoc, Inc..*, 50 S.E.C. 1063, 1065 (1992) (finding that a lower mark-up is customarily charged in the sale of bonds than in transactions of the same size involving common stock), *aff'd*, 994 F.2d 61 (2d Cir. 1993); *Staten Sec. Corp.*, 47 S.E.C. 766, 767 n.5 (1982) ("As a general rule, markups on municipal bonds are significantly lower than those for equity securities."). In order to comply with FINRA's mark-up guidelines, CIBC generally prohibited mark-ups on convertible bonds in excess of three percent.

We begin our analysis with a determination of the prevailing market price for the bonds at issue. Generally, in cases such as this in which the member firm is not a market maker in the securities at issue, the firm's contemporaneous cost is the best indicator of the prevailing market price. *See Daniel R. Lehl*, 51 S.E.C. 1156, 1159 (1994) (holding that a firm that is not a market maker must base its prices on its own contemporaneous cost), *aff'd*, 90 F.3d 1483 (10th Cir. 1996). Here, however, Gonchar and Polyviou used the 128 Account as their de facto trading account. On each of the 72 days at issue, respondents bought bonds for an unnamed customer and maintained them as inventory in the 128 Account throughout the day until they located a customer to purchase the bonds. Respondents then attributed the purchase to Avalon before executing a cross trade to their retail customer at an artificially inflated price. Given respondents' consistent method of purchasing bonds in the 128 Account and using Avalon to execute cross trades without involving CIBC's trading desk, we have determined to treat respondents' contemporaneous cost in acquiring the bonds in the 128 Account (purchases that respondents later in the day attributed to Avalon) as the best evidence of prevailing market price and have relied on this method for the calculation of mark-ups. *Cf. Bison Sec. Inc.*, 51 S.E.C. 327, 333 (1993) (holding that securities account belonging to firm holding company could be treated as firm's de facto trading account for purposes of calculating mark-ups).

Utilizing the cost of the purchases by respondents, purportedly for Avalon, and excluding the mark-ups charged to Avalon, for the prevailing market price of the convertible bonds, Enforcement calculated that respondents' mark-ups to customers ranged from 3.5 percent to 23.97 percent.[22] Indeed, in more than 108 of the 142 customer sales, respondents charged mark-ups of more than five percent. The convertible bonds that respondents sold were readily available, and the amount that each retail customer invested was relatively significant, ranging from $25,000 to $212,250 per transaction. Respondents have offered no justification for the size of their mark-ups, and we find none. Moreover, it is undisputed that respondents did not disclose to their customers that they interposed Avalon in these retail trades, so they concealed from their customers the full amount of the customers' mark-ups.

Given the size of the mark-ups that respondents charged, their failure to disclose that the customers were purchasing in cross trades from Avalon, their failure to disclose the full amount of the mark-ups that they charged, and the intentional nature of their interpositioning scheme, we find that respondents acted with the requisite scienter and that their mark-ups were fraudulently excessive. *See Sheldon*, 51 S.E.C. at 78 (holding that interpositioning scheme that resulted in

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[22] In 142 retail sales, Gonchar and Polyviou charged their customers total mark-ups in excess of 3.5 percent of $293,282.50.

mark-ups in excess of eight percent "demonstrates clear scienter"); *Lake Sec., Inc.*, 51 S.E.C. 19, 22 (1992) (finding mark-down of 7.4 percent in stripped mortgage-backed government securities fraudulently excessive); *Crosby & Elkin, Inc.*, 47 S.E.C. 526, 530-531 (1981) (finding mark-ups of eight to 10 percent fraudulently excessive for sales of municipal bonds).

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We therefore affirm the Hearing Panel's findings under causes three and four that Gonchar and Polyviou charged CIBC customers undisclosed and fraudulently excessive mark-ups, in contravention of NASD Rules 2110, 2120 and 2440, Section 10(b) of the Exchange Act, and Exchange Act Rule 10b-5.

