UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-15015

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In the Matter of

MICHAEL BRESNER, RALPH CALABRO, JASON KONNER, and DMITRIOS KOUTSOUBOS

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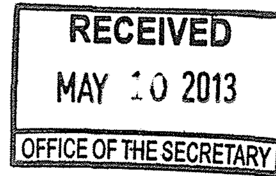

RESPONDENT RALPH CALABRO'S REPLY BRIEF

COUSINS CHIPMAN & BROWN, LLP
380 Lexington Avenue
17th Floor
New York, New York 10168
cole@ccbllp.com
Tel: (212) 551-1152
Fax: (302) 295-0199

Counsel for Respondent Ralph Calabro

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INTRODUCTION

Nothing in the Division's 81-page Initial Post-Heading Brief[1] mentions, much less comes to grips with, the full testimony of its own witnesses. The purpose of a *full hearing* with cross-examination, as the Supreme Court confirms, is to "minimize[] the risk that a judgment will be predicated on incomplete, misleading, or even deliberately fabricated testimony." *Taylor v. Illinois*, 484 U.S. 400, 411-12 (1988); *see* SEC Rule 326 (cross-examination permitted "for a full and true disclosure"). The entire evidence in this case proves the facts the Division offered were "incomplete," and the direct testimony was "misleading" and in many instances "fabricated."

ARGUMENT

I. CALABRO DID NOT ENGAGE IN EXCESSIVE TRADING

A. The Customers' "True Investment Objectives" Were to Make Money in a Declining Market Through Shorter-Term Trading

The "starting point" in considering whether trading was excessive is the customer's objectives, for they "significantly illuminate the context in which the trading took place and, indeed, form standards against which the allegations of excessiveness may be measured." *Costello v. Oppenheimer & Co., Inc.*, 711 F.2d 1361, 1369 (7th Cir. 1983); (DOE Br. at 55). Where objectives are "aggressive or speculative, as opposed to conservative and circumspect, it is easier to conclude that a given course of trading has not been excessive." *Id.*; *see Newburger, Loeb & Co. v. Gross*, 563 F.2d 1057, 1070 (2d Cir. 1977) ("a greater volume of activity will normally be expected" in a speculation account). For this reason, the SEC instructs that "[e]xcessive trading under the securities laws is not measured against some 'magical per annum percentage' that establishes per se excessiveness," but depends upon a customer's objectives. *In*

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[1] The Division's Initial Brief is referred to herein as "DOE Br." The defined abbreviations in Calabro's Initial Post-Hearing Brief ("Calabro Br.") will also be used herein.

the Matter of Pryor, McClendon, Counts & Co., Exchange Act Rel. No. 8245 (June 26, 2003); *In the Matter of Gerald E. Donnelly*, Exchange Act Rel. No. 39990 (Jan. 5, 1996).

Labels such as "aggressive," "speculation" or "conservative," however, are not conclusive; *the intended strategy also matters.* For instance, investing an entire account in a penny stock to hold long term would be "speculative." *See In the Matter of Joseph J. Barbato*, Admin. Proc. File No. 3-8575 at 6 (November 12, 1996) ("penny stock is a low priced stock . . . generally associated with a very small, risky company, typically a start-up company or a company that has not been in existence very long"). *Any trading* could be considered excessive because, although the account was marked "speculative," the *objective* was to *hold* the shares, not trade them.[2] By the same token, writing covered calls would be "conservative." *See Grove v. Shearson Loeb Rhoades, Inc.*, 1983 WL 1321 at *1 (S.D. Fla. May 31, 1983) ("purpose of engaging in covered call writing is to earn the income from the selling of the call and to provide a hedge against the possible decline in price of the underlying security").[3] Although the account objective is "conservative," the trading volume would be higher than the "aggressive" buy and hold penny stock strategy because options expire and would be renewed with new trades.

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[2] Trading in the stock would be an example of "'a difference between *aggressive* investing and *excessive* trading." (DOE Br. at 56 [quoting *In the Matter of Michael David Sweeney*, Admin Proc. File No. 3-7126, Rel. No. 29884 (Oct. 30 1991) and *In the Matter of Shearson Lehman Hutton, Inc.*, Exchange Act Rel. No. 26766 (April 28, 1989)].)

