INITIAL DECISION RELEASE NO. 296
ADMINISTRATIVE PROCEEDING
FILE NO. 3-11692

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of	:	
	:	INITIAL DECISION
RAYMOND JAMES FINANCIAL	:	September 15, 2005
SERVICES, INC.,	:	
J. STEPHEN PUTNAM and	:	
DAVID LEE ULLOM	:	
	:	

APPEARANCES: Luke T. Cadigan, Ian D. Roffman, Bradford E. Ali, and Dawn A. Edick for the Division of Enforcement, Securities and Exchange Commission

Burton W. Wiand, Maya M. Wolfe, Lara Thyagarajan, Seth Rosner, Darren Farfante, and Peter King for Raymond James Financial Services, Inc.

Jerry A. Isenberg, Thomas J. McGonigle, Lindi L. Beaudreault, and J. Burton Hong for J. Stephen Putnam

BEFORE: Brenda P. Murray, Chief Administrative Law Judge

The Securities and Exchange Commission (Commission) initiated this proceeding on September 30, 2004, pursuant to Section 8A of the Securities Act of 1933 (Securities Act), Sections 15(b) and 21C of the Securities Exchange Act of 1934 (Exchange Act), and Section 203(f) of the Investment Advisers Act of 1940 (Advisers Act). David Lee Ullom (Mr. Ullom) submitted an Offer of Settlement to the Commission in this proceeding on January 27, 2005, which the Commission accepted on January 28, 2005.[1] 84 SEC Docket 2866 (Jan. 28, 2005).

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[1] Mr. Ullom was barred: (1) from association in a supervisory capacity with any broker, dealer, or investment adviser; and (2) from association in any capacity with any broker, dealer, or investment adviser, with the right to reapply for association in a non-supervisory capacity after one year. Mr. Ullom was also ordered to pay a civil penalty of $100,000. Div. Ex. 480; 84 SEC Docket 2866 (Jan. 28, 2005). As a result of the conduct underlying this proceeding, on December 6, 2004, the district court entered a Final Judgment as to Relief Defendant David L.

The thirteen days of hearing in January and February 2005 are reflected in 3,636 pages of transcript. The Division of Enforcement (Division) presented fifteen witnesses in its direct case and one expert witness in rebuttal.[2] Raymond James Financial Services, Inc. (Raymond James), presented eleven witnesses, including four experts. J. Stephen Putnam (Mr. Putnam) testified and presented one expert witness. The record contains approximately 510 exhibits. The final brief was submitted on April 28, 2005.

ISSUES

1. Whether Raymond James and Mr. Putnam failed reasonably to supervise Dennis Herula (Mr. Herula), a person subject to their supervision, with a view to preventing or detecting Mr. Herula's violations of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

2. Whether, as a result of Mr. Herula's fraudulent conduct, Raymond James violated Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5.

3. Whether Raymond James willfully violated Section 17(a) of the Exchange Act and Rule 17a-4 thereunder.

FINDINGS OF FACT

The findings and conclusions herein are based on the entire record. I applied preponderance of the evidence as the standard of proof. See Steadman v. SEC, 450 U.S. 91, 102 (1981).[3]

Ullom in SEC v. Dennis S. Herula, No. CA 02-154 ML (D.R.I. Dec. 12, 2004), which ordered Mr. Ullom liable for disgorgement of $190,000, but waived payment of all but $10,000. (Div. Ex. 182.)

[2] Citations to the transcript of the hearing will be noted as "(Tr. __.)." Citations to the Division's exhibits will be noted as "(Div. Ex. __.)." Citations to Raymond James's and Mr. Putnam's exhibits will be noted as "(R.J. Ex. __.)," and "(Putnam Ex. __.)," respectively. Citations to the Division's Proposed Findings of Fact and Conclusions of Law and its Post-Hearing Brief will be noted as "(Div. Proposed Findings __.)" and "(Div. Post-Hearing Br. __.)," respectively. Citations to Raymond James's and Mr. Putnam's Proposed Findings of Fact and Conclusions of Law and Post-Hearing Briefs will be noted as "(R.J. Proposed Findings __.)" and "(R.J. Post-Hearing Br. __.)," and "(Putnam's Proposed Findings __.)" and "(Putnam Post-Hearing Br. __.)," respectively. Citations to the Division's Reply Brief will be noted as "(Div. Reply Br. __.)."

[3] I have considered and rejected all arguments and proposed findings and conclusions that are inconsistent with this Initial Decision. I deny Raymond James's contention that clear and convincing evidence is required to show that a respondent has violated Section 10(b) of the Exchange Act and Rule 10b-5. (R.J. Post-Hearing Br. 6 n.7.) The cases that Raymond James

Brite Business Corporation

Brite Business Corporation (Brite Business) was a non-public company set up to defraud investors. (Tr. 883, 1664-65.) Michael Clarke (Mr. Clarke) originated Brite Business in the United Kingdom. (R.J. Ex. 2642.) Mr. Clarke "began soliciting investors through Brite Business S.A., a British Virgin Islands company, which was established in December 1997." (Id.) Mr. Clarke's acquaintance Johan C. Hertzog (Mr. Hertzog) brought in Martin D. Fife (Mr. Fife), who agreed to manage client funds. (Id.) Mr. Fife allegedly had influential friends and accoutrements of wealth, including a residence on Central Park West in New York City. In April 1999, Mr. Fife arranged for Charles Sullivan (Mr. Sullivan) to incorporate Brite Business. (Id.) In 2000, Mr. Fife, Mr. Hertzog, Robert M. Wachtel (Mr. Wachtel), and Mr. Clarke, represented that they were on Brite Business's board. (Putnam Ex. 2210.) Mr. Fife and Mr. Sullivan represented that they were Brite Business's president and vice president, respectively.[4] From April 1999 until it was dissolved around March 2001, Brite Business was a Delaware corporation with an office address in New York City. (Div. Ex. 480 at 3, R.J. Ex. 2210.) Beginning in October 1999, Brite Business maintained investor funds in brokerage accounts at Raymond James's Cranston, Rhode Island, branch office (Cranston branch office). (Tr. 883, 1145.)

From 1999 through 2002, Brite Business engaged in a fraudulent offering scheme, run by Mr. Fife and others, in which it represented that investments of a minimum of one million dollars could earn double digit interest per month.[5] (Tr. 481-83.) Brite Business represented that when it accumulated $100 million it would "leverage" the funds to purchase T-bills, or some other government issue, and without leaving the Brite Business account those deposits would earn astronomical returns. (Tr. 480-81, 515, 559, 594.) It was not clear what Brite Business intended to do with the investment proceeds or how it would be able to pay such astronomical returns. (Tr. 230, 237.) Some understood that Brite Business intended to use the funds as a credit enhancer allowing it to borrow more funds, while others believed that international entities would pay astronomical sums to be allowed to show Brite Business's funds to "enhance their balance sheet." (Tr. 230.) At least one investor believed that Brite Business would deposit his funds at "Bank Raymond James," and would use pooled funds to buy T-bills, which would

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cites, Collins v. SEC, 562 F.2d 820, 824 (D.C. Cir. 1977) and Whitney v. SEC, 604 F.2d 676, 681 (D.C. Cir. 1979), were overruled by Steadman, supra.

[4] According to Brite Business, Mr. Fife, a Lehigh University graduate, was a trustee of each of the Dreyfus Funds and one of the most respected investment bankers in South Africa. Mr. Clarke gained extraordinary marketing expertise in the telecommunications industry as an area manager for British Telecom. Mr. Wachtel, Brite Business's representative for North, South, and Central America, "converted, leveraged, compounded and traded assets for some of the most well-known and influential industrialists, financial magnates such as the world-renowned gold trader, Mr. Jack Lazar." Mr. Sullivan served for eight years as Chairman of the National Football League. (R.J. Ex. 2210.)

[5] All amounts are in United States dollars.

enable Brite Business to borrow from other sources and earn more than the T-bill rate on the pooled $100 million. (Tr. 234, 237.) All investors believed the investment involved no risk of capital. (Tr. 230, 483-84.)

Raymond James

Raymond James Financial, Inc. (the holding company), a diversified financial services holding company headquartered in St. Petersburg, Florida, and listed on the New York Stock Exchange, combined two of its wholly owned subsidiaries to create Raymond James.[6] In January 1999, a holding company subsidiary, Robert Thomas Securities (Robert Thomas), merged with Investment Management & Research (IMR), another subsidiary, and IMR changed its name to Raymond James. (Tr. 1297-98, 1610-11.) Raymond James is registered with the Commission as a broker–dealer and as an investment adviser pursuant to Section 15(b) of the Exchange Act and Section 203(a) of the Advisers Act, respectively.

Raymond James "is an independent contractor firm that introduces its business into Raymond James & Associates, Inc.," and its primary regulator is the National Association of Securities Dealers (NASD).[7] (Tr. 1601, 2153; R.J. Ex. 2665 at 10.) Raymond James & Associates, Inc., (R.J. & Associates), a member of the New York Stock Exchange, performs the research, execution, clearing, bookkeeping, and is responsible for servicing all customer accounts at Raymond James. (Tr. 1602, 1617-18, 2153, 2752, 2822; R.J. Ex. 2658.) R.J. & Associates has clearing relationships with forty-four other broker-dealers, in addition to Raymond James. (Tr. 2822.) These two broker-dealers conduct the majority of the business of the holding company. (Tr. 3423.)

Raymond James referred to its registered representatives as financial advisers. (Tr. 2048.) During the relevant period, August 1999 through December 2000, Raymond James had from 1,100 to 4,000 registered representatives, who were allowed to engage in business activities other than buying and selling securities. (Tr. 2034, 2325, 3530.) About fifty percent of Raymond James's registered representatives engaged in some type of business activity outside the firm, such as selling insurance or financial planning. (Tr. 1900.) Between ten to twenty percent of Raymond James's registered representatives worked outside their assigned offices regularly, and about five percent never went to the office. (Tr. 2337-38.)

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[6] In February 2005, the holding company had about twenty subsidiaries or affiliates. (Tr. 1830.) These included Raymond James, Raymond James & Associates, Raymond James Trust Company, Raymond James Insurance, and Raymond James Bank. (Tr. 1618, 1830-31, 3423-24.)

[7] The expert testimony is that many brokerage firms operate with independent contractors, persons who have other businesses or sell products other than securities. The major self-regulatory organizations do not encourage independent contractors. (Tr. 2036; R.J. Ex. 2665 at 9.) In the "wire house" model, used by older national firms such as Merrill Lynch, Salomon Smith Barney, and Dean Witter, all registered representatives are employees and they are strongly discouraged from engaging in outside activities. The term comes the fact that years ago broker-dealers with branch offices communicated by Western Union's wire system, (Tr. 1619, 2040.)

The NASD applies the same rules to all registered representatives whether they are independent contractors or employees. (Tr. 2488-89.) This proceeding involves the Cranston branch office, part of the securities division of Raymond James.[8] (Tr. 1007, 1612; Div. Ex. 313 at 7.) Most of Raymond James's approximately 550 branch offices located throughout the United States were staffed by two or three registered representatives. (Tr. 1615-16, 1619.) Under NASD rules, Raymond James designated the Cranston branch office as an Office of Supervisory Jurisdiction (OSJ), which required that it have a registered principal. (Tr. 2325-27.)

Mr. Putnam

Mr. Putnam, sixty-two years old, graduated from Bowdoin College in 1965, and served with the Army in Vietnam. (Tr. 1603-04; Putnam Ex. 1075.) Mr. Putnam was with his family's securities firm, F.L. Putnam, from 1968 until 1981, and in 1979 was chairman of the board of directors of the NASD. (Id.) Mr. Putnam's Form U-4 shows five items in the late 1970s or early 1980s: two offers of settlement and three acceptance, waiver & consents. (Tr. 1604; Div. Ex. 286.) These matters involved allegations of failure to supervise, failure to maintain net capital, "integration with respect to a tax incentive investment," and excessive mark-ups. The result in almost each instance was a censure and a fine of $1,000 or $1,500, which F.L. Putnam paid. (Div. Ex. 286; Tr. 1605-09.) Mr. Putnam did not pay anything personally. (Tr. 1604.)

In July 1983, Mr. Putnam became president and chief executive officer (CEO) of Robert Thomas. (Tr. 1610, 1872.) He became an executive vice president and board member of the holding company in about 1987. When Raymond James was created in January 1999, Mr. Putnam became president, chief operating officer, and a director. (Tr. 1601, 1611.) Mr. Putnam reported to the CEO. (Tr. 2046.) Mr. Putnam's responsibilities included direct oversight of the securities division, which included the Cranston branch office. (Tr. 1612, 1614-15.) Mr. Putnam supervised the activities of the branch offices in conjunction with Raymond James's Compliance Department (Compliance Department). (Tr. 1614, 2052.) In carrying out his responsibilities, Mr. Putnam relied on the Compliance Department and the individual branch managers. (Id.) Raymond James's internal investigation did not find that Mr. Putnam was deficient in his supervision of Mr. Herula. (Tr. 1864.)