C. Procedural Argument

Respondents contend that FINRA failed to provide them with a fair process and that the Hearing Officer unfairly curtailed their ability to defend themselves. During the pre-hearing phase of this disciplinary proceeding, respondents issued civil subpoenas to compel the testimony of two individuals who were not subject to FINRA's jurisdiction – AC, Avalon's owner, and Vincent Rusciano ("Rusciano"), a runner who, respondents contend, delivered their hand-written trade tickets to Frank daily. Respondents asserted that they were entitled to issue the subpoenas under Article 23 of New York's Civil Practice Law and Rules ("CPLR"), Section 2302(a).[23]

The Hearing Officer provided the parties with the opportunity to brief the issue of whether CPLR Section 2302 applies in FINRA disciplinary proceedings. On November 17, 2005, the Hearing Officer determined that a FINRA disciplinary proceeding is not an "administrative proceeding" for purposes of CPLR 2302 and issued an order to quash respondents' subpoenas.

Subsequent to the Hearing Officer's issuance of an order to quash the subpoenas, respondents moved in the Supreme Court of the State of New York to enjoin the Hearing Officer from preventing respondents from issuing subpoenas under New York law CPLR 2302. Respondents argued that a FINRA disciplinary matter is an administrative proceeding under CPLR 2302. On February 7, 2006, the court denied respondents' motion. *See Gonchar v. Nat'l Ass'n of Sec. Dealers*, Index No. 101445-2006 (N.Y. Sup. Ct. Feb. 7, 2006), *dismissed as moot*, 829 N.Y.S. 2d 900 (N.Y. App. Div. Feb. 27, 2007). The court in *Gonchar* cited to a similar case involving FINRA and another disciplinary respondent, *NASD Regulation, Inc. v. Rosato*, Index No. 119971-1998 (N.Y. Sup. Ct. Nov. 5, 1998) (Interim Order). In *Rosato,* the Supreme Court of

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[23] CPLR 2302(a) provides: "Subpoenas may be issued without a court order by ... an attorney of record for a party to ... an administrative proceeding or an arbitration ... in relation to which proof may be taken or the attendance of a person as a witness may be required." New York CPLR does not specifically define "administrative proceeding" as the term is used in CPLR 2302.

New York ruled, based on a very similar fact pattern, that CPLR 2302 does not apply to FINRA disciplinary proceedings.

In *Gonchar*, the New York Supreme Court also rejected Gonchar's and Polyviou's reliance on *Crimmins v. Am. Stock Exch., Inc.*, 368 F. Supp. 270 (S.D.N.Y. 1973), *aff'd*, 503 F.2d 560 (2d Cir. 1974), a 1973 case that Gonchar and Polyviou also cite before us. In *Crimmins*, a respondent in an American Stock Exchange ("AMEX") disciplinary proceeding filed an action in the United States District Court for the Southern District of New York seeking an order vacating his suspension by an AMEX disciplinary panel. 368 F. Supp. at 274. One of Crimmins' many arguments in favor of reversing the AMEX's suspension was that he was denied access to exculpatory evidence because the AMEX refused to issue witness subpoenas. *Id.* The district court rejected all of Crimmins' arguments and upheld the suspension. *Id.* at 281. In dicta, the *Crimmins* court assumed, without any analysis, that AMEX proceedings were administrative proceedings within the meaning of CPLR 2302 and suggested that CPLR 2302 "seems to" empower counsel in AMEX proceedings to issue their own subpoenas. *Id.* at 277. The state court in *Gonchar* rejected any reliance on the *Crimmins* decision because the court in *Crimmins* addressed the applicability of CPLR 2302 to AMEX, not FINRA, disciplinary proceedings, addressed the issue only in dicta, and failed to analyze the issue fully. *Gonchar*, Index No. 101445-2006 (N.Y. Sup. Ct. Feb. 7, 2006). Respondents appealed the New York Supreme Court's decision to the Appellate Division, and the Appellate Division dismissed the appeal as moot because it came before the court after the Hearing Panel hearing had already ended. *Gonchar v. Nat'l Ass'n of Sec. Dealers*, 829 N.Y.S. 2d 900 (2007).[24]

