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 PETITON FOR REVIEW

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Respondent Ralph Calabro respectfully submits this Petition, pursuant to Rule 410 of the Rules of Practice of the United States Securities and Exchange Commission (the "Commission") (17 C.F.R. § 201.410), for review of the Initial Decision in this Administrative Proceeding dated November 8, 2013 (the "Initial Decision"). The Initial Decision found, *inter alia*, that Calabro churned the account of Dudley Wayne Williams, and ordered Calabro (1) to cease and desist from committing violations and any future violations of Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, (2) barred from association with a broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization (3) to disgorge $282,000 plus prejudgment interest, and (4) to pay a civil penalty of $150,000. Calabro takes exception with each of these findings and conclusions (as summarized below), and the Commission should, therefore, grant review of the Initial Decision.

BRIEF BACKGROUND

Ralph Christopher Calabro ("Calabro") was a broker and branch manager in the Parlin, New Jersey branch of J.P. Turner & Co. ("J.P. Turner") from March 2004 through February 2011. During that period, Calabro serviced as many as 70 clients, to which he made recommendations based upon his own research. Three of his clients were Dudley Williams ("Williams"), Waldo Wilhoft ("Wilhoft") and Harold Moore ("Moore").

Beginning in late 2007, Calabro's research led him to conclude that the bubble market of 2007 would falter, and that his clients could take advantage of the impending downturn. Calabro recommended that his clients either pull their money out of the market or, if they wanted to take a more aggressive approach, to engage in a "short" strategy that could be profitable should the market, in fact, decline. Calabro explained the strategy, including the shorter-term nature of the investments, as selling stock of companies in sectors that his research (based primarily on the

Standard Business Cycle and technical analyses) disclosed would be impacted most heavily, including stocks in the banking and consumer discretion sectors. Calabro's supervisors reviewed and approved of his strategy.

Williams (among other of Calabro's clients) decided to engage in the short strategy beginning in late 2007. When the market crashed throughout 2008 and into early 2009, as Calabro predicted, Williams' account grew by over $1 million. Throughout the period, Williams—a retired economics professor—understood and kept close track of the volume of trades in his account, his profits and losses on each trade, and the commissions he was charged.

Unfortunately, Calabro failed to predict the events of March 2009, that notwithstanding reports indicating that the largest banks were at great risk of failure, and the stock of Citigroup, Inc. was at a time trading for less than one dollar per share, the same banks reported that they were once again profitable. The reports, along with further government intervention, caused a sharp rise in the markets which ran contrary to Calabro's strategy and research. The sharp rise in the markets caused an equally sharp decline in many of Calabro's customer accounts including in Williams' once profitable account.

CALABRO IS CHARGED WITH CHURNING

Beginning in 2010, the Division of Enforcement initiated an investigation into certain trading and supervisory practices at J.P. Turner, which ultimately included seeking information concerning brokers whose accounts were actively traded. Given the short strategy he employed with many of his accounts—which was fully disclosed as involving more active management and trading—Calabro was among the brokers whose accounts were reviewed. The Division's review included the Williams, Wilhoft and Moore accounts.

On September 11, 2012, the Commission issued its Order Instituting Proceedings (the "OIP") charging Calabro with having "churned" the Wilhoft, Williams and Moore accounts. The OIP alleged that Williams, Wilhoft and Moore were each "generally unsophisticated in securities trading," and had "conservative investment objectives and low or moderate risk tolerances" with respect to their J.P. Turner accounts. (OIP ¶¶6, 13.) The OIP further alleged that Calabro "exercised *de facto* control over the accounts," and based upon "annualized turnover ratios" and "break-even rates of return," further alleged that he "knowingly or recklessly" engaged in excessive trading in those accounts. (OIP ¶¶6-8, 13.) The OIP also included charges against two other J.P. Turner brokers and its Executive Vice President dealing with four client accounts and supervision having nothing to do with Calabro or his clients. The combined trial lasted seventeen days.