In April 2003, Mr. Putnam left Raymond James and is now executive vice president, special projects, at the holding company. (Tr. 1599-601.) Mr. Putnam has no supervisory responsibilities in his new position. (Tr. 3431.) The holding company made this move, in large part, because it believed the Commission wanted Mr. Putnam removed. (Tr. 3442.) Several witnesses who worked with Mr. Putnam testified of their high regard for his professional accomplishments, intelligence, honesty, drive, and loyalty to Raymond James. (Tr. 1864-65, 2917, 3430-31, 3445.)

David Ullom

[8] Raymond James's other divisions are the financial institutions division, the investment management division, and the business development division. (Tr. 2297.)

Mr. Ullom, a graduate of Pennsylvania State University, began working in the securities industry in 1970. (Tr. 1002.) From 1974 until 1991, Mr. Ullom was an owner and the CEO of Barclay Investments, a broker-dealer with three offices and twenty registered representatives. (Tr. 1285.) Mr. Ullom first met Mr. Putnam in the 1970s when Mr. Ullom and some associates from Barclay Investments became a division of F.L. Putnam. (Tr. 1634.) Mr. Ullom considered Mr. Putnam a friend and contacted Mr. Putnam in 1991 when he was looking for a position. (Tr. 1013-14.)

Mr. Ullom had no significant regulatory violations when he signed a Registered Representative Agreement with Robert Thomas on June 7, 1992.[9] (Tr. 1287; R.J. Ex. 2016.) In 1994, when he became the principal of the Robert Thomas office in Rhode Island, Mr. Ullom held the following licenses: general securities, financial principal, general principal, options principal, municipal principal, and investment adviser. (Tr. 1002, 1293-94.) The Independent Sales Associate Agreement he signed with Robert Thomas in 1994 provided that Mr. Ullom was an independent contractor with Robert Thomas. (Tr. 1293; R.J. 2016 at 7.)

The terms of the Independent Sales Associate Agreement required Mr. Ullom to maintain an office, to bear the expenses, to be responsible for assuring that registered representatives in the office adhered to all applicable regulations, cooperated with audits, and to indemnify Raymond James against any liability arising from his conduct, or that of a registered representative in the office. (R.J. Ex. 2016 at 8; Tr. 1295-97.) Mr. Ullom managed Raymond James's Cranston branch office as an independent contractor, Foxhill Management (Foxhill), with a checking account in the name of "Foxhill d/b/a Raymond James Financial Services." (Tr. 1006-07.) The Foxhill account was the operating account for the Cranston branch office, and the account statements for 1999 and 2000 were in the Foxhill file at the Cranston branch office.[10] (Tr. 1280.) Foxhill, a Rhode Island C corporation, provided office space, utilities, staff support, employee benefits, and "interfaced with Raymond James for purposes of receiving commission dollars back that had been generated." (Tr. 1004-06.) Signs in the Cranston branch office identified only Raymond James. (Tr. 1007, 1324.) All mailings, account documents, and client payments were to Raymond James. (Tr. 1008.) Mr. Ullom could hire registered representatives subject to Raymond James's approval. (Tr. 1295; R.J. Ex. 2016 at 8.)

In 1995, Mr. Ullom settled an allegation that a registered investment adviser he co-owned had mischaracterized revenue. David Lee Ullom, 59 SEC Docket 1375 (June 13, 1995). The Commission Order found that Mr. Ullom: (1) made false statements to a Rhode Island Department of Business Regulation examiner; (2) directed the investment adviser's bookkeeper to alter financial documents; (3) distributed a brochure with misleading information; (4) violated Section 207 of the Investment Advisers Act by making untrue statements of material fact in a report filed with the Commission; and (5) knew, or acted with reckless disregard for whether his

[9] Prior to joining Raymond James, Mr. Ullom had a net capital violation and was involved in a dispute over the sale of a limited partnership. (Tr. 1287.)

[10] Mr. Ullom failed to produce the Foxhill check register for 2000 in response to a Commission subpoena. (Tr. 1522.)

actions were part of an overall activity that was improper and provided substantial assistance to the adviser's violations. (R.J. Ex. 2022.) When it accepted the settlement, the Commission knew Mr. Ullom was managing a broker-dealer branch office. (Tr. 1288-90; R.J. Ex. 2022 at FW 020432.) The Commission censured Mr. Ullom; ordered him to cease and desist; fined him $10,000; ordered him to retake and pass the general securities principal examination before any future association with an investment adviser in a supervisory capacity; and attached conditions to Mr. Ullom's ownership of more than twenty percent of an investment adviser. (Id.) The Commission's Order did not restrict Mr. Ullom's activities with a broker-dealer or investment adviser. (Tr. 1290, 2468-69.)

The Independent Sales Associate Agreement defined "Other Associates" as qualified registered representatives who enter independent contractor relationships with Raymond James. (R.J. Ex. 2016 at 6.) In the independent contractor relationship, each registered representative in the Cranston branch office had a direct contractual relationship with Raymond James, and a relationship with Foxhill. (Tr. 1004, 1309.) Raymond James took between ten and twenty-five percent of the commissions earned by registered representatives in the Cranston branch office. (Tr. 1311.) Raymond James forwarded the remainder monthly to the Foxhill account to be disbursed roughly twenty-five percent to Foxhill and fifty percent to the registered representatives.[11] (Tr. 1027-28; R.J. Ex. 109.) Raymond James terminated Mr. Ullom in November 2001 for failure to supervise. (Tr. 1273.)

I find Mr. Ullom totally lacking in credibility. He frequently changed his testimony after he was confronted with contradictory prior testimony or exhibits. Mr. Ullom lied and withheld information from Mr. Putnam, and he assisted Mr. Herula's fraudulent activities. (Tr. 1499-50, 1531-33.)

Dennis Herula

Mr. Herula is a fifty-eight-year-old high school graduate who attended college and served in the military. (Tr. 1737-38; Div. Ex. 82.) Mr. Herula claims to have been associated with "Kemper, Merrill Lynch, Shearson Lehman Brothers, Oppenheimer, W.C. Roney & Company, E.F. Hutton" in his twenty or more years in the securities industry. (Tr. 1738.) Mr. Ullom forwarded Mr. Herula's application to become associated with Robert Thomas to the Compliance Department in August 1999. (Tr. 2303-04.) Robert Thomas checked Mr. Herula's criminal record, his financial background, and with his prior employers before hiring him. (Tr. 2109-10, 2432.) In the materials the Compliance Department reviewed, Mr. Herula had no serious reported complaints in ten years of industry experience. (Tr. 2369; R.J. Exs. 2004, 2005.) Mr. Ullom knew Mary Lee Capalbo (Ms. Capalbo) was married to Mr. Herula. (Tr.

[11] As branch manager, Mr. Ullom was entitled to a percentage of the commissions earned by the branch. He assigned that amount to Foxhill. (Tr. 1310.) Foxhill paid out to the registered representatives forty-five percent of gross commissions on stocks/bonds, fifty percent on mutual funds and unit investment trusts, and fifty-five percent on insurance, variable and fixed annuities, and fifty-five percent on financial planning and advisory services. (Tr. 1310; Div. Ex. 109.)

1044.) Mr. Putnam terminated Mr. Herula on December 26, 2000, effective the first business day of January 2001. (Tr. 1271, 1517.)

The Registered Representative Agreement (Agreement) between Raymond James and Mr. Herula provided that: (1) Mr. Herula was being retained by Mr. Ullom as an independent contractor pursuant to an Independent Sales Associate Agreement between Raymond James and Mr. Ullom; (2) the Agreement did not create an agency, employment, or joint venture relationship; and (3) Mr. Herula had "the right to solicit and engage in the purchase and sale for [Raymond James] approved securities with the general public, and engage in other business activities except to the extent such activities are subject to the rules, regulations and interpretations of Regulatory Authorities." (Div. Ex. 111; Tr. 1036-37.) As branch manager, Mr. Ullom was Mr. Herula's first-level supervisor in 1999 and 2000. (Tr. 989-90, 1345, 2048.)

In August and September 1999, Mr. Herula worked in the Cranston branch office during normal business hours. (Tr. 1319.) For the remainder of 1999, Mr. Herula came to the office late in the day or at night because he said he was caring for his ill wife. (Tr. 1279, 1319-20.) Mr. Ullom claims that he allowed Mr. Herula to work from his home and other locations in accord with Raymond James's policies. (Tr. 990-92.) Beginning in January 2000, Mr. Ullom claims that Mr. Herula came to the office about once a month because he said he was traveling and raising funds for Brite Business, an outside business activity that Raymond James allowed. (Tr. 1091-93, 1179, 1206-07, 1543.) Mr. Herula came into the Cranston branch office about once a month in the first half of 2000, and a total of four times between May and December 2000. (Tr. 1091-92, 1206, 1280.) According to Mr. Ullom, this was unusual for a registered representative, but because the accounts Mr. Herula handled were very conservative accounts, they did not require frequent client contact. (Tr. 1092.)

This administrative proceeding follows a related civil proceeding in the United States District Court for the District of Rhode Island. SEC v. Dennis S. Herula, et al., C.A. No. 02-154 ML (D.R.I.). On October 17, 2002, the district court entered a Final Judgment and enjoined Mr. Herula from further violations of the antifraud provisions of the federal securities laws and ordered him to pay disgorgement and prejudgment interest totaling $18,941,665.63. (Putnam Ex. 1116, R.J. Ex. 2642 at 54009.) On January 27, 2003, the district court entered a Final Judgment and enjoined Ms. Capalbo, from further violations of the antifraud provisions of the federal securities laws and ordered her to pay disgorgement and prejudgment interest totaling $19,292,102.14. The court also ordered Mr. Herula and Ms. Capalbo to each pay civil monetary penalties of $250,000. (R.J. Ex. 2642 at 54009.)

On October 18, 2004, Mr. Herula pleaded guilty to criminal charges of wire fraud that included misrepresentations to investors, money laundering, and bankruptcy fraud brought by the U.S. Attorney in Rhode Island.[12] (Tr. 1713; Div. Exs. 82, 83 at 7, 85) Mr. Herula was sentenced to 188 months and ordered to make restitution of more than $13 million. (Tr. 1719.)

Raymond James and Brite Business

[12] The Rhode Island criminal proceeding was transferred to Colorado.

Mr. Ullom, on behalf of Mr. Herula, requested that Mr. Putnam meet with Brite Business, about a business opportunity for Raymond James from people with substantial assets.[13] Mr. Putnam had complete trust in Mr. Ullom and hired him in mid-1992. (Tr. 1014, 1965; Div. Ex. 106.) At the time, Mr. Herula had been associated with Raymond James for about two months and had fifteen to twenty client accounts, the largest with assets of about $2 million. (Tr. 1047-48, 1051, 1349-50.)

Mr. Putnam was on the holding company's Capital Markets Committee, and was told that Brite Business would deposit $5 million in a Raymond James account. (Tr. 1638-39.) On October 19 and 20, 1999, Mr. Herula sent Mr. Putnam the resumes of Ian Doidge (Mr. Doidge), Principal & Practice Leader, Global Asset Services Group, Arthur Andersen Business Consulting (Arthur Andersen), Toronto, and Mr. Fife. (R.J. Exs. 2423, 2424.) Mr. Putnam called Arthur Andersen and confirmed that Mr. Doidge was at the phone number he provided. (Tr. 1665, 2073.) Mr. Putnam believed that Brite Business was a legitimate business enterprise based on Mr. Doidge's position with Arthur Andersen, Mr. Fife's credentials, and Brite Business's $5 million deposit. (Tr. 1665-66, 1679.)

During the week of October 20, 1999, Mr. Putnam, assembled an ad hoc committee composed of John C. Maynard (Mr. Maynard)[14], a vice president with Raymond James Trust Company (R.J. Trust); Thomas R. Tremaine (Mr. Tremaine), vice president and treasurer at R.J. & Associates; Jeff Julien (Mr. Julien), chief financial officer at the holding company; John Kritsas (Mr. Kritsas)[15] and John Walsh (Mr. Walsh) from R.J. & Associates. This committee met with Mr. Herula and Mr. Doidge, representing Brite Business, at Raymond James's headquarters. (Tr. 1640-42, 2115, 2805-06.) Mr. Ullom was not invited but attended the meeting. (Tr. 1052.)

The meeting lasted less than an hour. (Tr. 1657.) Mr. Putnam understood that Brite Business was involved in construction in foreign jurisdictions. (Tr. 1647.) Brite Business proposed that Raymond James participate in its activities by: (1) loaning money for purchase of Treasuries; (2) holding a trust; (3) doing the transactions such as the purchase of Treasury bonds or securities; and (4) having R.J. Trust hold the assets in escrow as well as the trust receipt. (Tr. 1660-61.) Brite Business described a series of transactions in the range of $50 to $100 million each where United States Treasuries (Treasuries) would enter the United States from England

[13] In 1999, the average account at the Cranston branch office had assets of $1 or $2 million; a few accounts exceeded that amount, and no accounts had assets in excess of $4 million. (Tr. 1009, 1050.) This was the first meeting Mr. Ullom had ever arranged. (Tr.1349.) Mr. Fife was allegedly referred to Mr. Herula by a Canadian investment adviser.

[14] Mr. Maynard, a graduate of Miami University in Oxford, Ohio, and the University of Wisconsin Law School, has over thirty years experience in the area of trusts. He served in Vietnam with the Marine Corps. (Tr. 2639-40.)