We reject respondents' argument and find that the Hearing Officer's order to quash respondents' subpoenas was proper. The Code of Procedure applicable in FINRA's disciplinary proceedings does not provide parties to disciplinary proceedings with subpoena authority. *See Dep't of Enforcement v. Faber*, No. CAF010009, 2003 NASD Discip. LEXIS 3, at *36-37 (NASD NAC May 7, 2003) (holding that "respondents in NASD disciplinary proceedings cannot request a subpoena"), *aff'd*, Exchange Act Rel. No. 49216, 2004 SEC LEXIS 277 (Feb. 10, 2004); *Thomas E. Warren, III*, 51 S.E.C. 1015, 1020 n.22 (1994) (holding that "NASD rules do not provide for the use of subpoenas"). FINRA's Code of Procedure provides for discovery and testimony only pursuant to NASD Rules 8210 (Provision of Information and Testimony) and 9252 (Requests for Information), and it does not endorse reliance on state statutes for the issuance of subpoenas in FINRA disciplinary proceedings. Furthermore, given the New York Supreme Court's ruling on Gonchar's and Polyviou's motion, we find no support for the

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[24] Gonchar and Polyviou also relied on *Hessel v. Merrill Lynch, Pierce Fenner & Smith, Inc.*, Index No. 106285-2000 (N.Y. Sup. Ct. Aug. 9, 2000), which involved a disciplinary decision before the New York Stock Exchange. The court in *Hessel* found that NYSE's internal rules, unlike FINRA's disciplinary procedures, confer on parties to disciplinary proceedings "such powers of subpoena as may be provided by the law of the state where the hearing is held." Because of this provision, the court found that NYSE procedures, which specifically allowed for subpoena authority granted under state statute, did not conflict with CPLR 2302 and that CPLR may apply to NYSE proceedings.

contention that the Hearing Officer acted improperly. We therefore reject respondents' procedural argument.

V. Sanctions

The Hearing Panel aggregated respondents' violations for purposes of imposing sanctions and barred respondents in all capacities and fined them each $115,000.[25] For the reasons discussed below, we affirm these sanctions with a minor adjustment to the fine amount.

The FINRA Sanction Guidelines ("Guidelines") for failing to comply with FINRA's best execution requirements recommend a fine of $20,000 to $200,000 and a possible bar for egregious, intentional misconduct, as we have found in this case.[26] The Guidelines for material omissions of fact recommend considering a bar in egregious cases involving intentional or reckless misconduct.[27] The Guidelines for excessive mark-ups recommend a fine of $5,000 to $100,000 plus the gross amount of excessive mark-ups and, in egregious cases, a suspension for up to two years or a bar.[28] The sanctions that we have imposed therefore are within the ranges contemplated in the Guidelines.

"It is familiar law that the purpose of [significant sanctions] is to protect investors, not to penalize brokers." *McCarthy v. SEC*, 406 F.3d 179, 188 (2d Cir. 2005). We have considered: (1) all mitigating factors that respondents have raised; (2) the seriousness of their offenses; (3) the corresponding harm that they caused to members of the trading public; (4) respondents' potential gain for disobeying the rules; (5) the potential for repetition of their misconduct in light of the current regulatory and enforcement regime; and (6) the deterrent value of imposing a bar to Gonchar, Polyviou and others. *See id.* at 188-191. We conclude that Gonchar's and Polyviou's misconduct was egregious and harmful to the investing public and that a bar is necessary to protect adequately the investing public from future violations.

Respondents argue that the record does not demonstrate that their actions caused customer harm. We disagree. Regardless of whether Enforcement demonstrated that the retail customers did or did not ultimately profit on their investments, by interposing Avalon between the Firm and the customers, respondents ensured that the customers did not get the best available prices. Based on the prices at which respondents could have sold to their customers but instead sold to Avalon, respondents charged their retail customers mark-ups that, in many instances,

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25 The Hearing Panel also assessed costs of $21,558.

26 *FINRA Sanction Guidelines*, at 52 (2007), http://www.finra.org/web/groups/enforcement/documents/enforcement/p011038.pdf (hereinafter "*Guidelines*").

27 *Id.* at 93.

28 *Id.* at 95.

were so excessive as to make them fraudulent under applicable case law. *See Edward J. Blumenfeld*, 47 S.E.C. 189, 191 (1979) (finding that mark-ups of eight percent or more in municipal bonds are fraudulently excessive).