[3] A covered call is when "a person sells ('writes') a call option to buy stock he or she owns." 1983 WL 1321 at *1. The Chicago Board Options Exchange recognizes that writing covered calls is a conservative strategy: "It allows an investor to be paid for assuming the obligation of selling underlying shares at a specified price higher than purchase price, in return for a reduced downside risk from holding underlying shares (a lower break-even point)." http://www.cboe.com/strategies/equityoptions/coveredcalls/part6.aspx; *see* Poser, *Options Account Fraud: Securities Churning In A New Context*, 39 Bus. Law 571 (Feb. 1984).

Contrary to the Division's claim (DOE Br. at 55-57, 65), a mountain of evidence proved each Customer's objectives were speculation, trading profits and short-term trading (consistent with a short and options strategy). Each signed multiple new account or account update forms reflecting those objectives, which were confirmed in letters that included glossaries to enable each to understand and correct any misstated objective. (Calabro Exs. 2, 9, 14, 15, 23, 28, 41, 43, 57, 65.) Each signed an Options Trading Agreement with an attached Options Suitability Questionnaire declaring speculation an objective and disclosing the higher risk nature of options trading. (Calabro Exs. 4, 5, 26, 45; DOE Ex. 48.) Willhoft and Williams signed Active Account Suitability Questionnaires ("AASQ") reflecting the same. (Calabro Ex. 6; DOE Ex. 6.) And each Customer invested and/or maintained accounts independent of J.P. Turner in which each declared an interest in higher risk investments: Moore knew his self-directed Fidelity account was day-traded (Tr. 697:14-18; 700:2-6; 777:17-19; 781:22-786:18); Willhoft self-directed speculative short-term trades in his Ameritrade account for which his "Investment Objectives" were "Growth" and "Speculation," opened a Prestige account with "Speculation" as its designated "Investment Objective," and invested in oil "programs" in which he acknowledged a "high degree of risk" (Calabro Exs. 20, 70-78, 80, 81; Tr. 1208:7-14; 1222:25-1224:21; 1226:16-1228:5; 1240:3-13; 1276:6-11; 1289:19-23); and Williams opened a Newbridge account with an "Investment Objective" of "Speculation" and a "Risk Tolerance" of "Aggressive," and invested in the same high risk oil programs as Willhoft (Calabro Exs. 54, 56, 82; Tr. 1550:2-7).

But the evidence was even more compelling as each Customer *understood* the *strategy employed* was shorter-term. Calabro's strategy involved short sales and options trades to take advantage of a market decline. (*See* Tr. 3946-3984; 4073-4077.) Each Customer testified that Calabro explained his strategy, including its design to take advantage of a falling market. (Tr.

620:13-621:6 [Moore]; 1265:8-23 [Willhoft]; 1426:13-19; 1428:20-1429:1 [Williams].) The Options Trading Agreement each signed emphasized "the short term nature of options" and the likelihood trading would be "to a greater degree than with stocks and/or bonds." (Calabro Exs. 4, 5, 26, 45.) And Willhoft and Williams signed Active Account Suitability Supplements asking each to "*PLEASE READ CAREFULLY*" and making clear that "[a]ctive trading can involve a higher degree of risk, increased costs and is suitable only for risk tolerant investors," and that "[d]ue to the higher degree of activity, overall commissions on your account may tend to be greater than a buy and hold strategy." (Calabro Ex. 6; DOE Ex. 6.)

And there is even more. Williams confirmed his understanding of the intended trading objectives in a handwritten letter to Calabro, which included a detailed analysis of gains, losses and commissions along with a prayer that "the 'short' gods will turn in our favor in the not too distant future." (Calabro Ex. 47.) Moore knew his account's shorter term nature from speaking with Calabro "as many as five or six times a day," which was consistent with active trading. (Tr. 650:25-651:23.) Willhoft also spoke to Calabro frequently and described how short sales were intended to make money in "a market that's falling": "You sell a stock you don't own for a certain amount of money and you of course have to replace it." (Tr. 1099:20-1100:3; 1265:8-1266:17); *see Moody v. Bache & Co.*, 570 F.2d 523, 528 (5th Cir. 1978) ("frequent communication . . . including daily phone calls" along with evidence that a broker "explained his investment methods" indicates "knowledge or approval of the broker's transactions . . .").

It is in this complete context that excessiveness should be judged; the accounts were not only designated speculative and not only were the Customers' objectives to engage in a shorter term trading strategy, but each was well-aware of the strategy as it occurred. Williams "wasn't against it, by any means" (Tr. 1534:5-23), Willhoft did not object to commissions as long as he

was making money (Tr. 1267:20-1268:9), and Moore, after speaking to Calabro daily and understanding his account's volatility by April 2009, opened an account for his son and went so far as to introduce Calabro to his attorney and a friend, Mark Wilkinson (Tr. 806:7-808:15). The Division's suggestion that each Customer's "true" objective was "essentially conservative" and each was an unwitting participant in more speculative and shorter term trading thus rings hollow.