[15] Mr. Julien was controller for the holding company and Mr. Kritsas was a vice president at R.J. & Associates. (Tr. 1681-82.)

and be leveraged so that the asset side of Brite Business's balance sheet would be increased. (Tr. 1649, 1666.) Brite Business proposed placing the Treasuries and other funds under a trust arrangement, which would protect the funds and allow the transaction to be unwound. (Tr. 1649, 1546.) These activities would supposedly allow Brite Business some tax advantages. (Tr. 1691, 1748.) Supposedly, the interest cost of the borrowing would be a tax benefit as it would offset income earned abroad. (Tr. 1650, 1656.) Mr. Doidge said that the offsetting increase in liabilities did not matter for this particular strategy. However, he claimed that he could not disclose the tax implications in detail because of confidentiality issues. (Tr. 1662-64, 1742.) The meeting participants were told the strategy was proprietary to Arthur Andersen and that Raymond James did not have to be concerned about what happened inside the "black box." (Tr. 2663-64.) In his investigative testimony, Mr. Putnam acknowledged that there were several renditions of the "balance sheet enhancement," but that it was a tax strategy and involved "depositing money into some sort of an escrow, buying some treasuries, doing either a repo or a reverse repo with a bank." (Tr. 1652-53.) Mr. Putnam testified that one issue was whether Raymond James would be willing to make a loan. (Tr. 1655-56, 1760.) In an e-mail sent on January 17, 2000, Mr. Putnam described the transaction as follows:

> It involved moving treasuries from England to the U.S. and creating a loan from one group to another through [Raymond James] and then doing a repo on the instruments with the proceeds going into a trusteed bank account and the transactions being able to be unwound every ninety days. It was suggested that [Raymond James] would be the custodian of the bonds, do the transactions, trustee the account, and have an [Investment Management Program for Advisory Clients] arrangement with respect to the account. We were told this had something to do with a balance sheet for a deal or deals. Arthur Andersen's representative assured us that the money was not fraudulent and that the money came from good sources. The principal Martin Fife sits on the boards of several Dreyfus Funds and his wife has been the Deputy Mayor of NY and he appears to be quite connected.

(R.J. Ex. 2467.)

This transaction would have been very unusual for R.J. Trust, which provided only personal fiduciary trust services to Raymond James's clients. (Tr. 2684-85.) Mr. Maynard attended the meeting in place of his boss, David Ness (Mr. Ness), the head of R.J. Trust, and described Brite Business's proposal as a complicated tax shelter that involved debt-financed purchase of Treasuries. (Tr. 2703.)

The ad hoc committee met only once soon after the October 1999 meeting to discuss the proposal. (Tr. 2138.) Everyone was skeptical about the proposal and questioned Brite Business's motives. (Tr. 1668-70, 1848.) The consensus was that Raymond James should not get involved in something they did not fully understand. (Tr. 1355, 1662, 2861.) Mr. Putnam indicated that the transaction did not sound like something Raymond James would involve itself with. (Tr. 1054, 1061.) In an e-mail on October 29, 1999, Mr. Walsh wrote to Mr. Putnam and others, "My gut feeling on this deal is bad. Let's continue to proceed very cautiously." (Tr. 1690; Div. Ex. 240.)

Mr. Putnam testified that some people jumped to conclusions about what occurred in October but that the ad hoc committee: (1) did not take a formal vote and reject the transaction; (2) reached a consensus to do more discovery but would not commit to the transaction; and (3) had healthy skepticism, but was willing to look at subsequent proposals from Brite Business. The size of the transaction was beyond Raymond James's normal transaction size. Brite Business also wanted to start the transaction before the end of 1999. (Tr. 1668-69.) Mr. Putnam testified that the proposal considered in October became moot within days because of its size, complexity, and Brite Business's desire to complete it by year end. (Tr. 1770, 1800, 1810-11; Div. Ex. 253.) Following the October meeting, Mr. Maynard and Mr. Tremaine looked at whether there were some parts of the transaction that Raymond James could be comfortable with. (Tr. 1675, 1683-84.) For example, on October 25, 1999, Mr. Maynard reported that Brite Business thought "[Mr. Putnam's] suggestion will work" and R.J. Trust might be able to hold the cash for Brite Business. (Div. Ex. 238.)

On October 25, 1999, Brite Business opened a cash account at Raymond James with a $5 million deposit. Mr. Herula was the account representative, and Mr. Ullom approved the new account form. (R.J. Ex. 2342.) The Corporate Resolution accompanying the New Account Form was signed by Brite Business Assistant Secretary, Farouk Alam Khan; President, Mr. Fife; Chairman & CEO, Mr. Hertzog; and trader, Mr. Doidge. (R.J. Ex. 2342.) Mr. Putnam believed that Raymond James knew its client, Brite Business, "quite well." (Tr. 1956.) On October 26, 1999, Brite Business entered an Investment Management Program for Advisory Clients (IMPAC), which provided that Raymond James would be paid $250,000 for investment advisory services. (R.J. Ex. 2106.)

On November 9, 1999, Mr. Ullom called Mr. Ness and yelled at him complaining that Raymond James would lose the Brite Business transactions to First Union Bank "because the folks in the home office were concerned about minor details." (Tr. 2709.) Mr. Ullom claimed that Mr. Maynard had behaved in an unprofessional manner at the October meeting with Brite Business and had lost Raymond James the business. (Tr. 2669-70, 2708.) Mr. Ullom also told Mr. Ness that Brite Business was a big client and that R.J. Trust had one more chance to get the job done. (Tr. 2708-09.)

Mr. Ness informed Mr. Maynard of Mr. Ullom's criticisms, which Mr. Maynard denied. (Tr. 2670.) Mr. Maynard was so taken aback by Mr. Ullom's actions that he learned through business contacts that Brite Business had contacted First Union Bank with the same deal and First Union Bank had "sent them packing." (Tr. 2669-71; Div. Ex. 244.) Contrary to the representations of Mr. Ullom and Mr. Herula, the deal made no sense to First Union Bank and it had "distinctly not" done the deal. (Id.) Mr. Maynard relayed this information to Mr. Ness, Mr. Putnam, Mr. Julien, Mr. Kritsas, and Mr. Tremaine. (Div. Ex. 244.)

On November 10, 1999, upon learning this information, Mr. Ness e-mailed Mr. Putnam and stated that he found the fact that First Union Bank had not done the deal "particularly disturbing since it potentially casts some question in the direction of [Brite Business's] principals." (Div. Ex. 245.) Mr. Tremaine was convinced that Raymond James should not

participate "at any level." (Tr. 1845, 2810; Div. Ex. 244.) Mr. Tremaine's comment referred to the transaction Brite Business proposed in October. (Tr. 2810.)

Mr. Ness was "profoundly skeptical" and informed Mr. Putnam that Mr. Tremaine and Mr. Walsh opposed involvement in the transaction. (Div. Ex. 245.) Mr. Putnam did not believe that Mr. Ness, Mr. Tremaine, and Mr. Walsh thought that Raymond James should not do business with Brite Business, but, rather, that Raymond James should not do the transaction Brite Business proposed in October 1999. (Tr. 1763.)

On November 9, 1999, in an e-mail to Mr. Putnam, Mr. Julien, Mr. Kritsas, and Mr. Tremaine, Mr. Ness: (1) asked whether Mr. Ullom was a significant producer with experience in sophisticated transactions; (2) criticized the quality of the escrow agreement that Mr. Ullom had sent him for Brite Business; (3) stated that Brite Business's current proposal did not pass "the smell test either," i.e., as an aggressive tax shelter; and (4) stated it was too difficult "to understand the economic justification of the deal." (Tr. 2714-15, 2718, 2730; Div. Ex. 244.) Mr. Ness questioned the economic justification for the deal, the "C Team player" involved, and worried about being the only one with clean hands in a dirty deal and aggressive tax shelter. (Tr. 2716-18.) In a November 10, 1999, response, Mr. Putnam did not adopt Mr. Ness's concerns. (Tr. 1753; Div. Ex. 245.) Rather, Mr. Putnam stated that he understood that "the first deal was done with First Union"; that Mr. Ullom had "run a brokerage firm and been responsible for underwriting multi-million dollar deals"; and he questioned whether the reference to "C Team players" was to the English broker, an alleged participant, whom Raymond James was unable to identify. (Tr. 1693; Div. Exs. 240, 245.)

The fact that First Union Bank could not make sense of the Brite Business transaction did not concern Mr. Putnam because Raymond James "was not going to make the loan." (Tr. 1755.) Mr. Putnam and Michael J. DiGirolamo (Mr. DiGirolamo), who was head of compliance at IMR, believed that the ad hoc committee that met with Brite Business in October 1999 turned the transaction down. (Tr. 1870; Div. Ex. 253.) Mr. Putnam's position was that Raymond James should look at each transaction Brite Business presented, and do extensive due diligence on Brite Business if Raymond James decided to go forward with a transaction.

On November 10, 1999, Mr. Ness responded to a draft agreement from Mr. Ullom concerning a Brite Business transaction. In the transaction, Raymond James would act as an escrow agent where Brite Business borrowed funds from a bank. (Div. Ex. 246.) Mr. Ness viewed Brite Business's November proposal as only using R.J. Trust as an escrow agent, where Brite Business's October proposal would have had Raymond James lend funds, serve as an escrow agent, and do securities transactions. (Tr. 2716-18.)

On December 9, 1999, when Brite Business had about $12.3 million in its Raymond James brokerage account, Raymond James filled a Brite Business order to purchase $115 million of Treasuries on margin. (Tr. 1068-69, 1071, 2069, 2839, 2862.) In effect, Raymond James lent Brite Business approximately $103 million, with the United States Treasuries as security. (Tr. 2840-41.) Considering the liquidity of Treasuries, the risk to Raymond James was minimal. (Tr. 2841.) This purchase was a "highly unusual transaction" for Raymond James because of its size,

and was likely the largest margin purchase of Treasuries that Raymond James had ever executed.[16] (Tr. 1386, 1840.)

The transaction was unusual because of its size, but principally because it resulted in a loss to Brite Business, in that the coupon on the Treasuries was less than the lending rate, which created a negative spread. (Tr. 1841-43, 2125, 2813-14.) Mr. Putnam was satisfied that persons representing Brite Business were sophisticated investors who understood the transaction and wanted it to happen. (Tr. 2125.) Kevin A. Carreno (Mr. Carreno), one of three Raymond James principals who could approve such a large trade, approved the transaction and subsequently informed Mr. Putnam of the transaction. (Tr. 2444-45.) Operating persons in Raymond James's government bond department handling the purchase were upset that the order arrived late on a Friday afternoon, without any advance notice, which gave them little time to arrange adequate financing to close the transaction.[17] (Tr. 2184-85, 2811.) On December 13, 1999, Mr. Tremaine informed Mr. Putnam that "[a]t this point I do not want to do another trade of this size in this account. Once we fully contemplate the impact [on operations and the firm's cash and capital position] we can then discuss." (Tr. 1785; Div. Ex. 249.)

Mr. Putnam was not concerned by the transaction, which he considered to be in the normal course of business. (Tr. 1773-74, 2123; Div. Ex. 250.) Mr. Putnam was not concerned that the transaction was part of the balance sheet enhancement program because he understood the purchase was in connection with a repurchase agreement that Brite Business had with the Bank of New York, and that the securities were being delivered to that institution.[18] (Tr. 1744, 1776, 1784; R.J. Ex. 2445.) Mr. Herula gave Mr. Putnam this information after the purchase of the Treasuries. (Tr. 1420; R.J. Ex. 2044.) On December 16, 1999, Mr. Herula mentioned that Mr. Fife would be depositing an additional $22 million in the Brite Business account, and that Mr. Fife had provided a reference to Bill Britt, who had a portfolio of $100 million. (R.J. Ex. 2044.) Mr. Putnam urged Mr. Fife to sell the Treasuries when the reverse repurchase transaction did not occur by January 1, 2000, because he was concerned that regulators might fault Raymond James for the margin interest Brite Business was paying. Mr. Fife, however, assured Raymond James that he wanted the arrangement to continue. (Tr. 1780-81, 1890, 2817.) Mr. Putnam, Mr.

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[16] Mr. Ullom claims not to have seen a facsimile Mr. Herula sent from the Cranston branch office to Brite Business dated December 9, 1999, on Raymond James's letterhead confirming the purchase, but omitting that the purchase was made on margin. He also claimed not to have seen facsimiles of Treasuries confirmations to Mr. Hertzog or "BB Brit, Beehive Int'l." (Tr. 1385, 1390; R.J. Exs. 2040-43.)

[17] Mr. Ullom testified that Mr. Herula gave Raymond James advanced notice of the purchase but this appears to be erroneous. (Tr. 1068-72.)

[18] Mr. Putnam understood that as part of the repurchase agreement, the Bank of New York would buy the Brite Business Treasuries held at Raymond James. Brite Business would receive any amounts over the amounts owed in margin interest, and Brite Business would agree to repurchase the Treasuries from the Bank of New York at a later date at a fixed price. (Tr. 2128-29.)

Augenbraun, Mr. Carreno, and Mr. Tremaine did not understand the purchase of Treasuries as indicating participation by Raymond James in the transactions that Brite Business proposed in October 1999. (Tr. 1776, 2203-05, 2456, 2849-50.)