Furthermore, the seriousness of respondents' offenses is a significant factor that favors imposing a bar. The importance of a broker's obligation to get the best price for his customer cannot be overstated. It is "an obligation that is basic and vital to the broker-customer relationship." *Star*, 47 S.E.C. at 60; *see also Thomson & McKinnon*, 43 S.E.C. 785, 788-789 (1968) ("We have on numerous occasions stressed the importance of the broker's fiduciary obligation to get the best price for his customers."). Similarly serious is respondents' related misconduct of charging Firm customers excessive mark-ups. *See G.K. Scott & Co.*, 51 S.E.C. 961, 973 (1994) (affirming FINRA's sanctions and finding that charging fraudulently unfair prices is serious misconduct), *aff'd*, 56 F.3d 1531 (D.C. Cir. 1995) (table); *Steven B. Theys*, 51 S.E.C. 473, 481 (1993) (same). Given the importance in the securities industry of a customer's ability to trust that his broker-dealer is treating him fairly, respondents' misconduct must be viewed as egregious and deserving of significant sanctions.

Gonchar's and Polyviou's conduct also demonstrates a willingness to evade FINRA's rules that we find disturbing. They concealed their trading patterns from CIBC by orchestrating what they referred to as cross trades between Avalon and retail customers so that the trades could occur away from CIBC's trading desk, which may have limited their mark-ups, and without regard to the pricing and methodology used by the Firm. They, in effect, utilized the 128 Account as their own trading account and evaded Firm oversight of their conduct. Respondents also concealed their conduct and the true size of their mark-ups from their customers, who did not even know that they had purchased convertible bonds in cross trades. Given respondents' ability to avoid detection and the number of trades in which they perpetrated their interpositioning scheme, we find that there is a significant danger of their repeating their misconduct if they are allowed to continue in the securities industry.

Respondents placed their own interests and, to a lesser extent, Avalon's interests before those of their customers. They charged excessive mark-ups by interposing Avalon and, in the end, reaped significant benefits. On the trades at issue, Gonchar and Polyviou generated compensation for CIBC of $534,965, of which they each received $114,021.81, and Avalon earned a total of $29,875. Clearly, Gonchar and Polyviou acted for their own potential gain and placed their own and Avalon's interests before those of their customers. They demonstrated a "marked insensitivity to their obligation to deal fairly with customers" and caused CIBC's customers significant financial harm. *Frank L. Palumbo*, 52 S.E.C. 467, 480 (1995). Adding to this insensitivity is the fact that they always selected the high stock price of the day – plus a gratuitous addition of one dollar – when deriving the prices to be charged to their retail customers.

As directed by the Guidelines,[29] we also have considered the number of trades involved (142) and the number of retail clients (71) who were the victims of respondents' interpositioning

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[29] *See Guidelines*, at 6 (Principal Considerations in Determining Sanctions).

scheme over the course of one and one-half years. Respondents concealed the true nature of their actions from both CIBC and their customers, and they violated their customers' trust. In order to protect the investing public from the recurrence of their misconduct, we impose a bar in all capacities. In our view, a lesser sanction will not suffice to provide adequate protection to the investing public.

We have not ordered that respondents pay restitution to their injured customers because CIBC has made all of respondents' customers whole. We have, however, affirmed the fine imposed by the Hearing Panel on each respondent, but have adjusted the amount to $114,022 to mirror the amount of respondents' ill-gotten financial benefit.

VI. Conclusion

We affirm the Hearing Panel's findings that Gonchar and Polyviou violated NASD Rules 2110, 2120, 2320 and 2440, Section 10(b) of the Exchange Act, and Exchange Act Rule 10b-5 by fraudulently interpositioning Avalon's account between CIBC and 71 retail customers in 142 convertible bond trades and charging those customers undisclosed and fraudulently excessive mark-ups.

We find that respondents' violations were intentional and egregious, and we bar respondents in all capacities and fine them $114,022 each.[30] We affirm the Hearing Panel's assessment of costs of $21,558 (joint and several), and we assess appeal costs of $1,412 as to each respondent. The bars imposed in this decision are effective immediately upon issuance of this decision.

On Behalf of the National Adjudicatory Council,

Marcia E. Asquith, Senior Vice President
and Corporate Secretary

[30] We also have considered and reject without discussion all other arguments advanced by the parties.