B. The "Blank Document" Argument Fails as a Matter of Fact and Law

Attempting to dodge the mass of real-time documents declaring each Customer's speculative objectives, the Division turns to the long-after-the-fact excuse that each signed "blank documents." (DOE Br. at 57.) Founded upon that predicate, the Division then claims each Customer's "true" objective was "essentially conservative." (*Id.* at 65.) The Division's argument is internally inconsistent, as it also says it would have been *improper* for Calabro to have provided pre-filled documents because pre-filling would have been "done to ensure that the form contained information *necessary to avoid compliance interference while pursuing active trading*." (*Id.* at 57.)[4] In any event, and as explained in Calabro's Initial Post-Hearing Brief, the evidence proves the Division's "blank document" claim unfounded.

For instance, Moore's story that Calabro cajoled his signature in a mad rush to the airport on November 21, 2008 was contrary to the uncontested evidence proving the account documents

[4] This argument is misplaced as well. As demonstrated throughout the trial, the account forms were not the only trigger for compliance or supervisory review for actively traded accounts. To be sure, they triggered letters confirming each Customer's objectives, which the evidence proved each received. (*See* Calabro Exs. 14, 15, 28, 65; DOE Ex. 48.) But J.P. Turner's systems also triggered supervisory review including a close review of Calabro's accounts and trading strategy by both his direct supervisor, James McGrath (who spoke to certain of Calabro's customers) and J.P. Turner's Executive Vice President, Michael Bresner. (Tr. 3046:25-3052:3.) The system also triggered active account notices to be sent, which each Customer received (Moore after his account closed). (Calabro Ex. 6; DOE Ex. 6.) Calabro was well-aware of the confirmation letters and the compliance systems and thus "the more likely inference" is that he would have made sure the account objectives were not misstated.

were mailed to him and then signed weeks later on December 2, 2008 (Calabro Exs. 23, 25, 26, 64); Moore ultimately conceded the flaw in his story. (Tr. 749:24-25; 776:18-777:5) (*See* Calabro Br. at 5-6.) The Division's "blank document" claim is also undermined by the uncontested fact that Moore received a *complete* IRA account form (containing his speculative account objectives) by fax, which he admitted was "sent to [his] offices for [him] to take a look at and then sign and send back." (Calabro Ex. 41) (Tr. 761:1-5; *see* Tr. 756:10-14.)

Williams' story was also misleading since he admitted the opposite to the SEC Staff with respect to the Options Suitability Questionnaire he signed on September 24, 2008. (*See* Calabro Br. at 15-16.) J.P. Turner sent the Questionnaire confirming "Speculation" and "Growth" as his account objectives on October 6, 2008 with a request that Williams "review the accuracy of the questionnaire" and "notify us" of "any changes in your investment objectives." (DOE Ex. 48.) Williams chose not to question his objectives for years, and later provided the letter and attached Questionnaire to the SEC Staff on December 13, 2010 confirming *it had not been blank*; Williams stated instead that it had been "*'pre' filled out* and then mailed for my signature." (*Id.*) (emphasis added). Thus, any suggestion during the trial *more than two years later* that the form was, in fact, blank when signed or that Williams was unaware of his stated objectives is spurious.

And it strains credulity that Willhoft signed no less than *nine* "blank" J.P. Turner account documents without raising a single question or filling in a single blank—even those with a single page such as the Options Suitability Questionnaire or the AASQ. (Calabro Exs. 1-6, 9, 14, 15, 42.) For during the same period, Willhoft filled in *all the blanks* on his Ameritrade "Margin/Options Account Upgrade" form including his "Speculation" and "Growth" investment objectives, *all the blanks* on his Prestige "New Account Application" including his "Speculation" objective, and *all the blanks* on four oil project agreements in which he

acknowledged their "high degree of risk." (Calabro Exs. 20, 75-78, 80.) Willhoft even testified he never received the "paperwork" for his triple net real estate investments, but in truth he not only received the paperwork, he filled in *all the blanks* on those documents as well and represented that he had "the capacity to evaluate the merits and risks of the prospective investment" including their "substantial risk." (Tr. 1127:23-1128:14; Calabro Exs. 21, 22.)[5]