Around December 13, 1999, Mr. Putnam told Mr. Carreno that Brite Business was involved in balance sheet enhancement and that Brite Business might bring some managed accounts to Raymond James.[19] (Tr. 1786.) On December 16, 1999, Mr. Putnam indicated to Mr. Tremaine, Dennis Zank (Mr. Zank) and Mr. Van Sayler, from R.J. & Associates, that Mr. Fife appeared to be using a tax strategy using Treasuries, and that if Mr. Fife's relationship with Raymond James was going to be more than a treasury trade, perhaps "Tom [James] or Tremaine and me" should meet with Mr. Fife. (Tr. 1791; Div. Ex. 250.)

On December 20, 1999, the Compliance and Standards Committee of the holding company (C&S Committee), chaired by Thomas James (Mr. James), the chairman and CEO of the holding company, discussed what standards should apply for processing large-size trades on margin. (Tr. 1793, 1874; Div. Ex. 251.) Mr. Putnam, who was also on the C&S Committee, was in London and missed the meeting.

On December 20, 1999, Mr. DiGirolamo informed Mr. Putnam, Mr. Greene, and Mr. Zank that the C&S Committee: (1) noted apparent failures on the bond desk and in the margin department in approving Brite Business's $115 million margin purchase of Treasuries; (2) questioned why the trade was done since the client was paying more in margin interest than it was receiving in interest; (3) questioned why the trade was placed after a committee declined an earlier strategy; and (4) questioned whether the trade should stay on Raymond James's books and wondered if "there was some sort of scam going on." (Tr. 1841-42; Div. Ex. 251.) Mr. DiGirolamo commented that without knowing all the details "this smells a little fishy." (Id.) Mr. Putnam believes the C&S Committee would have been satisfied if he had been present to explain that Mr. Fife was a sophisticated and knowledgeable client who was being advised by Arthur Andersen. (Tr. 1805.) However, several people who had looked at Brite Business's proposals were on the C&S Committee. (Tr. 1801.) Mr. Putnam had expressed concerns about Brite Business's motives for the Treasury transaction to Mr. DiGirolamo, Mr. Van Sayler, Mr. Zank, and Mr. James. (Tr. 1803-05.) On December 21, 1999, the C&S Committee approved a policy that any retail order for fixed income securities in excess of $1 million must be referred by the trading desk to the Compliance Department for approval prior to execution. (Div. Ex. 438.) The policy was further modified by raising the amount to $5 million, substituting customer relations for the Compliance Department, and specifying the transaction referred to margin purchases. (Tr. 2193.)

Mr. James informed Mr. Putnam on January 8, 2000, that he was strongly biased "to not do any trade or participate in any strategy that we do not understand. Thus, unless the Arthur Andersen and Holland [&] Knight people can convince the original committee to do the

[19] Mr. Putnam was referring to the situation where an outside investment adviser provides the advice and Raymond James provides the record keeping. This is one of Raymond James's principal businesses, and is different from IMPAC where the financial adviser advises the client. (Tr. 1790.)

transaction, I want no other parts of it executed here." (Div. Ex. 253.) Mr. James understood that those who looked at the transaction in October concluded that Raymond James should not do the transaction, but "then the first phase occurred anyway." (Div. Ex. 253.) Mr. Putnam replied that: (1) he too was leery of doing any transaction that involves large number and appears illogical; (2) the original transaction Brite Business proposed in October was moot; (3) following his trip to New York the ad hoc committee would convene to consider Brite Business's proposals; and (4) the throw-off in personal business from Brite Business could be significant for the branch and the firm. (Id.) Mr. James replied that a participant on the ad hoc committee informed him that it had rejected the transaction, and Mr. James did not want another step taken without a super majority vote of the ad hoc committee, and that at least one person was "more than nervous." (Div. Ex. 253.)

On January 7, 2000, Mr. Herula sent Mr. Putnam an e-mail describing an additional transaction that Brite Business would like to do with Raymond James that included a trust account. (R.J. Ex. 2451.) On January 12, 2000, Mr. Putnam and Barry Augenbraun (Mr. Augenbraun), senior vice president and corporate secretary of the holding company, an attorney and C&S Committee member, met with Mr. Fife and others at Mr. Fife's home, a large penthouse on Central Park West in New York City. (Tr. 1075, 1657, 1974, 2173; Div. Ex. 257.) The purpose of the meeting was to learn more about Brite Business, the new Brite Business proposal, and to meet Mr. Fife and other Brite Business principals. (Tr. 1798, 2194; Div. Exs. 254, 503.) Mr. Augenbraun also wanted to determine why Brite Business had purchased Treasuries on margin in December 1999. (Tr. 2204, 2259.) At the January 2000 meeting, representatives of Brite Business presented an elaborate business plan from a package with Arthur Andersen's name on the cover. (Tr. 2200-01.) Brite Business's plan was to create new corporations, similar to Brite Business, to finance construction projects where Treasuries would be used to enhance the corporate balance sheets. (Tr. 2206-08.) There was no discussion of high-yield trading programs or high rates of return. (Tr. 2261.) Farouk Khan represented that he was involved in a bank in the Middle East. Mr. Doidge and Nick Gatto, an attorney with Holland & Knight, represented that balance sheet enhancement had been used in other places, that Sunoco used it in a bidding process, and that it was done all the time.[20] (Tr. 1673, 1819, 1821, 2074-75, 2208; Putnam Ex. 1047.)

On January 17, 2000, Mr. Putnam sent ten people at Raymond James a: (1) description of the New York meeting, which included a description of a complex transaction that involved an encumbered pool of cash that would convince certain people that Brite Business was large enough to bid on certain jobs; and (2) recommendation from himself and Mr. Augenbraun that Raymond James "not become any further involved in these transactions." (Tr. 1674; Div. Ex. 261.) Mr. Putnam believes that the transactions Raymond James rejected had nothing to do with Brite Business's purchase of Treasuries. (Tr. 1921.) Mr. James and Mr. Maynard informed Mr. Putnam that they agreed with the decision. (Tr. 1890-91; Div. Exs. 259, 260, 261.) Mr. Putnam

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[20] Mr. Putnam came away thinking that balance sheet enhancement was used in the bidding process, but he remained uncomfortable, especially with the litigation that could result if something went wrong. (Tr. 1821-22.) Mr. Doidge provided copies of his resume on Arthur Andersen letterhead. (Tr. 2259; R.J. Ex. 2423.)

informed Mr. Fife that Raymond James would not be interested in the transaction Brite Business proposed in January, and suggested that Mr. Fife contact Bear Stearns, because it did a lot of aggressive work in the fixed-income area.[21] (Tr. 2086.) Neither Mr. Augenbraun nor Mr. Putnam saw any need to terminate Brite Business's brokerage account at Raymond James based on the meeting in New York. (Tr. 2260.)

Mr. Putnam believed that Raymond James should continue to "see if there was something [Raymond James] could do that we would feel comfortable doing with" Brite Business. (Tr. 1764, 1807, 1892-93, 1906.) A relationship with Brite Business offered the potential of large fees for Raymond James and the possibility of additional advisory business from wealthy friends and associates of Mr. Fife. (Tr. 1666-67; Div. Ex. 253.) Mr. Putnam might have rejected Brite Business out of hand, except that the people associated with Brite Business appeared to have substantial wealth, which could translate into new business for Raymond James. (Tr. 1852.)

On January 18 and 19, 2000, Mr. Herula communicated with Mr. Putnam, advancing support for the balance sheet enhancement program and projected that Raymond James would receive a large new account as a referral. (Div. Ex. 466.) Mr. Putnam was not able to obtain confirmation on the legitimacy of balance sheet transactions from two references supplied by Mr. Herula and Brite Business. (Tr. 2083-84; Div. Ex. 467.) On January 19, 2000, Mr. Herula informed Mr. Putnam that a new unnamed account was considering depositing $100 million to purchase an "RJ Bank CD," or another product that "we may wish to structure for him." "The purpose would be to assist Brite [Business] by margining or borrowing against the product." (R.J. Ex. 468.) Mr. Herula asked for Mr. Putnam's help in salvaging the relationship. (Div. Ex. 468.) Mr. Putnam responded on January 19, 2000, that "[i]f this is the only thing they would do I can't see a problem but you mentioned some other transactions including a loan to Brite Business." (Div. Ex. 469.) Mr. Putnam talked with the referral from this transaction, professional investors "who would be purchasing bonds in large amounts, keeping a very large balance with" Raymond James. (Id.) On January 28, 2000, Mr. Fife requested Mr. Putnam's assistance in establishing a line of credit at Raymond James or another institution for fixed income trading by a new special purpose corporation. (Div. Ex. 264.) Mr. Putnam rejected the request on February 1, 2000, because the note issued by a new special purpose corporation backed by assets in escrow and an insurance bond would not be considered a marginable security. (Tr. 2091; Div. Ex. 265.)

Mr. Ullom informed Mr. Putnam on February 29, 2000, that Mr. Fife was raising money and Brite Business would possibly sell the Treasuries it had purchased on margin.[22] (R.J. Ex.

[21] Mr. Augenbraun believed that Mr. Putnam was going to inform Mr. Fife to wind down the Brite Business account so that Raymond James was not extending credit on the purchase of Treasuries. (Tr. 2211-12.)

[22] Mr. Ullom did not tell Mr. Putnam that, on the same day, he had approved a letter of authorization (LOA) transmitting $10 million from the Brite Business account to Beehive International, LLC (Beehive), and a LOA transmitting $100,000 to Bill Britt representing "interest and is final payment to close out Britt/Beehive investment." (Div. Ex. 136, R.J. Exs. 2059, 2060.) Raymond James's Customer Accounts notified Mr. Putnam of the $10 million

2062.) Mr. Putnam approved the sale of the Treasuries on February 29, 2000, but he and Mr. Zank questioned whether it made sense to do so a week before the maturity date of March 9, 2000. (Tr. 1907, 2140; Div. Ex. 267.) Mr. Zank commented, "I'm not sure why one would sell with maturity so close. However, I haven't understood this trade from the get go, so a sale at this time wouldn't surprise me." (Div. Ex. 471.)

On March 5, 2000, Mr. Herula sent Mr. Putnam an e-mail informing him that: (1) Brite Business planned to deposit substantial funds into its Raymond James account and that it may need to escrow with a third party; (2) Brite Business may need to purchase T-bills; and (3) he was developing additional business from a money manager that may bring in a $100 million deposit. (Div. Ex. 268.) On March 7, 2000, at Mr. Putnam's request, Mr. Ness agreed to look at whether R.J. Trust would serve as an escrow for a portion of Brite Business funds. (Tr. 2724; Div. Ex. 269.)

On March 13, 2000, Mr. Fife directed Mr. Herula to buy $100 million in Treasuries in the "Brite Business margin account" for the purpose of offsetting a substantial tax benefit elsewhere. (Div. Ex. 140.) Mr. Putnam did not consider this proposed Treasury purchase as related to Brite Business's "balance sheet enhancement program." (Tr. 1923-24.) Mr. Putnam considered the March proposal as standing alone. Mr. Putnam would not allow Brite Business to purchase additional Treasuries on margin so he rejected the transaction. (Tr. 1122, 1450, 1924.) Mr. Putnam did not want another situation like December when Raymond James's books showed Brite Business paying margin interest on a Treasury purchase, a situation that lacked economic sense. (Tr. 1914.) On March 15, 2000, Mr. Van Sayler informed Mr. Putnam that he believed that Mr. Herula "misrepresented the facts on this situation to the desk." Mr. Putnam asked for details and Mr. Van Sayler did not provide them. (Tr. 1929-31; Div. Ex. 271.) At the same time, Mr. Putnam approved Brite Business's purchase of $10 million of Treasuries for cash. (Tr. 1129, 1927.)

Investors in Brite Business

1. Rheaume Holdings Ltd. (Rheaume Holdings), an investment vehicle of Mr. and Mrs. Fitzhenry, Canadian citizens and residents of Barbados, deposited $12.5 million in account No. 380 036-82 at Raymond James in the name of Brite Business on March 27, 2000. (Tr. 27-28; Div. Exs. 51, 52.) Mr. Fitzhenry relied on the due diligence investigation and recommendation of Robert Curl (Mr. Curl), his financial adviser since 1983. Mr. Fife represented to Mr. Fitzhenry's representative, Mr. Curl, that he had engaged in this type of private placement, and that his responsibilities with Brite Business were to provide the safety of deposits. It was represented that "the moneys are safeguarded so there is no risk of loss and verification is needed daily to participate in a transaction used to finance humanitarian or World Bank, Third World projects." (Div. Ex. 54.)

Mr. Herula wrote a letter to Mr. Fitzhenry on Raymond James letterhead as Raymond James Investment Manager, dated March 10, 2000, in which he acknowledged that:

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transfer to Beehive because it was a third-party distribution and it was unable to verbally confirm with Mr. Fife. (Div. Ex. 470.)