THE INITIAL DECISION

On November 8, 2013, Administrative Law Judge Cameron Elliot issued an Initial Decision setting forth his findings relating to each broker and customer that was the subject of the OIP. With regard to Calabro, Judge Elliot found that Calabro did not churn the Wilhoft or Moore accounts, but found that he churned the Williams account. Judge Elliot further ordered Calabro to cease and desist from the enumerated securities violations, barred him from association with a broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization, to disgorge $282,000 plus prejudgment interest, and to pay a civil penalty of $150,000.

SUMMARY OF ISSUES FOR REVIEW

Actionable "churning" occurs when a broker trades "without regard to the customer's investment interests" for the principal purpose of generating commissions. *Thompson v. Smith*

Barney, Harris Upham & Co., 709 F.2d 1413, 1416 (11th Cir. 1983). The charge has three elements: (1) excessive trading in light of "'investment objectives,'" (2) "control" and (3) *scienter*. *Id.* at 1416-17 (quoting *Miley v. Oppenheimer & Co.*, 637 F.2d 318, 324 (5th Cir. 1981)). Because more active trading may be appropriate in many instances while in others it may not, whether active trading is actionable depends on the specific circumstances adjudged in light of established legal guideposts. In a nutshell, "[t]he essence of a churning claim is not a particular transaction, it is the aggregation of transactions, allegedly excessive in number, judged in relation to the plaintiff's investment objectives and the market conditions at that time." *Baselski v. Paine Webber Jackson & Curtis Inc.*, 514 F. Supp. 535, 541 (N.D. Ill. 1981); *see Gopez v. Shin*, 736 F. Supp. 51, 58 (D. Del. 1990).

1. <u>Calabro Requests Review Of The ALJ's Ruling On *De Facto* Control</u>

There was no evidence that Calabro exercised actual control over the Williams account through a grant of discretion or otherwise, and the ALJ did not find actual control. Rather, the ALJ determined that Calabro exercised "*de facto* control," the "touchstone" of which is "whether or not the customer has sufficient intelligence and understanding to evaluate the broker's recommendations and to reject one when he thinks it unsuitable." *J.W. Barclay & Co.*, Initial Decision Release No. 239 (Oct. 23, 2003), 81 SEC Docket 1630, 1657.; *Follansbee v. Davis, Skaggs & Co.*, 681 F.2d 673, 677 (9th Cir. 1982); *see Moran v. Kidder Peabody & Co.*, 609 F. Supp. 661, 666 (S.D.N.Y. 1985) ("Where a customer has the independent capacity to accept or reject his broker's recommendations, he cannot accuse his broker of having control of his account even if he habitually follows his broker's recommendations."). Thus, as the ALJ recognized, "a customer does not give up control of his account if he has sufficient financial acumen to determine his own best interests, even if he acquiesces in the broker's management of the account." (Initial Decision at 98.)

The Commission should grant review of the Initial Decision as is applies to Calabro because the ALJ's ruling that Calabro exercised *de facto* control was erroneous, and indeed misapplied these legal guideposts to mostly uncontested facts. Indeed, the evidence demonstrated that Williams had more intelligence and understanding of his account to evaluate Calabro's recommendations and his own best interests than investors in other cases in which a churning charge was ruled unfounded.[1] In particular:

a. Williams holds a master's degree in business and had been a professor at California Polytechnic University for 30 years where he taught economics and quantitative analysis;

b. Williams admitted both in sworn testimony and in writing that he had more than 30 years of investment experience, including investing in a number of private placement investments involving oil exploration as an accredited investor;

c. Williams kept close track of his account performance (as well as the performance of Wilhoft's accounts), including calculating gains and losses on a per trade basis, the tax impact on net gains, the dividends received, the commissions paid, and the amount of unrealized gains and losses;

d. Williams understood the manner in which the short trading in his account operated, writing to Calabro in real time, and when the market was increasing and after having analyzed his account performance, that "Hopefully, the 'short' gods will turn in our favor in the not too distant future";

e. Williams also explained his understanding of the manner in which the short trading in his account operated in sworn testimony in which he declared that he "understood [he