Even if the Division's "blank document" theory were credible as a matter of fact—which it is not—it is unsustainable as a matter of law. The theory is that because the Customers failed to read the documents they signed, they should now be allowed to disaffirm all real-time representations about their objectives. The law is to the contrary and provides that "absent a showing of fraud or mental incompetence, a person who signs a contract cannot avoid her obligations under it by showing that she did not read what she signed." *Coleman v. Prudential Bache Sec., Inc.*, 802 F.2d 1350, 1352 (11th Cir. 1986). None of the Customers claimed mental incompetence, and there is no evidence Calabro fraudulently prevented them from reading or filling in blanks. *See First Union Discount Brokerage Services, Inc. v. Milos*, 997 F.2d 835, 846 n.21 (11th Cir. 1993) (investors "may derive neither comfort nor legal protection from their willingness to sign [margin and option] contracts without reading them"); *Dodds v. Cigna Securities, Inc.*, 12 F.3d 346, 351 (2d Cir. 1993) ("a failure to read" investment documents "is not excused because of the documents' length"); *Tapia v. Banque Indosuez*, 1999 WL 4948 at *2 (S.D.N.Y. January 6, 1999) ("Were the Court to allow [the investor] to avoid his responsibilities under the agreement, it would discourage investors from reading the documents they sign in the

[5] The Division's suggestion that Willhoft only "learned later that these investments were limited partnership investments, a type of investment about which Willhoft had no knowledge" ignores the evidence. (DOE Br. at 16.) Willhoft conceded his long term experience with similar types of investments having, since the 1970s, invested in multiple oil well programs that operated a in a manner identical to limited partnerships. (Tr. 1276:6-11; Calabro Exs. 75-78.)

hope that they could later argue they were misled. This would be an unacceptable result."). In short, the Division's "blank document" theory is baseless as a matter of both fact and law.

C. The Division's Evidence of Turnover and Cost/Equity was Unreliable

The level at which trading becomes excessive is a "recondite subject." *Costello*, 711 F.2d at 1369. Because there is no "'magical per annum percentage' that establishes per se excessiveness" (*Pryor, McClendon*, Exchange Act Rel. No. 8245), the Division is *correct* that courts have considered "two metrics" as *indicators* of excessive trading—the turnover and cost/equity ratios. (DOE at 59.) Neither on its own, however, "necessarily demonstrates churning" and the purpose of each is to introduce "*some measure of objectivity or certainty*" in determining whether an account was excessively traded. *Costello*, 711 F.2d at 1369 (emphasis added); *see Craighead v. E.F. Hutton & Co.*, 899 F.2d 485, 490 (6th Cir. 1990) (same). When the underlying methodology and factual predicates upon which each ratio is calculated are unreliable, as they were here, the measure of objectivity and certainty those metrics afford fails.

As explained in Calabro's Initial Post-Hearing Brief, the Division's expert failed to consider in his calculations the significant mathematical anomalies borne of accounts—such as the Customers' accounts in this case—that are short the market *and* experience rapid declines. (Calabro Br. at 24-27.) The range of potential error was so material that the Division's expert conceded the calculations were "inherently" "not precise." (Tr. 3283:19-24.) Thus, the "objectivity" and "certainty" each ratio was intended to lend was attenuated.

In any event, the theoretical lines the Division contends are conclusive of excessive trading—six annually for turnover and 20% for cost/equity (DOE Br. at 59)—are inapplicable in this case. A turnover of six has generally been recognized as excessive, but only with respect to accounts with *conservative* objectives. As the ALJ in *In the Matter of J.W. Barclay* explained:

> No turnover rate is universally recognized as determinative of churning, but an annualized portfolio turnover rate in excess of 6 is generally presumed to reflect excessive trading *if the customer's objective is conservative*. . . . On occasion, the Commission has found excessive trading based on turnover rates of less than 4 where the customer's objective is conservative. . . . *Of course, if a customer wants to speculate, the portfolio turnover rate could be unlimited.*

Admin. Proc. File No. 3-10765 (October 23, 2003) (emphasis added); *see Newburger*, 563 F.2d at 1070 (turnover of seven not excessive as "a greater volume of activity will normally be expected" given the customer's objectives included speculation). The Division's expert explained, by contrast, that "[t]here is no stated theoretical line for an account that is moderate or aggressive" with "regard to turnover." (Tr. 3274:18-22.) The same is true regarding cost/equity, for as the ALJ in *Barclay* explained, a "cost-to-equity ratio of 15% to 21% on a *conservative* account generally indicates churning." *Barclay, supra* (emphasis added); *see In the Matter of Sage Advisory Services LLC*, Exchange Act Rel. No. 44600 at n.10 (July 27, 2001) (same).