> Raymond James has received irrevocable instructions from Brite Business Corp. regarding the deposit from Rheaume Holdings Ltd., if and when received, in the amount of $12,500,000 USD for the purpose of completing a purchase of US Treasury Bills, Note or Bond.
>
> Raymond James will follow these instructions with the full faith and backing of the company to assure that funds deposited by Rheaume Holdings Ltd. will not be withdrawn from the account without written instructions from Rheaume Holdings Ltd.
>
> Raymond James will return the funds in full, without delays or encumbrances, upon the maturity of the T-Bill, Note or Bond transaction. Accumulated interest on the funds deposited based upon the T-Bill, Note or Bond interest rate from the date of purchase will be included if the T-bill, Note or Bond are held to maturity.
>
> The maturity of the T-Bill, Note or Bond will be 90 days unless specific instructions are received from Rheaume Holdings Ltd. within 10 days of maturity to rollover the treasury instrument.

(Div. Ex. 45.)

In a letter dated March 15, 2000, Mr. Sullivan gave Mr. Herula irrevocable instructions on behalf of Brite Business for the Rheaume Holdings Ltd. $12.5 million deposit when received into the Brite Business account.

> Upon my instructions, purchase T-bills, Notes, or Bonds, with a maturity of 90 days from the execution of the order for the purpose of providing leverage for the Brite account at Raymond James.
>
> At no time place these funds in harms way via an investment vehicle not authorized in writing by Robert Fitzhenry.
>
> Upon written notice from Robert Fitzhenry, you are authorized irrevocably to liquidate his Treasury Bill, Note or Bond and return the balance to him upon the standard settlement date of the liquidation.
>
> Accept no requests for these funds to be transferred out of the account except from Robert Fitzhenry.

(Div. Ex. 46.)

Mr. Fitzhenry believed that he was investing in "T-bills" and that, at the least, he would realize the "T-bill" rate and anything additional would be extra. (Tr. 285.) He did not believe that Brite Business would be able to pay the promised ten percent a week interest rate. Mr. Fitzhenry became concerned when he did not receive a payment in twelve business days. He

requested the return of funds from Mr. Herula and Mr. Fife after ninety days. (Tr. 289.) Rheaume Holdings never received a single interest payment and Brite Business did not return the $12.5 million investment. Mr. Fitzhenry only received about $3,500 from Mr. Fife. (Tr. 245-46.) Mr. Fitzhenry did not contact Raymond James until 2002, when Rheaume Holdings brought a civil suit against Raymond James, Mr. Herula, Mr. Ullom, and others. That litigation was settled in June 2004. (Tr. 120.)

2. Rashed Mohamed Mahran Al Bloushi (Mr. Al Bloushi), a forty-six-year-old business man, is a citizen of Abu Dhabi, United Arab Emirates (UAE). Mohamed B. Hamad (Hamad), a former Sudanese diplomat with a Masters in Economics, is Mr. Al Bloushi's trusted friend and adviser who conducted business in English on behalf of Mr. Al Bloushi. (Tr. 315-16, 328, 388-89, 437, 490.)

Mr. Al Bloushi started in the Brite Business trading program in May 1999. (Tr. 672.) In June 1999, Mr. Al Bloushi made the largest investment of his life when he signed several documents and transferred $10 million to a Brite Business account at SG Cowan Securities Corp. (SG Cowan). (Tr. 311-13, 319, 344-45; Div. Ex. 1.) Mr. Al Bloushi understood that he would control the account and no one could do anything with the funds without his consent. (Tr. 315; Div. Ex. 1.)

In August 1999, in response to Mr. Fife's request, Mr. Al Bloushi authorized the transfer of $7.5 million of his $10 million from SG Cowan to the Canadian Imperial Bank of Commerce (CIBC), for credit to CIBC Wood Gundy Securities, Inc., for credit to Brite Business on August 14, 1999, and $2.4 million of the $10 million was used to buy a new leverage note from Societe Generale. (Div. Exs. 3, 4, 5.) On October 19, 1999, Brite Business transferred $5 million of Mr. Al Bloushi's $7.5 million from the Brite Business account at CIBC to the Brite Business account at Raymond James. (Tr. 892-93, 958; Div. Ex. 99.) Mr. Clarke, Mr. Hertzog, Mr. Herula, and Mr. Sullivan reaffirmed there was no risk of principal. (Tr. 488, 582.) Mr. Hertzog and Mr. Clarke assured Mr. Bloushi that his funds would be "blocked" in the Brite Business account at CIBC, but CIBC gave no such assurance. (Tr. 587.)

Mr. Hamad first requested promised profits from Brite Business beginning in August 1999. (Tr. 406.) Beginning in the fall of 1999 or early 2000, Mr. Al Bloushi believed that Raymond James was in charge of investing the funds he transferred to Brite Business. (Tr. 330, 605, 607.) In September 1999, Mr. Clarke informed Mr. Hamad, on a confidential basis, that Raymond James was the major financial institution involved in the transaction. (Tr. 591-93, 598-99.) To confirm his oral representations, Mr. Clarke gave Mr. Hamad a copy of a letter on Raymond James letterhead on or about December 9, 1999, signed by Mr. Herula, Raymond James Financial Consultant, to Brite Business confirming the purchase of $115 million of Treasuries in the Brite Business account at Raymond James. (Tr. 426-28, 588-89; Div. Ex. 11.). Mr. Herula first wrote directly to Mr. Al Bloushi on January 21, 2000, using Raymond James letterhead. (Div. Ex. 12.) Mr. Hamad checked and found the information on Raymond James's website to be identical to the letterhead. (Tr. 428.) Mr. Al Bloushi and Mr. Hamad believed that participation by Raymond James, a company that described itself on the Internet as managing $15 billion, indicated that the transaction was legitimate. (Tr. 617.) In a letter on Raymond James letterhead dated March 22, 2000, Mr. Herula told Mr. Al Bloushi that "the treasury

account for Brite Business Corp. is in place and has been blocked under my control and supervision at Raymond James Financial Services. You can rest assured that the treasury package will stay in the account." (R.J. Ex. 39.) Mr. Al Bloushi and Mr. Hamad considered this statement a guarantee by Raymond James that Mr. Al Bloushi's $7.5 million was safe. (Tr. 654-55.)

When he never received any of the promised profits, Mr. Al Bloushi demanded the return of his $7.5 million in a letter to Brite Business, Mr. Clarke, and Mr. Hertzog dated November 21, 1999. (R.J. Ex. 40.) Mr. Al Bloushi contacted Raymond James on March 27, 2001. (Tr. 631.) As late as March 2002, Mr. Sullivan represented to Mr. Al Bloushi that Raymond James was working on the transaction and the promised profits were coming. (Tr. 632.) Mr. Al Bloushi has not received his $7.5 million, or any profits or interest on his investment. (Tr. 333-34, 378, 466.) Mr. Al Bloushi has received approximately $1.3 million of the $2.4 million sent to Societe Generale in August 1999. (Tr. 379, 683-84.)

3. Malcolm Joseph Monlezun (Mr. Monlezun), a fifty-two-year-old certified registered nurse anesthetist, signed a new account form for a money market account with Raymond James on October 24, 2000. (Tr. 705, 707, 1257; Div. Ex. 60.) Mr. Ullom approved and signed the new account form. Mr. Herula was the financial adviser on the account. (Tr. 1258; Div. Ex. 60.) When he approved the new account form, Mr. Ullom knew that Mr. Monlezun was participating in transactions with Brite Business. (Tr. 1499-50.) Based on Mr. Herula's representations and instructions, Mr. Monlezun transferred $1 million, on October 26, 2000, for deposit in a money market account at Raymond James. (Tr. 711, 724; Div. Exs. 65, 66, 77, 105.)

Mr. Monlezun opened the account at Raymond James on the advice of Mr. Herula, and a company called ECCE.[23] (Tr. 707, 853.) According to ECCE, trading in medium-term notes would take place outside the United States based on the fact that $100 million was on deposit at a specific location in the United States. Investors would earn returns of between ten and thirty percent a month. (Tr. 771; R.J. Ex. 2124.) Mr. Herula told Mr. Monlezun that he was gathering $100 million, in $1 million minimums, from investors for deposit with Raymond James. Mr. Herula represented to Mr. Monlezun that his funds would stay at Raymond James under Mr. Monlezun's control. Raymond James would issue a document to ECCE that would allow ECCE to facilitate a transaction, in which Mr. Herula was an expert. (Tr. 707.) Mr. Herula represented that Mr. Monlezun's funds would not be at risk, and returns would be ten to thirty percent a month once the transactions began. (Tr. 712, 730.)

Mr. Monlezun received monthly account statements from Raymond James for the period of October 25 through December 29, 2000. (Tr. 727; Div. Ex. 81.) He also received a statement on Raymond James letterhead dated October 30, 2000, for account No. 44902174 showing receipt of $1 million and the transfer of $1 million to Raymond James's Heritage Cash Trust, a money market account.

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[23] Benjamin L. Moss, III (Mr. Moss), a resident of Halton City, Texas, and graduate of Louisiana State University, is one of three ECCE owners. (Tr. 2972-74.) According to his sworn testimony, Mr. Morse believes that ECCE is legitimate. (Tr. 2974-75, 2997.)

When the ECCE transaction did not materialize, Mr. Herula informed Mr. Monlezun that he and Mr. Fife, a well known investor with connections to the Dreyfus Funds, were gathering investors capable of pooling $100 million for similar high-yield transactions. (Tr. 731-32.) According to Mr. Herula, it was possible to make handsome profits based on documentation that deposits of $100 million were in place at Raymond James. (Tr. 741-42.) Mr. Herula represented that the transaction involved no risk, that Monlezun's funds would stay with Raymond James, and that monthly returns could be from ten to thirty percent but monthly returns of ten to twelve percent were more realistic. (Tr. 732-33, 737.) A short time later, Mr. Herula informed Mr. Monlezun that the deal was going forward and that his $1 million had to be transferred to an escrow account set up by Ms. Capalbo, who Mr. Herula represented was an attorney working for Raymond James. (Tr. 733-34, 738.) On November 24, 2000, Mr. Monlezun, based on Mr. Herula's representations, authorized Raymond James to transfer $1 million from his account to the Mary Lee Capalbo, Esq., Special Client Account No. 49114444 at Raymond James.[24] (Tr. 826, 853; Div. Exs. 73, 76, 105.)

Mr. Herula did not tell Mr. Monlezun that Ms. Capalbo was his wife. (Tr. 734-35.) Mr. Herula and Ms. Capalbo assured Mr. Monlezun that transfers from the account would occur only with his written permission, however, $500,000 of the $1 million was immediately transferred out of the Mary Lee Capalbo, Esq., Special Client Account to the Abbot Capitol account.[25] (Tr. 743, 1513; Div. Ex. 75, R.J. Ex. 2390 at 14815.)

Mr. Monlezun received $20,117 from Mary Lee Capalbo Herula, Citizens Bank, on January 8, 2001, and $105,817.30 from Dennis Herula\Mary Lee Herula, at WMB FA bank, on February 6, 2001, which Mr. Herula represented were trading profits. (Tr. 750; Div. Exs. 78, 496.) In February, March, and October 2001, Mr. Monlezun attempted to organize investors willing to invest millions in high-yield investments organized by Mr. Herula. (Tr. 813-19; Div. Exs. 2142, 2145, 2146, 2158.) Mr. Monlezun demanded a return of his $1 million from Mr. Herula in February 2002. (R.J. Ex. 2179.) In that correspondence, Mr. Monlezun acknowledged that Mr. Herula had represented that his funds were in Ms. Capalbo's escrow account at Charles Schwab. (R.J. Ex. 2179.) Mr. Monlezun has not received any additional payments and he has not been able to obtain the return of his $1 million from Mr. Herula. (Tr. 753.) On August 1, 2002, Mr. Monlezun filed with Raymond James a claim for $3 million, plus other damages and attorney fees. (R.J. Ex. 2196.) Also, Mr. Monlezun initiated a civil suit against Raymond James

[24] The Manager Account Review System (MARS) report mistakenly omitted this $1 million dollar transfer. (Tr. 2533-34; Div. Ex. 81 at 2461.) However, the underlying records show that Raymond James followed its internal procedures and called Mr. Monlezun to confirm that he wanted the transfer made. (Tr. 1512; R.J. Exs. 2132, 2390, 2391, 2593-95.)

[25] In March 4, 2002, Mr. Monlezun gave a more detailed and slightly different version of these events in a sworn statement. (Tr. 847; R.J. Ex. 2191.) The major difference is that in the written statement, Mr. Monlezun recalled that Herula transferred his $1 million to the Capalbo account at Charles Schwab in early 2001, and Mr. Monlezun agreed to participate in European trading programs initiated by Herula in February and March 2001. (Id.) Mr. Monlezun testified at the hearing that he did not authorize the transfer of his $1 million from the Mary Lee Capalbo, Esq., Special Client Account at Raymond James. (Tr. 755, 804-05.)

but was ordered to pursue arbitration, which he has not done. (Tr. 2266.) Raymond James has not received a response to its settlement offer. (Tr. 2266.)