[1] *See, e.g., Follansbee* 681 F.2d at 677 (no control where customer had a degree in economics, a course in accounting, and read and understood corporate financial reports); *Norniella v. Kidder Peabodv & Co., Inc.*, 752 F. Supp. 624, 629 (S.D.N.Y. 1990) (investors maintained control over account where they monitored and raised questions about the accounts with stockbroker); *Xaphes v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 632 F. Supp. 471, 483 (D. Maine 1986) (a "well-educated, sophisticated investor" who "monitored his account constantly and in great detail, checking confirmation slips as they were sent to him, checking the monthly statements, and making notes about the account for himself and his accountants" had "sufficient financial acumen to determine his own best interests").

was] short in the account and [he] wanted the stock market to go down," further "understood the basic concept" that "you could sell the stock now and buy it back at a reduced price," and lamented not having made even more profit from "short" trading given the market was down by a larger percentage than the profit in his account.

The ALJ nevertheless determined that Calabro exercised *de facto* control of the Williams account for the following reasons:

a. Despite having an MBA and having been a college level economics professor, the ALJ found persuasive that Williams "did not teach courses relating to finance or investment"; *the test for de facto control, however, is whether Williams had sufficient intelligence and understanding to evaluate Calabro's recommendations, not whether he taught college-level finance or investing*;

b. The ALJ found persuasive that even though Williams was capable of analyzing—and did analyze—the activity and profits and losses in his account, "this ability is not evidence of, and cannot be interpreted as, securities trading experience"; *the issue, however, is not whether Williams had specific experience in the nature of investments recommended, but whether he had sufficient intelligence and understanding to evaluate Calabro's recommendations*;

c. The ALJ found that Williams' ability to "conduct a profit and loss analysis does not imply the ability to pick stocks"; *the core issue in determining whether Calabro exercised de facto control was whether Williams had sufficient intelligence and was able to understand the frequency of trading in his account, not the ability to "pick" the particular stocks used to accomplish a particular trading strategy*;

d. The ALJ found the fact that "Calabro communicated his investment strategy to Williams and did not prevent him from understanding it, and that Williams did have an understanding of short selling . . . beside the point"; *to the contrary, Williams' ability to understand (and in this case his actual understanding of) Calabro's recommendations is a core point in negating de facto control*;

e. The ALJ found that Williams "merely acquiesced" to short selling and that Calabro "altered or changed" the strategy "without Williams' participation" when it stopped being profitable; *the uncontested evidence was that Williams agreed to engage in short selling after Calabro explained its nature and risks, and the fact that Calabro stopped recommending short selling when Williams' account had suffered losses and the market had changed is* ***consistent*** *with a broker's responsibility, not an indicator of de facto control*; and

f. The ALJ found that Calabro engaged in unauthorized trading, "thereby making it impossible for Williams to evaluate and reject unsuitable recommendations"; *no documentary evidence was submitted to demonstrate an unauthorized trade, and more importantly, Williams admitted having known of the trades in his account and* *having continued to trust Calabro throughout, not having complained about Calabro trading without authority.*

In short, the ALJ made findings of fact that were clearly erroneous, and reached conclusions of law that were erroneous, in determining that Calabro exercised *de facto* control of Williams' account. Accordingly, the Commission's review of the Initial Decision is warranted under Rule 411 of the Commission's Rules of Practice.