Here, each Customer's objectives were speculative and aggressive, and each intended to take advantage of a declining market through short selling supported by options. The strategy was risky, as Calabro explained and the documents each Customer signed made clear, and was inherently shorter term than a buy and hold strategy. (Calabro Exs. 4, 5, 6, 26, 4.) Indeed, the Division's expert confirmed that "[a] short investment is typically a shorter term investment." (Tr. 3244:23-3245:2; *see* Tr. 3244:10-22 [options "are meant to be short-term investments"].) Moreover, the strategy was well-known to each Customer, and each was well-aware it was not "conservative" notwithstanding that each now contends the opposite in hindsight.[6]

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[6] The cases the Division relies upon are distinguishable for this reason. (DOE Br. at 59.) *See In the Matter of Andra K. Simpson*, Exchange Act Rel. No. 45923 (May 14, 2002) ("extremely conservative investment objectives"); *In the Matter of Jones Canady*, Exchange Act Rel. No. 41250 (April 5, 1999) (customers had "conservative investment objectives"). *In the Matter Of Sage Advisory Services LLC*, Exchange Act Rel. No. 44600 (July 27, 2001) concerned a settlement "without admitting or denying any of the findings contained herein."

Given the calculation anomalies and each Customer's actual investment objectives, even the Division's expert was forced to conclude that whether the accounts were excessively traded was far from clear. As demonstrated in Calabro's Initial Post-Hearing Brief, when turnover and cost/equity are recalculated considering the short nature of the accounts and their rapid declines, which the expert confirmed "you could" do (Tr. 3255:9-21), they dropped below or very close to the theoretical lines on which the Division asserts the Court should presume churning. (Calabro Br. at 24-27.) Adding the account objectives were speculative, the expert thus confirmed:

> Q. And when you're comparing [the recalculated ratios] to an aggressive account where the customer marks the account aggressive and understands that there is going to be a lot of trading in the account, once you get into this range, it becomes a much closer question as to whether or not it was in fact churning, right?
>
> A. Correct. (Tr. 1384:2-9.)

In short, the Division failed in its burden to prove excessive trading by a preponderance of evidence.

II. CALABRO DID NOT EXERCISE *DE FACTO* CONTROL

The Division asserts that the "key factor" in control is "whether the customer lacks the ability to manage the account and routinely follows the recommendations of the registered representative (as opposed to exercising independent judgment)." (DOE Br. at 60.) The "touchstone" of *de facto* control, however, is whether "the customer has sufficient intelligence and understanding to evaluate the broker's recommendations and to reject one when he thinks it unsuitable." *Follansbee v. Davis, Skaggs & Co., Inc.*, 681 F.2d 673, 677 (9th Cir. 1982). Here, each Customer had the intellect and business experience to understand and make decisions on Calabro's recommendations. (Calabro Br. at 32-37.) Moreover, the strategy was disclosed, and Calabro did nothing to prevent the Customers from understanding his recommendations; indeed, he spoke to them virtually every day.

The cases the Division cites prove the point. For instance, *In re Matter of Rizek*, Admin. Proc. File No. 3-9041 (Aug. 11, 1999) (DOE Br. at 61) involved customers "who were incapable of making an independent judgment" concerning an "extremely high risk" strategy that was "directly contrary to the customers' conservative investment objectives," and a broker who was "well aware" of his impropriety which he "*tried to conceal*." (Emphasis added). Here, by contrast, the Customers were not only able to, but did make independent judgments concerning a trading strategy that was fully disclosed and was consistent with their stated objectives.

Similarly, in *Barbato*, *supra*, at 24-25, a broker's *misrepresentation of material facts prevented* a customer from making "an independent evaluation" of his recommendations and thus *de facto* control existed. However, control did not exist, notwithstanding the broker's misrepresented facts, where another customer "had the financial background to track his investments, calculate profits and losses, and investigate more thoroughly the investments he was making." In this case, Calabro hid no facts, and Williams tracked his investments and calculated his profits and losses. (DOE Ex. 48.) Willhoft admitted he was able to do the same (Tr. 1300:15-19), but he chose to leave the matter to Williams. (Tr. 1301:15-1302:2; Calabro Ex. 49.) And after decades in his own business and certainly having the requisite financial background, Moore followed his account activity through his frequent calls with Calabro in which he learned "how [his] account was doing," and likely through "Pam" who was designated the person to "monitor" his investments. (Tr. 804:12-22; Calabro Ex. 61.)[7]