Supervision and Compliance at Raymond James

Pursuant to Rule 3030 of the NASD, Raymond James required persons conducting business outside the firm to file a form with the branch manager and the Compliance Department stating the nature of their outside activities. (Tr. 1898-99.) Mr. Putnam and Mr. Ullom knew in August 1999 that Mr. Herula was attempting to raise funds from commercial banks for Brite Business, and that this activity required that a form be filed. (Tr. 1900.) Raymond James has no form or memoranda on file showing that it was aware that Mr. Herula was conducting this outside business activity. (Tr. 1898-02, 2042, 2169-70.) Mr. Ullom did not file a Request for a Non Branch Location for Mr. Herula, which Raymond James required when a registered representative was conducting business from his home. (Tr. 1332-33, 1444, 1723.) Mr. Ullom did not know of any special procedures or compliance policies that Raymond James had in place for supervising registered representatives who worked outside the office. (Tr. 992.) Raymond James had a long-standing policy that all outgoing written communications from registered representatives, including e-mails and facsimiles, had to be approved in advance by the branch manager. (Tr. 2371-72; R.J. Ex. 2640 at 12015, 111961.) Raymond James always prohibited the use of Raymond James stationery for business outside of Raymond James. (Tr. 2940.) Mr. Ullom never inspected or reviewed Mr. Herula's work locations outside the Cranston branch office. (Tr. 991.) Mr. Putnam did not know that Mr. Herula spent considerable or significant time away from the Cranston branch office. (Tr. 1966.)

Excluding provisions of the money laundering statutes, Raymond James's procedures for disbursing funds from an account had the sole objective of assuring that the client authorized the transfer of funds.[26] (Tr. 2524-25, 2567, 2776.) The branch manager and registered representative are responsible for knowing the client and what type of business the client is conducting. (Tr. 2775.) Raymond James believes it has no right to question why a client is making a disbursement or whether the funds in the account belonged to the client. (Tr. 1951.)

Raymond James considered the transfer of funds to an unrelated or third-party account to be an out-of-the-norm transfer. (R.J. Ex. 2534 at 11514.) In these situations, Raymond James's Operations Manual required:

1. Client signature on a LOA;
2. Branch Manager signature;
3. Verbal verification with client for disbursements over $50,000; and
4. Verbal verification with escrow or title company for property closings.

LOA should be sent to Customer Accounts to be stamped, reviewed, and imaged into the client's file;

[26] These events occurred before enactment of the United States Patriot Act and before major changes were made to the anti-money laundering statutes. (Tr. 2778-79.)

> If approved, a letter of acknowledgement will be sent to the client confirming that the disbursement was made on their behalf.

(R.J. Ex. 2534 at 11514.)

On transfers to a third-party account inside Raymond James, the Customer Accounts department at R.J. & Associates checked: (1) that the LOA matched the account registration; and (2) whether the account was restricted. On third-party transfers outside Raymond James, Customer Accounts would also check the designated account at the receiving bank.[27] Customer Accounts then sent the LOA back to Raymond James, where the Operations Department also verified the signatures on the LOA and personally contacted the client to verify.[28] The Operations Department then returned the LOA to the Customer Accounts Department at R.J. & Associates, which would accomplish the transfer. (Tr. 2155-58, 2427, 2581, 2754-57, 2765.) All third-party transfers were noted in exception reports provided to the Compliance Department. (Tr. 2531.) Transfers to an employee related account would be a third-party transfer, and were subjected to the same level of review. (Tr. 2531.) The Compliance Department received reports on funds transferred into employee or employee related accounts. (Tr. 2770.)

Trudy Bixby (Ms. Bixby), R. J. & Associates's Vice President, Customer Accounts Department, sees no problems with the way Raymond James handled the Brite Business account. Ms. Bixby believes that Customer Accountants questioned "compliance at some point, and they spoke with the branch and were comfortable with the type of business the client [was] conducting." (Tr. 2775-76.) Ms. Bixby testified:

> A lot of business accounts do have money that flow through from one business to another or from a business to an escrow account or from a business out to make investments. So [the Brite Business transfers] doesn't look like an unusual pattern in terms of what we were dealing with then.

(Tr. 2779.)

Between January 1999 and March or April 2000, what had been Robert Thomas's and was now Raymond James's securities division and what had been IMR's and was now Raymond James's investment management division, operated two separate compliance departments. Mr. Carreno was director of compliance at Raymond James's securities division and financial

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[27] According to one of Raymond James's experts, Mr. Forde, Customer Accounts contacted the customer on transfers to third-party or related accounts to confirm that the account holder authorized the transfer. (R.J. Ex. 2665 at 17.) Both Customer Accounts and Operations confirmed with account holders transfers of more than $50,000. (Tr. 3162; R.J. Ex. 2665 at 17.)

[28] The Operations Department maintained a list of every third-party LOA that it approved. (Tr. 2768-69; R.J. Ex. 2408.)

institutions division from January 1, 1999, until March 2000.[29] (Tr. 1628-29, 2058, 2295, 2296.) Mr. Carreno reported to Mr. Putnam. (Tr. 2047; R.J. Ex. 2003.) To monitor both the securities division and the financial institutions division, the Compliance Department was staffed with only sixteen employees.[30] (Tr. 2324-25.) Mr. Carreno testified that Robert Thomas had about 1,100 registered representatives located in 300 offices of supervisory jurisdiction. (Tr. 2325.)

Mr. Carreno considered the 1995 settlement Mr. Ullom entered with the Commission in 1995, and decided following discussions with Mr. Ullom and his counsel, that Robert Thomas should not subject Mr. Ullom to additional supervisory procedures. (Tr. 2437-38.) In making his decision, Mr. Carreno considered that Mr. Ullom's actions did not result in losses to clients, the bookkeeping entry involved was $1,800, and the Commission did not restrict Mr. Ullom's activities as a registered representative. (Tr. 2437-38, 2468-69.)

From January 2000 through the end of February 2000, Mr. Carreno spent about seventy percent of his time on compliance matters and he worked directly with Mr. Putnam, James Zahradnick (Mr. Zahradnick), and Mr. DiGirolamo.[31] (Tr. 2300-01.) Mr. Carreno did not know anything about Brite Business until January 2000, when Mr. Putnam mentioned briefly that he was going to meet with representatives of Brite Business in New York City.

When the Robert Thomas and IMR compliance departments merged in about April 2000, Mr. DiGirolamo became chief of compliance for all Raymond James divisions.[32] (Tr. 2473, 2935; Div. Ex. 309.) It appears that when Mr. DiGirolamo took charge, he applied the supervisory policies of IMR to the entire firm. Mr. DiGirolamo installed a new structure for the securities division in which a regional compliance officer reported to an associate director, who then reported to him. (Tr. 2474.) Mr. DiGirolamo reported to Tony Greene (Mr. Greene), Raymond James's CEO and chairman. (Tr. 2046.) Mr. DiGirolamo had no involvement with Mr. Herula or Brite Business in 1999 and 2000. (Tr. 2483.)

Raymond James used its branch managers as its first line of defense against illegal activities by registered representatives. (Tr. 2870; R.J. Ex. 2665 at 20.) Raymond James

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[29] Mr. Carreno, a graduate of the U.S. Air Force Academy and the University of Denver Law School, became chief compliance officer at Robert Thomas in 1994. Mr. Carreno assumed a position with Raymond James in England in March 2000. (Tr. 2350-52, 2295.)

[30] Persons in Operations and New Accounts at R.J. & Associates had compliance responsibilities and reported serious items to the Compliance Department. (Tr. 2325.)

[31] Division Exhibit 321 contains the internal supervisory policies in effect at Raymond James's securities division and financial institutions division between April 1999 and March or April 2000. (Tr. 2311; Div. Ex. 309.) Mr. Zaharadnick replaced Mr. Carreno until the compliance departments of Robert Thomas and IMR merged. (Tr. 2058, 2061, 2352-53.)

[32] Mr. DiGirolamo has been with Raymond James since graduating from the University of Florida in 1984. He has spent almost his entire career in compliance. (Tr. 2490-01.)

required that branch managers pass either the branch managers exam or the general securities principal exam. (Tr. 1010-11.)

Raymond James's Compliance Department had three major areas: (1) internal audits; (2) account monitoring, which included exceptions reports; and (3) dealing with customer complaints. (Tr. 2353.) The Compliance Department's role was to: (1) educate financial advisers and staff on rules, regulations, and policies; (2) conduct branch office audits; and (3) review exception reports and report results to supervisors. (Tr. 2868-69.) Raymond James conducted oversight of its branch offices by daily reviews of all business and an annual surprise audit conducted by its Branch Audit Department. (Tr. 1008-09; Div. Ex. 297.) Additional audits were performed if Raymond James had special concerns or special circumstances existed. (Tr. 2339.) The branch audit was the means of determining whether the supervisory practices were, in fact, being carried out. (Tr. 3156.) A compliance audit is not conducted by auditors and auditing standards are inapplicable. A compliance audit is really an inspection or an examination that should be conducted by a person with a questioning mind. (Tr. 3113-14) Broker–dealers depend on effective compliance audits to ensure their branch managers are supervising appropriately. (Tr. 3130.) The internal auditors are part of the Compliance Department. (Tr. 1963.)

According to Mr. Carreno, Raymond James's Internal Supervisory Procedures (Supervisory Procedures) was a summary of the supervisory procedures at Raymond James. (Div. Ex. 321.) Raymond James had more detailed written procedures and there were also NASD rules.[33] (Tr. 2315.) The Supervisory Procedures provided that a branch manager was to review and approve any business communication written by a registered representative to a member of the public, and a copy was to be retained in the branch files for review by the Internal Audit Department. (Tr. 1089, 2315; Div. Ex. 321 at 1017, 1049.) Letters that were to be sent to three or more people were to be forwarded to the Compliance Department for review and approval. (Tr. 2327.) Registered representatives were to send all business related e-mails from the Cranston branch office to Mr. Ullom for his review. (Tr. 1101.) Registered representatives were prohibited from acting as an agent for a client, or an individual, without permission in writing from Raymond James. Registered representatives were also prohibited from raising, or agreeing to raise, money for any company, or individual, other than as an independent contractor for Raymond James, without written permission. (Tr. 2321-23; Div. Ex. 321 at 1050.) The Supervisory Procedures also required branch offices to submit a monthly Compliance Report to the Compliance Department. (Div. Ex. 321 at 1095.) The Supervisory Procedures contained a single sheet of Procedures for Raymond James Financial Services, Inc., Outside Activity, and a Request to Engage in Outside Activity (Form 1790) to be submitted to the Compliance

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[33] The Compliance Department continued to use "Robert Thomas Securities, Inc. Supervisory Procedures," which it had used before the merger. (Tr. 2361-62; Div. Ex. 321, R.J. Ex. 2529.) That document has a seven-page section on Rogue Brokers, which was a response to the Commission's concern about the supervision of registered representatives with a history of poor compliance. (Tr. 2363; Div. Ex. 2559 at 4102.) Before April 2000, the rogue broker provisions of Robert Thomas applied to the securities division and financial institutions division. (Tr. 3133, 3167.)

Department.[34] (Tr. 2519; Div. Ex. 321 at 1134-36.) In some cases, the Compliance Department reviewed the Form 1790. (Tr. 2329.) Mr. Herula's activities in raising funds for Brite Business was the type of business activity that required a Form 1790, however; he never filed one. (Tr. 2330, 2520-21.) Every registered representative, including Mr. Herula, certified annually that he or she knew and understood Raymond James's compliance policies. (Tr. 2394, 2434; R.J. Ex. 2533B, R.J. Ex. 2009.)

During the relevant period, the NASD and Raymond James required that any location where a registered representative worked as a primary or regular work location, other than the branch office, should be registered as a satellite office. (Tr. 3168.) In 1999-2000, the four room Cranston branch office had five or six registered representatives and only three desks. This space allocation was possible because Mr. Herula and three other registered representatives did not work at the branch office.[35] (Tr. 1031-32, 1280, 1389) The evidence is that only Mr. Ullom and Jason Ullom, his son, worked from the Cranston branch office in 1999–2000. (Tr. 1409.) Raymond James depended: (1) on the voluntary submission of requests for a non-branch location to inform them that a registered representative was working regularly from home; and (2) on the branch manager to make sure that correspondence and documentation for business activity conducted outside the office came through the office to which the registered representative was assigned. (Tr. 2106, 2338.) The Compliance Department was never notified that Mr. Herula worked almost entirely from locations other than the Cranston branch office. (Tr. 2440.) In his investigative testimony, Mr. DiGirolamo testified that branch managers were not required to report that a registered representative worked regularly from home, and acknowledged that Raymond James did not know the number of registered representatives working from home. (Tr. 2499-50.) At the hearing, however, Mr. DiGirolamo changed his testimony based on his review of the auditor's questionnaire. He testified that branch managers were asked during the 2000 audit if any registered representatives were working regularly outside the branch office. (Tr. 2498.) Mr. DiGirolamo's present position is that if the registered representative was regularly working at a location other than a branch office in 1999 and 2000, Raymond James required disclosure so that it could register the location as a satellite office with the NASD. (Tr. 2459, 2600.) Donald Runkle (Mr. Runkle), who became Raymond James's chief compliance officer in May 2004, acknowledged that prior to 2003, Raymond James did not maintain a list of who it believed worked at unregistered locations. (Tr. 2865, 2938.)

In accordance with Raymond James's policy, Mr. Ullom allowed Mr. Herula to work from locations other than the Cranston branch office. (Tr. 990-92.) Raymond James allowed this and, in keeping with NASD requirements, insisted that locations outside the branch office

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[34] Mr. Carreno estimates that thirty percent of Raymond James's registered representatives are employed outside for compensation and therefore, should, submit an Outside Activity form. (Tr. 2331.)