2. <u>Calabro Requests Review Of The ALJ's Ruling On Excessive Trading</u>

The Commission should also grant review of the Initial Decision relating to the ALJ's factual and legal conclusions regarding the critical element of excessive trading. The ALJ's error falls into two general categories: (1) the ALJ disregarded clear and contemporaneous documentary evidence proving that Williams maintained an aggressive risk tolerance, and his investment objective was to engage in more speculative trading, and (2) the ALJ relied upon expert testimony that was unreliable under the "spirit" of the law to reach conclusions regarding the trading levels in Williams' account. Thus, review is warranted because the ALJ's factual findings were clearly erroneous and his legal conclusions were erroneous.

a. <u>The ALJ's Ruling On Williams' Investment Objectives Was Erroneous</u>

In considering whether churning occurred, the level of trading in an account must be measured in light of a customer's investment objectives to determine whether the trading was excessive. Trading in an account with stated objectives of speculation and trading is expected to be more frequent than an account with a conservative objective, such as preserving principal or seeking fixed income. *See Costello v. Oppenheimer & Co., Inc.*, 711 F.2d 1361, 1369 (7th Cir. 1983) (where "the goals of an investor 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");

Follansbee v. Davis, Skaggs & Co., Inc., 681 F.2d 673, 676 (9th Cir. 1982) ("a trader looking for quick, short-term gains, and taking short-term gains and losses requires frequent trading").

The Commission should grant review of the Initial Decision because the ALJ's predicate finding that Williams was a "conservative" investor is inconsistent with the mountain of contemporaneous documentary evidence. In particular:

a. Williams signed a New Account Form for his account and a New Account Form for an IRA account declaring his investment objectives as "Speculation," "Trading Profits" and "Capital Appreciation" and his risk tolerance as "Aggressive";

b. Williams confirmed his objectives in signed Options agreements, in which he acknowledged the trading in his account included "a high degree of risk" and that "due to the short term nature of options it is likely" he "may be trading such options to a greater degree than with stocks and/or bonds";

c. Williams also signed an Options Suitability Questionnaire in which he confirmed as "correct" that his investment objectives were "speculation" and "growth";

d. When sent notice about the increased activity in his account, Williams represented in an Active Account Suitability Questionnaire ("AASQ") and related Supplement that he acknowledged his higher risk investing and objectives of "Growth," "Trading Profits," "Speculation" and "Short-Term Trading";

e. Williams also acknowledged in a Supplement to the AASQ his understanding that "[a]ctive trading can involve a higher degree of risk" and "increased costs," a "higher degree of activity" and "overall commissions on your account may tend to be greater than a buy and hold strategy," and his "portfolio value may tend to be more volatile with shorter-term trading";

f. Williams also acknowledged his investment objectives in documents he signed in another account he maintained at Newbridge Securities in which he stated his interest in "Speculation" with a "Risk Tolerance" of "Aggressive"; and

g. At the time of his J.P. Turner account, Williams invested in a number of oil exploration private placements that not only required him to be accredited, but involved a "high degree of risk."

The ALJ nevertheless determined that Williams' "investment objectives did not include speculation and that he did not have an aggressive risk tolerance," but instead his objectives were "capital preservation and capital appreciation" with a risk tolerance of "no greater than moderate." The ALJ's holding was based upon Williams' trial testimony. For instance, the ALJ disregarded no less than six documents Williams signed and multiple others that made his speculative investment objectives clear *in the time period during which Williams maintained his J.P. Turner account* in favor of his testimony (1) that he was an inactive investor *prior to* opening his J.P. Turner account, and (2) that all the forms he signed "contained inaccurate information." The ALJ noted that Williams's testimony in both regards was consistent and emphatic.