The Division next misinterprets Calabro's defense when it contends "[m]ere receipt of the account statements and confirmation slips does not establish that the customers understood what was happening in their accounts." (DOE Br. at 64.) The Division's argument is misplaced

[7] *In the Matter of Mark Gilbert Platt*, Exchange Act Release No. 48408 (August 25, 2003) was a default judgment, in which no factual allegations were subject to dispute.

as the issue is whether the Customers were able to *understand* the confirmations and statements "to determine his or her overall position or the total amount of real profit or loss." *Karlen v. Ray E. Friedman & Co.*, 688 F.2d 1193, 1200 (8th Cir. 1982) *see Altschul v. Paine, Webber, Jackson & Curtis, Inc.*, 518 F. Supp. 591, 594 (S.D.N.Y. 1981) (ratification where investor was "able to comprehend the trading in his account" and knew commissions). Here, Williams and Willhoft understood the confirmations and statements; Williams confirmed his understanding in analyses he conducted for himself and for Willhoft (Calabro Exs. 47, 49), and Willhoft made it clear that he reviewed confirmations and was "able to identify the commissions." (Tr. 1299:8-1300:8.)[8]

In any event, Calabro *never* relied on statements or confirmations to assure his Customers understood their accounts. Rather, he explained his strategy (including its shorter term nature) and was in constant contact with each Customer regarding account status. Each customer, moreover, signed multiple documents acknowledging the intent to engage in shorter term investing. Under these circumstances, each maintained ultimate control, and therefore the Division's churning charge is unwarranted. *See Leib v. Merrill Lynch, Pierce, Fenner & Smith Inc.*, 461 F. Supp. 951, 954-955 (E.D. Mich. 1978), *aff'd*, 647 F.2d 165 (6th Cir. 1981) ("[I]f the customer and the broker speak frequently with each other regarding the status of the account or the prudence of a particular transaction, the courts usually find that the customer, by maintaining such active interest in the account thereby maintained control over it.").

III. CALABRO DID NOT COMMIT FRAUD

Separate from excessive trading and control, the Division was duty-bound to prove Calabro acted with *scienter*, which the Supreme Court holds is "a mental state embracing intent

[8] Thus, the Division's allegation that "Willhoft received trade confirmations, but he did not really know how commissions were calculated" is wrong. (DOE Br. at 16.)

to deceive, manipulate, or defraud." *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 (1976).[9] *Scienter* in a churning case is when a broker trades "without regard to the customer's investment interests" and "*for the purpose of generating commissions.*" *Thompson v. Smith Barney, Harris Upham & Co.*, 709 F.2d 1413, 1416 (11th Cir. 1983) (emphasis added); *see In re Donald A. Roche*, Exchange Act Release No. 38742 (SEC June 17, 1997) (same). Thus, short of proving a purpose of generating inflated commissions, the Division's charge must be denied.[10]

The Division contends its "strongest evidence" of a purpose to overtrade was an alleged lack of "trading strategy or other explanation justifying the large number of trades" combined with "trading that was inconsistent" with the Customers' "essentially conservative" objectives. (DOE Br. at 65.) Calabro however "testified at length" about his strategy, as the Division concedes, which during the alleged "churn period" involved short sales and associated options

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[9] The Division contends that "[r]ecklessness satisfies the scienter requirement." (DOE Br. at 53, 64.) The Supreme Court has never gone so far in an enforcement action. *Aaron v. SEC*, 446 U.S. 680, 686 n. 5 (1980). Indeed, in *SEC v. Falbo*, 14 F. Supp. 2d 508, 524 (S.D.N.Y. 1998) (DOE Br. at 53), the Court stated that it "remain[ed] an open question" whether recklessness may apply in an "enforcement action," and pointed to now Justice Sotomayor's decision in *SEC v. Softpoint*, 958 F. Supp. 846, 864 (S.D.N.Y.1997) in which she relied on a "knowing misconduct" standard of *scienter*.

In any event, the "degree of recklessness" to prove *scienter* is "extremely high" and requires "severe recklessness." *SEC v. Betta*, 2011 WL 4369012 at *9 (S.D. Fla. Sept. 19, 2011). Severe recklessness are "those highly unreasonable omissions or misrepresentations that involve not merely simple or even inexcusable negligence, but an *extreme departure* from the standards of ordinary care, and that present a danger of misleading buyers or sellers which is either known to the defendant or is so obvious that the defendant must have been aware of it." *Mizzaro v. Home Depot, Inc.*, 544 F.3d 1230, 1238 (11th Cir. 2008); *accord SEC v. Shanahan*, 646 F.3d 536, 543 (8th Cir 2011); *Rizek v. SEC*, 215 F.3d 157, 162 (1st Cir. 2001). As demonstrated above, the evidence proved Calabro's actions were not deceptive or meant to mislead his customers; he explained his strategy to his clients and pursued it, and each customer received multiple documents setting forth the objectives for their accounts.