[35] One person worked out of an office of Robert Thomas in Westerly, Rhode Island, and two people, who were primarily active in insurance type products and financial planning, worked from home offices. (Tr. 1031-32.)

could not be advertised, that all correspondence be sent from the branch office, and all files be maintained at the branch office. (Tr. 2332, 2409-10.) Mr. Carreno testified during the investigation that Raymond James did not require a registered representative to obtain approval to work from home. (Tr. 2335.) At the hearing, however, Mr. Carreno testified that Raymond James asked branch managers to fill out a form when a registered representative was going to operate regularly from home. Mr. Ullom never inspected or reviewed Mr. Herula's work locations outside the Cranston branch office. He was also unaware of any special procedures or compliance policies that Raymond James had in place for supervising registered representatives who worked outside the office. (Tr. 991-92.)

The files in the Cranston branch office did not contain copies of correspondence from Mr. Herula to B.B. Britt who operated Beehive International LLC, on Raymond James letterhead, sent from the Cranston branch office. (Tr. 1435, 1437-39.) The Cranston branch office files did not contain a facsimile Mr. Herula sent from the Cranston branch office to B.B. Britt on Raymond James letterhead, dated December 6, 1999, making unauthorized representations and guarantees concerning the $10 million deposit from Bill Britt. (Tr. 1409-10; R.J. Ex. 2035.) Jason Ullom notarized Mr. Herula's signature on the e-mail. (R.J. Ex. 2035.) The Cranston branch office files did not have a copy of a facsimile Mr. Herula sent from the office on Raymond James letterhead dated December 7, 1999, which included instructions from Mr. Fife to Mr. Herula concerning Mr. Britt's $10 million deposit. (Tr. 1407; R.J. Ex. 2036.) Mr. Herula was to deposit the funds into the Brite Business account to purchase "T-Bills, Notes or Bonds on margin, with a maturity of 90 days from the execution of the order, for the purpose of transacting a reverse repo using Sovereign Advisers, a Raymond James Advisory Services Group advisor." (R.J. Ex. 2036.) The Cranston branch office files did not contain: facsimiles sent to Mr. Herula by Mr. Britt on February 4, 2000; a letter from Mr. Britt to Mr. Clarke making demands on Raymond James related to the Brite Business transaction; or a letter from Mr. Herula on Raymond James letterhead to Mr. Britt dated February 16, 2000, stating the Raymond James had his funds in a T-bill. (R.J. Ex. 2054-2056, 2059-60, 2062, 2064.) Mr. Herula testified that he worked out of his home offices from mid-December 1999, until he left Raymond James, and that his files contained copies of all his unauthorized correspondence. (Tr. 1723-24.)

Mr. Ullom submitted monthly compliance reports to Raymond James's Compliance Department in 2000, indicating that the Cranston branch office had no compliance problems. (Tr. 1262; Div. Ex. 441-48, 450, 452-54, R.J. Ex. 2553.) From May 1999 through January 2001, Mr. Ullom represented that he had reviewed and initialed all outgoing correspondence, including e-mails pertaining to the solicitation or execution of securities transactions. (Tr. 1524; Div. Ex. 443, 447, R.J. Ex. 2553.) Mr. Carreno reviewed these compliance reports until the compliance departments merged, and Raymond James went to a regional structure for compliance oversight. (Tr. 2053-54.) The Compliance Department did not contact Mr. Ullom with inquiries on any compliance report in 2000. (Tr. 1262-64.)

Mr. Ullom and the registered representatives in the Cranston branch office signed a form annually representing that they observed the company's ethics policies, and its financial adviser business procedures. (Tr. 1303; R.J. Ex. 2018.) Mr. Ullom did not have Mr. Herula submit a Request to Engage in Outside Activity for his work raising funds for Brite Business. Mr. Ullom

testified that this was because Raymond James knew of Mr. Herula's attempts to arrange loans for Brite Business. (Tr. 1302.)

Raymond James's had Operations Manuals for compliance available in hard copy and online during the relevant period. (Tr. 2486-87; R.J. Exs. 2531, 2532, 2539, 2540, 2542.) The Compliance Department established parameters for situations that required review from a compliance perspective and the clearing firm produced computer generated exception reports showing these situations (exception reports). (Tr. 2425-26.) During the relevant period, R.J. & Associates periodically provided Raymond James's Compliance Department with over fifty different exception reports. (Tr. 2359, 2420-21.) On a monthly basis, the Compliance Department sent Mr. Ullom and other branch managers, MARS reports, which were a summary of exception reports applicable to the specific branch. The branch manager was required to review the MARS reports and perform any investigation that was required. (Tr. 2418, 2770; R.J. Ex. 2559 at audit letter dated Aug. 6, 1997.)

Sending the MARS reports to the branch offices, "didn't relieve the [C]ompliance [D]epartment from doing what it needed to do with the exception report" from a compliance perspective (Tr. 2424.) The MARS reports for March, April, May, August, September, and October 2000, noted that the Brite Business and Mary Lee Capalbo, Esq., Special Client, a related account, issued third-party checks for millions of dollars, and/or transferred millions of dollars between accounts at Raymond James. (Div. Exs. 458, 459, 460, 462, 463, 464.) The Compliance Department's concern was that the transactions occurred pursuant to LOAs, and that the client orally confirmed the authorization where the transfer was over a certain amount. (Tr. 2427.) Review by the Compliance Department consisted of ensuring that procedures were followed, that a LOA was authorized, and that operations and customer accounts had signed off on the transaction. (Tr. 2586.) The evidence is that the Compliance Department did nothing more with this information. (Tr. 2424.) Mr. DiGirolamo testified that, after the compliance departments merged in May 2000, compliance procedures that applied to transfers in the investment management division applied to the securities division as well. (Tr. 2588-89.)

Raymond James had the following standards in effect for infractions during the relevant period:

First offense:	Letter of caution;
Second offense:	Letter of caution and/or a fine; and
Third offense:	Fine and potential termination.

(Tr. 2565.)

Following the events that are the subject of this proceeding, Raymond James has taken steps to enhance its compliance efforts. (Tr. 2879.) In the last two years, the firm has changed structurally with new and increased numbers of people occupying key management positions at the firm. (Tr. 3429.) Chet Helck (Mr. Helck), the president and chief operating officer of Raymond James, maintains that supervision and compliance are among the firm's highest priorities and that the tone from the top is to always put the client's interest first. (Tr. 3427-28.) The events that are the subject of the proceeding have been a huge embarrassment for

the firm and have strengthened its resolve that they never happen again. (Tr. 3439.) Mr. Helck testified that at the request of the holding company's audit committee, an outside consultant was considering the effectiveness of Raymond James's compliance and supervisory procedures. (Tr. 3439.) On August 19, 2003, following NASD guidance, Mr. DiGirolamo advised all branch managers and registered representatives that:

> Effective immediately, the firm will require audits of each location (home, vacation home, etc.) where any Financial Advisor **regularly** conducts business at least two or more days per week **or** 25 days in any quarter **or** 10 days in any month **or** for six consecutive weeks. (emphasis in original)

(Tr. 3169; Div. Ex. 507.) Raymond James has also increased the number of "compliance professionals," to forty-eight, created a rapid response team, and instituted reviews in new areas. (Tr. 2878-82.) Raymond James has also implemented procedures which, among other things, require additional "assessment of who [its] customers are."[36] (R.J. Ex. 2665 at 21.)

Raymond James's Notice of Mr. Herula's Unauthorized Correspondence and Other Information

Throughout the relevant period Mr. Herula signed and transmitted correspondence on Raymond James letterhead to investors in Brite Business.[37] (Tr. 1104-14; Div. Exs. 12-21, 23, 24.) Mr. Herula signed most of this correspondence on Raymond James letterhead as Financial Consultant or Investment Manager. (Id.) On November 28, 1999, Mr. Herula sent Brite Business, by facsimile, from the Cranston branch office, a form letter with three paragraphs of unauthorized representations and guarantees. This material appears in much of his later correspondence on behalf of Brite Business. (Tr. 1411; R.J. Ex. 2030.) Mr. Ullom denies he knew of this form letter, and agrees that no one at Raymond James was aware of it until a similar unauthorized letter appeared in March 2000. (Tr. 1411.)

1. Provident letter

On January 20, 2000, Mr. Herula informed Mr. Putnam that he had written a letter on December 8, 1999, on Raymond James letterhead to Provident Investment Counsel, Inc., (Provident), an independent investment adviser in the Raymond James Investment Advisor Group. (Div. Ex. 262.) In the Provident letter, Mr. Herula as a representative of Brite Business seeks to enlist Provident in a reverse repurchase agreement between Brite Business and the Bank of New York. (Id.) Mr. Putnam considered the letter questionable, but he does not consider it to be unauthorized correspondence by Mr. Herula. (Tr. 1994.) Mr. Putnam thought it possible that

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[36] This change was required by NASD's Notice to Members 0221, prompted by the United States Patriot Act.

[37] Mr. Ullom denied seeing the e-mails Mr. Herula sent and received at the Cranston branch office concerning Brite Business on January 12 and 13, and February 23, 2000. (Div. Exs. 132, 133, 135.)

Mr. Herula wrote this letter acting for Raymond James and not for Brite Business. (Tr. 1959-60.) Mr. Putnam assumed Mr. Ullom had approved the Provident letter. (Tr. 2146.) Mr. Putnam warned Mr. Ullom that letters had to accurately portray the relationship between Raymond James and Brite Business. (Tr. 1896-97.) Mr. Putnam did not inform the Compliance Department of the Provident letter. (Tr. 1904.)

2. Lanciano letter

Hugh M. McGovern, Senior Vice President, Salomon Smith Barney, Inc., provided Joseph Tuorto (Mr. Tuorto), chief compliance officer at R.J. & Associates, a letter written by Mr. Herula on March 1, 2000, on Raymond James letterhead, to Lanciano Limited (Lanciano letter) at an address in Cyprus. (Tr. 1933; Div. Ex. 272.). Mr. Putnam received the letter on or about March 20, 2000.[38] (Tr. 1596; Div. Ex. 272.) In the letter Mr. Herula stated:

> Please let me introduce Raymond James Financial, Inc. Raymond James was established in 1962 and is a publicly traded company since 1983. Raymond James Financial is listed on the New York Stock Exchange and manages in excess of $14 billion USD for individuals, pension plans and municipalities with more than 3200 financial advisers in over 1000 offices located throughout the United States.
>
> Brite Business is a valued client of Raymond James, maintaining an account with an aggregate nine-figure balance. This letter is to confirm my review and understanding of the financial plans of Brite Business Corp. Upon extensive review and confirmation of the irrevocable instructions from Brite Business Corp. I am confident that the profits from their Treasury transactions will be used to honor their commitments and contract with you. Further, I know and have worked with our client, Brite Business, and can confirm that they are of the highest rank of moral character and business acumen.
>
> Please be advised of the following acknowledgements:
>
> Raymond James has received irrevocable instructions from Brite Business Corp. regarding the deposit from Lanciano Limited, when received, in the amount of $25,000 USD (Twenty Five Million) for the purpose of completing a purchase of U.S. Treasury Bills, Notes or Bonds for leverage for Brite Business Corp.
>
> Raymond James will follow these instructions with the full faith and backing of the company to guarantee the funds deposited by Lanciano Limited will not be withdrawn from the account without the express written instructions of Lanciano Limited. . . .

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[38] The facsimile cover sheet indicates Mr. DiGirolamo was sent a copy, but he denies that he saw it. (Tr. 2483-84; Div. Ex. 272.)

> I trust you will find this letter acts as a full faith undertaking and guarantee to Lanciano Limited that their funds will not be at risk at any time during or after the anticipated transaction, and as such the funds plus interest will be returned intact, as long as the T-Bills, Notes or Bonds are held to maturity.

(Div. Ex. 272.)

Mr. Putnam's initial concern on reading the Lanciano letter was whether the Brite Business account had funds deposited as a result of the letter. (Tr. 1949-50.) Another concern was that the letter gave the impression that Raymond James owed a duty to Lanciano Limited when its duty ran solely to Brite Business. Mr. Putnam was "plenty agitated," and called the Compliance Department immediately and asked that the Brite Business account be frozen. (Tr. 1943-44, 2092.) The representations in the Lanciano letter, especially the false representations and guarantees, are contrary to Raymond James's policies. (Tr. 1941-42.) Moreover, all the representations were inappropriate, because they were "representations and guarantees that Raymond James could not make" with respect to the Brite Business account. (Tr. 1941.) Mr. Putnam believed that the letter showed that Mr. Herula was conducting an outside business activity using Raymond James stationery. (Tr. 1960.)

Mr. Putnam called Mr. Herula on March 24, 2000, to review the contents of the letter. (Tr. 1945-46, 2093.) Mr. Putnam also called Mr. Ullom, who claimed to have not seen the letter. (Tr.1964, 2094-95.) Mr. Putnam accepted Mr. Herula's representation that Brite Business did not receive funds as a result of the Lanciano letter, and he trusted and relied on Mr. Ullom to make sure this was true. (Tr. 1453, 1946-47.) Mr. Putnam presumed that Raymond James would have been notified if Lanciano Limited had deposited money as a result of the letter. (Tr. 1946.)