The Commission should review the ALJ's factual and legal conclusions regarding excessive trading for, at least, two reasons. *First*, the ALJ's decision to disregard the consistent forms Williams signed expressing his risk tolerance and objectives was erroneous because it is well-settled that a person cannot avoid legal obligations or representations made in a signed document short of proving duress, direct fraud or mental incompetence. *See First Union Discount Brokerage Services, Inc. v. Milos*, 997 F.2d 835 (11th Cir. 1993); *Coleman v. Prudential Bache Sec., Inc.*, 802 F.2d 1350, 1352 (11th Cir. 1986). There was no evidence that Calabro forced Williams to sign the documents, misrepresented to him what they contained, or that Williams suffered from a mental incapacity. In other words, the law precluded Williams from disavowing, in hindsight and after he sustained losses, representations and covenants set forth in investment-related documents on the ground he failed to read them before signing. The ALJ's legal conclusion that Williams' risk tolerance was "no greater than moderate" was erroneous for this reason alone.

The *second* reason the Commission should grant review is that the factual conclusion that Williams consistently signed inaccurate investment forms is clearly erroneous. In making his "credibility" determination, the ALJ relied on Williams' trading activity in an account that predated his J.P. Turner account and on testimony in hindsight at a time when Williams maintained a pending action against J.P. Turner in which he needed to prove a moderate risk tolerance. Thus, the ALJ disregarded contemporaneous signed documents in favor of purported trading activity from a mostly irrelevant period, in a separate account, maintained at a separate broker dealer and testimony of a witness who stood to gain monetarily from not only ensuring his story was consistent, but also ensuring a potential favorable finding by the ALJ. Given the substantial evidence that contradicted Williams' testimony, the Initial Decision should be vacated. *See Kenneth R. Ward*, 56 S.E.C. 236, 260 (March 19, 2003) (while credibility findings are given "considerable weight," the Commission does not accept such findings "blindly" where self-serving testimony is contradicted by overwhelming documentary evidence), *aff'd*, 75 F. App'x 320 (5th Cir. 2003).

In short, the ALJ's conclusion of law that trading was excessive was erroneous as it was based upon an incorrect predicate that Williams maintained a moderate risk tolerance. In fact his risk tolerance was aggressive and his investment objective was short term trading, which by definition would result in a higher volume of trades.

b. <u>The ALJ Should Have Disregarded The Purported Expert Testimony</u>

In an effort to establish that trading in Williams' account was excessive, the Division presented testimony of a purported expert, Louis Dempsey. Dempsey testified that his charge was to review and confirm the Division's calculations of "turnover" and "cost-to-equity ratios" in the various accounts that were the subject of the OIP. Dempsey concluded that the turnover and cost-to-equity ratios indicated excessive trading in the Williams account. The Commission should grant review of the Initial Decision because the ALJ should have disregarded Dempsey's calculations as unreliable under *Daubert v. Merrell Dow Pharmaceuticals, Inc.*, 509 U.S. 579, 589 (1993). *See also* SEC Rule 320 (irrelevant evidence "shall" be disregarded).

Daubert requires trial courts to evaluate the admissibility of expert testimony both from a standpoint of the proposed expert's ability to provide the testimony (based on the witness' experience, educational background, and the like) and from a standpoint of the reliability of the proposed expert conclusions (based upon the acceptability and accuracy of the methods employed). While it appears that the Commission has not yet considered or accepted the applicability of *Daubert* to administrative hearings (which it should now do), courts have declared that at least "the spirit of Daubert" applies to administrative proceedings because "'[j]unk science' has no more place in administrative proceedings than in judicial ones." *Niam v. Ashcroft*, 354 F.3d 652, 660 (7th Cir. 2004); *see Elliott v. CFTC*, 202 F.3d 926, 934 (7th Cir. 2000) ("*Daubert* and *Kumho Tire* were decided in the context of admissibility, but the principle for which they stand-that all expert testimony must be reliable-should apply with equal force to the weight a[n agency] factfinder accords expert testimony.").