[10] The Division's assertion that *scienter* may be "inferred from the commissions charged" is an overstatement. (DOE Br. at 65.) Commissions are compensation for executing a trade. Thus, a large number of trades that ultimately results in "losses while [the broker] was receiving substantial commissions," standing alone, is not sufficient to prove churning. *Hotmar v. Lowell H. Listrom & Co., Inc.*, 808 F.2d 1384, 1386 (10th Cir. 1987).

trades. (*Id.*) (*See* Tr. 3946-3984; 4073-4077.) The Division's expert confirmed that both "are meant to be short-term investments," which would result in more trades than a long-term buy and hold strategy. (Tr. 3244:10-3245:2; *see* Tr. 3052-3054 [Bresner] [shorts and options "shorter term"].) And as demonstrated above, each Customer's objectives were consistent with the strategy Calabro employed. The Division's "strongest evidence" is thus refuted by the truth.

Calabro's strategy was also transparent. Moore testified that Calabro explained the strategy using a "bunch of charts and graphs and things like that" during an hour long meeting at Corriher's office. (Tr. 620:13-621:12; 746:11-747:21.) Willhoft testified he was aware the strategy goal was to make money in "a market that's falling," and was able to explain that a "short sell" is when "you sell a stock you don't own for a certain amount of money and you of course have to replace it with." (Tr. 1265:8-1266:17.) And Williams made clear that when he and Calabro concluded "the economy was going to fall" and they "thought [the market] was going to go, down," Calabro explained his short strategy and Williams "understood the basic concept" that "you could sell the stock now and buy it back at a reduced price." (Tr. 1426:13-19; 1428:20-1429:1; 1535:12-19; 1614:9-13-23); (Calabro Exs. 47, 48); *see Hotmar,* 808 F.2d at 1386 (where broker "freely shared all his knowledge and information," the court unable "to perceive any real evidence of deception" by the broker, notwithstanding the customer "suffered substantial losses while [the broker] was receiving substantial commissions").

That Calabro's strategy was transparent was confirmed by Bresner, who testified both he and James McGrath closely scrutinized Calabro's account activity. (Tr. 3046:25-3047:4; *see* 4172:9-4173:8.) McGrath even reviewed Calabro's research, and spoke to some of his customers to determine if they were satisfied. (Tr. 3050:24-3052:3.) Stated simply, the "strongest evidence" proving that Calabro lacked *scienter* or purpose to overtrade his Customers'

accounts is that he, in fact, followed a strategy which he explained to each of his customers and which was reviewed and approved by his superiors.

Its "strongest evidence" having failed, the Division claims Calabro "engaged in deceit and manipulation" because he added "critical investment objective and risk tolerance information to his brokerage account applications either after they were signed by the customers, or giving customers only the last page to sign so that the objectives were undisclosed." (DOE Br. 66.) As explained in Calabro's Initial Brief and above, each Customer's objectives were *fully disclosed in documents each received in real time*, including in the following:

- Moore was faxed a *full* new account form for his IRA *including the page* containing his investment objectives of "Speculation," "Trading Profits" and "Capital Appreciation," for him "to take a look at and then sign and send back" (Calabro Ex. 41; Tr. 761:1-5), and received letters from J.P. Turner on December 9, 2008 and February 9, 2009 that not only confirmed his investment objectives of "Speculation," "Trading Profits" and "Capital Appreciation," but included definitions of each to allow him to review and correct his stated objectives if wrong (Calabro Exs. 28, 65);

- Willhoft also received letters from J.P. Turner on October 31, 2006 and November 24 2006 that confirmed his investment objectives of "Speculation," "Trading Profits" and "Capital Appreciation" (Calabro Exs. 14, 15), and signed a one page Active Account Suitability Supplement reiterating his interest in higher risk investing by confirming that (1) "[a]ctive trading can involve a higher degree of risk, increased costs and is suitable only for risk tolerant investors," (2) active trading "should be entered into only by investors who understand the nature of the risk involved and are financially capable to sustain a loss of part or all of their capital," and (3) "[h]igh-risk tolerance and investment objectives consistent with high-risk investing are appropriate to an active account" (Calabro Ex. 6); and

- Williams received a *pre-filled and signed* Options Suitability Questionnaire along with a letter from J.P. Turner on October 6, 2008 requesting he "review" for "accuracy" and "notify" it of any change to his designated investment objectives as "speculation" and "growth" (DOE Ex. 48), and on March 9, 2009, signed an Active Account Suitability Supplement with the same disclosures as that Willhoft signed.