The ALJ should have disregarded Dempsey's testimony as it applied to the Williams account because the "turnover rate" (which measures average account equity to the value of purchases) and "cost/equity ratio" calculations were based on a faulty methodology. Dempsey admitted that he failed to account for the anomaly of market forces that impact a "short account," which ultimately and improperly inflated his turnover and cost/equity calculations particularly where, as here, Williams' account value declined rapidly due to a spike in the market. As was established during the trial, the inaccuracy of the turnover formula due to fluctuating account equity is highly magnified where transactions in an account are predominantly "short" sales because *both* the purchase price *and* the average equity fluctuate. As Dempsey conceded, "it would modify turnover," and have a "really big impact" during "a very large spike in the marketplace upward" – precisely what happened during the alleged "churn" period in this case.

Dempsey also did not account for the large market spike, and resulting rapid decline in average equity in the Williams account in calculating the cost/equity ratio. Dempsey made it clear that an "account that declines rapidly can also have an impact on the return on equity calculations," which was confirmed by Michael Bresner ("Bresner"), J.P. Turner's Executive Vice President (testifying that the ratio would "go up dramatically") and Michael Issacs, J.P. Turner's compliance chief during the period, confirmed. Having failed to account for the severe market forces, the methodology Dempsey employed to determine excessive trading in the Williams account was unreliable and his calculations should have been disregarded.

In sum, as the Commission recognizes, an "assessment of the level of trading . . . does not rest on any 'magical per annum percentage,' however calculated." *In re Matter of Gerald E. Donnelly*, Exchange Act Rel. No. 39990 (Jan. 5, 1996). Here, the ALJ's determination that the turnover rate and cost/equity ratio for the Williams account demonstrated excessive trading was erroneous and should be vacated for this separate reason.

3. <u>Calabro Requests Review Of The ALJ's Ruling On *Scienter*</u>

A large number of trades in a customer's account that ultimately results in "losses while [the broker] was receiving substantial commissions," standing alone, is not churning. *Hotmar v. Lowell H Listrom & Co., Inc.*, 808 F.2d 1384, 1386 (10th Cir. 1987). Rather, churning "involves a conflict of interest in which a broker or dealer seeks to maximize his or her remuneration in disregard of the interests of the customer." *In re Donald A. Roche*, Exchange Act Release No. 38742 (SEC June 17, 1997). The ALJ's conclusion of law that Calabro acted with *scienter* was erroneous because the evidence proved that his investment recommendations were designed to take advantage of the anticipated and then actual market collapse though a short-term strategy involving short sales and options. There was no evidence that Calabro implemented the strategy for the *principal* purpose of generating commissions.

Rather, Calabro developed his strategy and openly shared it with Williams, who testified that he was aware that the strategy involved shorter term trading. *See Hotmar*, 808 F.2d at 1386 (where broker "freely shared all his knowledge and information," the court was unable "to perceive any real evidence of deception on the party" of the broker, notwithstanding the fact that the customer "suffered substantial losses while [the broker] was receiving substantial commissions"). Calabro also shared his strategy with his superiors, who conducted an extensive analysis of the investment strategy. Indeed, this transparency proved that Calabro acted in good faith, not with a principal intent to generate commissions.

4. Calabro Requests A Reduction Of The Disgorgement And Penalty Amounts

Should the Commission ultimately determine on appeal that Calabro engaged in churning of the Williams account, the Commission should reduce the disgorgement and penalty amounts for two reasons. *First*, Williams recovered most, if not all, of his losses (which included commissions paid) in a settlement of a separate action against J.P. Turner. Disgorgement of amounts already recovered would constitute an unwarranted windfall.

The *second* reason the disgorgement and penalty amounts should be reduced is that Calabro is unable to pay the amounts set forth in the Initial Decision. Calabro is no longer working in the securities industry and thus is struggling to establish a new source of income. In addition, Calabro currently has a negative net worth, and no assets from which to pay the stated disgorgement and penalty. Review of the Initial Decision should be granted for this separate reason.

CONCLUSION

For all the foregoing reasons, the Commission should grant Calabro's Petition for review of the Initial Decision.

Dated: November 26, 2013

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