In all these ways Calabro's actions stand in sharp contrast to the brokers found to have acted fraudulently in the SEC decisions the Division cites. (DOE Br. at 65-66.) For example, in *In re David Wong*, Exchange Act Rel. No. 45426 (Feb. 8, 2002) the broker's *scienter* was

"apparent from *his concession that he pursued this aggressive trading strategy for his personal financial advantage*—that is, to generate commissions—and [was] also apparent from the fact that the trading was effected *in disregard of his customer's interests and account objectives.*" (Emphasis added). In *Roche*, 1997 SEC Lexis 1283, "[n]one of the three customers had speculation as an account objective or had an expectation of rapid turnover." And in *Rizek*, Admin. Proc. File No. 3-9041, the broker thwarted his supervisors' efforts to understand his strategy. Calabro, to the contrary, pursued a transparent strategy consistent with his Customers' objectives, which he went out of his way to ensure his supervisors knew about and understood.

The Division's next assertion that Calabro misled Moore into borrowing money in March 2009 and that he could lose no more than $125,000 is also dubious. (DOE Br. at 66.) Calabro testified that he did and said no such things. More importantly, by April 2009, Moore knew he could lose more than $125,000 because his account value had decreased by over $200,000 in a single month. He nevertheless chose to open a new account for his son, to introduce Calabro to his friends, and keep his account opened until February 2010. (Calabro Ex. 39; Tr. 647:18-23; 700:2-6; 806:7-808:15.) If anything, the evidence proves Calabro explained his investment strategy and any representations he made concerning his confidence was likely nothing more than non-actionable puffery. *See Metzner v. D.H. Blair & Co.*, 689 F. Supp. 262, 264 (S.D.N.Y. 1988) ("Guarantees, and assurances of success generally, are merely 'puffery,' and . . . are not actionable under the securities laws."); *Miller v. New America High Income Fund*, 755 F. Supp. 1099, 1103 (D. Maine 1991) ("Defendants cannot be held liable for creating the impression that investments in junk bonds or an investment in New America would be risk free. In the first place, investors are presumed to know the basic risks of the stock market, and mere sales talk is not actionable.") (citation omitted); *Shamsi v. Dean Witter Reynolds, Inc.*, 743 F. Supp. 87, 91-

92 (D. Mass. 1989) ("A broker's boasts of his own infallibility as an investment advisor are generally not actionable under Rule 10b–5" and "optimistic statements about the stock market and particular stocks belong, for the most part, in the category of nonactionable puffery").

The Division next assertion that "there is no explanation for the April 2007 account update" for Willhoft's '247 account is also incorrect. (DOE Br. at 57.) As explained in Calabro's Initial Post-Hearing Brief, the update was driven by the fact that the income portion of the money intended to be deposited into the '247 account was satisfied by the triple-net investments that never became part of the account. (Calabro Br. at 29-30.) As a result, the entire remaining account was intended to be invested in more speculative investments, which was confirmed when Willhoft directed Calabro to purchase concentrated positions in two stocks Willhoft himself recommended and then shadow traded in his self-directed Ameritrade account. (Calabro Exs. 70-74; Tr. 1217:12-15; 1227:14-19; 1353:6-10.)

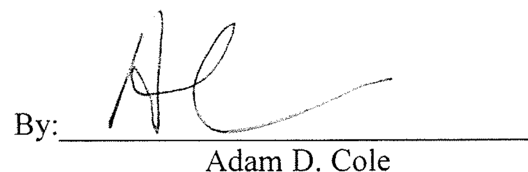
In short, the Division failed to prove Calabro acted with *scienter*. For this separate reason, the Division's charge should be overruled.

CONCLUSION

For all the foregoing reasons, and for the reasons set forth in Calabro's Initial Post-Hearing Brief, the Division's charges against Calabro should be denied.

Dated: May 9, 2013

COUSINS CHIPMAN & BROWN, LLP



By:____________________
Adam D. Cole

380 Lexington Avenue
17th Floor
New York, New York 10168
cole@ccbllp.com
Tel: (212) 551-1152
Fax: (302) 295-0199