Mr. Putnam directed that a copy of the Lanciano letter be sent to Mr. DiGirolamo. (Div. Ex. 272; Tr. 1962.). Mr. Putnam did not inquire or ascertain whether Mr. Herula's statement that Brite Business maintained an account at Raymond James with an aggregate nine-figure balance was true. (Tr. 1935-36; Div. Ex. 403.) It was not. Mr. Putnam did not initiate a review of activity in the Brite Business account, nor did he direct anyone else to do so. (Tr. 1947.) He did not ask Mr. Herula for a copy of the irrevocable instructions referred to in the Lanciano letter. (Tr. 1960.) Mr. Putnam and Mr. Ullom each talked separately with Mr. Herula, who said he did not understand "the ins and outs of all of these things." (Tr. 1961.) Mr. Putnam accepted Mr. Herula's representations that this was the only letter of this type he had sent, and was not something Brite Business was doing on an on-going basis. (Tr. 1947, 1960-61.) Mr. Putnam did not fire Mr. Herula because Mr. Herula was contrite and Mr. Putnam believed Mr. Herula was naïve. (Tr. 1961, 2095.) Mr. Herula did not produce anything in response to Mr. Putnam's request for any additional correspondence of this type. (Tr. 1453.)

Mr. Herula was not put on formal heightened supervision status by Mr. Putnam or the Compliance Department. (Tr. 1272, 1961-62.) Mr. Putnam thought heightened supervision would have been unusual based on a single piece of unauthorized correspondence and where Mr. Herula, in Mr. Putnam's view, was naïve. (Tr. 1965.) Mr. Putnam directed Mr. Ullom to monitor Mr. Herula's activities closely and to review Mr. Herula's correspondence. (Tr. 1452,

1961.) Mr. Putnam believed that Mr. Ullom knew he had "to get on top of [Mr. Herula's] correspondence," and that Mr. Ullom had placed Mr. Herula on enhanced monitoring. (Tr. 2020, 2096.) Mr. Putnam did not follow up to assure that Mr. Ullom was supervising Mr. Herula appropriately. (Tr. 1964.) Mr. Putnam testified that he may have directed Mr. Ullom to tell Mr. Fife to make sure that Brite Business was not misrepresenting its relationship with Raymond James. (Tr. 1968-69.) Mr. Putnam did not contact Mr. Fife directly and he cannot recall whether he checked to see whether Mr. Ullom followed his instructions. (Tr. 1969.)

Mr. Putnam characterized the restriction that he placed on the account as a "little second check." (Tr. 1949-50.) The restriction required that Mr. Putnam review and approve any funds leaving the account. (Tr. 1130, 1453, 1944.) The account file contained a statement "NO WITHDRAWAL OF FUNDS OR SECURITIES OR ACATING WITHOUT CONTACTING STEVE PUTNAM."[39] (R.J. Ex. 2344.) The restriction also applied to transfers to other unaffiliated accounts at Raymond James. (Tr. 1456-57, 1569, 1944-45.) Considering that Raymond James had more than 500,000 accounts, the restriction on the account by the president of Raymond James was unusual. (Tr. 2788.) Mr. Putnam did not monitor the account, but relied on the Operations Department to call him when there was an issue. (Tr. 1949.) When the Operations Department contacted Mr. Putnam pursuant to the restriction, Mr. Putnam would simply ensure that Mr. Fife, or another person from Brite Business, had authorized the transfer. (Tr. 1949.) Mr. Putnam and Raymond James followed the directions of Mr. Fife or Brite Business as to disbursements from the account without any questions.[40] (Tr. 1958.)

The Compliance Department was never informed about the Lanciano letter. Mr. DiGirolamo testified that he did not see the Lanciano letter and had no involvement with Mr. Herula or Brite Business through the end of 2000. (Tr. 2483.) Mr. Putnam did not instruct the internal auditors to take action because he was not responsible for compliance. (Tr. 2022-23.) Mr. Putnam never sent internal auditors to the Cranston branch office to review Mr. Herula's correspondence. (Tr. 1963, 2000.) Raymond James's auditors are instructed to look for correspondence like the Lanciano letter; unauthorized correspondence can be the basis for further investigation. (Tr. 1942-43.) No one from Raymond James's headquarters came to the Cranston branch office to interview Mr. Herula or review his correspondence file following Mr. Putnam's receipt of the Lanciano letter. (Tr. 1137.)

R.J. & Associates's Client Services Department informed Mr. Putnam of the transfers to and from the restricted Brite Business account. (Tr. 1144, 1153, 1160, 1166, 1169; Div. Exs. 187, 190, 195.) Raymond James followed its procedures and established that the person controlling the account authorized each transfer. Mr. Putnam did not stop transfers from the Brite Business restricted account or question Mr. Ullom about them; no one at Raymond James called for more information on transfers of more than a million dollars from a restricted account

[39] In this situation, ACATING meant that no positions in the account were to be transferred to another broker-dealer or bank without contacting Mr. Putnam. (Tr. 1455.)

[40] Mr. Putnam knew Ms. Capalbo was married to Mr. Herula when he authorized the transfers from the Brite Business account. (Tr. 1952.)

to non-restricted accounts at Raymond James, and then to accounts outside Raymond James. (Tr. 1139-41, 1158, 1160-61, 1163-67, 1169-71, 1202.)

3. The Fingessa letter

On March 9, 2000, Mr. Herula sent a letter to Fingessa, S.A., Lugano, Switzerland, (Fingessa letter) on Raymond James letterhead, stating that:

(1) Raymond James had received irrevocable instructions from Brite Business concerning Fingessa's deposit of $12.5 for the purpose of completing a purchase of U.S. Treasury Bills, Notes, or Bond;

(2) Raymond James will follow these instructions with the full faith and credit of the company to assure that funds deposited by Fingessa will not be withdrawn from the account without written instructions from Fingessa;

(3) Raymond James will return the funds in full, without delays or encumbrances, upon the maturity of the instruments; and

(4) The maturity of the T-Bill, Note or Bond will be 90 days unless specific instructions are received from Fingessa within 10 days of maturity to roll over the treasury instrument.

(Div. Ex. 44.)

4. Additional Unauthorized Correspondence and Disturbing Information

On April 10, 2000, Mr. Herula sent a letter sent from the Cranston branch office on Raymond James letterhead, which acknowledged wiring Vince Farrugia, Jr., J.C. Bradford & Co., $4.5 million from an attorney escrow account at Raymond James on behalf of his unnamed client. (Tr. 1467-68; R.J. Ex. 2338.) If no transaction took place between his client and Capital Dynamics Corporation, Mr. Herula instructed that the funds were to be returned to First Union National Bank, Mary Lee Capalbo, Esq., Special Client Account. (Id.) This correspondence was not in the files of the Cranston branch office. (Tr. 1463-64.) Mr. Herula's April 10 letter followed a letter on April 6, 2000, to Jude Onukwugha in which Mr. Herula requested the coordinates to transfer funds to J.C. Bradford, pursuant to a conversation with Dorian Brisbois (Mr. Brisbois). (Tr. 1469-70.) Mr. Ullom denied knowing of the subject matter of Mr. Herula's April 6 and 10, 2000, letters; however, Mr. Ullom wrote five letters between June 28 and December 28, 2000, attempting to collect on a personal loan to Mr. Brisbois from Mr. Herula. (Tr. 1466-71; R.J. Ex. 2075.) In those letters, Mr. Ullom refers to his review with Mr. Herula "of any deals with Martin that might have life in them" and noting that the "Bradford/Jude" deal is dead for all practical purposes. (R.J. Ex. 2075.) Mr. Ullom did not provide Mr. Putnam with any information on these matters. (Tr. 1471.)

On April 12, 2000, Mr. Herula and Dana Sherman (Mr. Sherman), administrative assistant at the Cranston branch office, sent by facsimile to Brite Business a signed letter, on Raymond James letterhead, confirming, "with full banking responsibility and liability," that specific United States Treasury bonds were held in a custodial account in Brite Business's name,

and that the cash value was $110,860,000.[41] (R.J. Ex. 2071.) On June 1, 2000, Mr. Herula and Mr. Sherman, sent by facsimile to Brite Business a signed letter on Raymond James letterhead confirming that certain treasury bills that matured on June 8, 2000, would be replaced, and that the market value on June 8, 2000, would be approximately $112 million. (R.J. Ex. 2073.) The information in both letters was false. Brite Business did not have treasury bills with a cash value of $110 million on deposit with Raymond James. (Tr. 1463-64.) This correspondence was not in the files of the Cranston branch office. (Tr. 1468.)

On July 7, 2000, the Cranston branch office received a letter by facsimile from Lewis P. Blackburn (Mr. Blackburn) requesting that Mr. Herula provide him with an accounting of his position with Brite Business. Mr. Blackburn noted the long wait and happiness at seeing "it come to fruition." (R.J. Ex. 2077.) Mr. Ullom did not inform anyone at Raymond James. (Tr. 1473.)

5. Brite Business's Solicitation to Michael McCue

Mr. Ness informed Mr. Putnam on May 3, 2000, that a Raymond James employee in Cleveland, Tennessee, reported that Brite Business representatives had offered a local attorney, Michael McCue, participation in a transaction where banks would borrow from a $100 million fund at Raymond James Trust at a discount, and the attorney, acting as a middleman, would place the debt with an investor at par and pocket the spread. (Tr. 1173-74, 2724; Div. Ex. 275.) Mr. Ness told Mr. Putnam:

> What bothers me here is someone may be out there using [Raymond James Trust Company's] name without our knowledge and involving us in a transaction or using our name to give legitimacy to a potentially questionable situation. As I recall, the folks at First Union had a similar reaction when we spoke to them.

(Div. Ex. 275.)

Mr. Putnam responded to Mr. Ness that "absent a retail account we have no current dealings with [Brite Business]." (Id.) On inquiry by Mr. Putnam, Mr. Ullom reported that the persons named were not representatives of Brite Business. (Tr. 1972-73.) Mr. Putnam did not send Mr. Ness's communication to the Compliance Department. (Tr. 1972.) Mr. Putnam suggested to Mr. Ullom that Brite Business should be more circumspect in its statements. (Id.)

6. Mr. Cohn and Four Star Financial Services, LLC

On or about July 10 and 12, 2000, Mark Cohn, representing Four Star Financial Services, LLC (Four Star), informed Mr. Ullom that Four Star was "the real party in interest" to $12 million in the Brite Business account and demanded that Raymond James not allow transfers out of the account until Four Star's claim was satisfied. (Tr. 1207-09; Div. Exs. 149-152.) Mr. Cohn provided Mr. Ullom with materials that described deposits from Larry Taggart and Lewis P. Blackburn in January and February 2000 made in connection with Brite Business's purchase

[41] The facsimile was sent from Mr. Herula's home number.

of Treasuries. (R.J. Ex. 2082.) The materials included a letter dated March 10, 2000, that stated Raymond James would provide safekeeping for the transaction and provided instructions and coordinates for depositing $5.5 million in a Brite Business account at Raymond James. (Tr. 1213; Div. Ex. 151 at 98.) Also included were letters, on Raymond James letterhead, to Mr. Blackburn dated March 8, 9, and 22, 2000, and May 16, 2000, one of which repeated some of the unauthorized representations contained in the Lanciano letter. (Tr. 1226, 1536-37; Div. Ex. 149.) Based on his review of the materials, it was clear to Mr. Ullom that Mr. Herula had written the letters. (Tr. 1475; Div. Ex. 506.)

Mr. Ullom called Mr. Putnam and claims he forwarded Mr. Cohn's letter and maybe some of the materials he received from Mr. Cohn to Mr. Putnam. (Tr. 1474-75, 1538, 1546-47, 1579; investigative testimony July 16, 2002 at 191-93.) Given Mr. Ullom's lack of credibility, I accept Mr. Putnam's position that: (1) he never asked to see the letter and materials because initially he was in Alaska where there was with limited facsimile capability and when he returned on July 19, Mr. Ullom told him the issue was resolved; and (2) Mr. Ullom told him that the Four Star correspondence was unlike the Lanciano letter, as it did not commit Raymond James to anything; and (3) he did not ask to see the Four Star correspondence when he returned because Mr. Ullom told him the matter had been resolved. (Tr. 1596, 1993-2002.)

On July 13, 2000, Mr. Putnam informed Mr. Augenbraun and Mr. James that Mr. Cohn had a letter written by Mr. Herula and that: (1) he was nervous that Raymond James's name was mentioned; (2) he had instructed Mr. Ullom to inform Mr. Fife that Raymond James was closing the Brite Business account; and (3) "since this is the second time that this has taken place," he wanted "[Mr. Herula] out of here after [Mr. Ullom] gets every piece of paper that he ever wrote on this subject back as well as a debrief."[42] (Tr. 1216; Div. Ex. 506.) Mr. Augenbraun's sole focus was dealing with the demand for funds in a Raymond James account. He did not request to see the correspondence, which was the basis for Mr. Putnam's statement that, "this is the second time that [unauthorized correspondence on Raymond James letterhead] has taken place." (Tr. 2225-27, 2230; Div. Ex. 506.) Neither Mr. Putnam nor Mr. Augenbraun informed the Compliance Department of the Four Star correspondence. (Tr. 2001, 2229.)

Mr. Augenbraun advised Mr. Putnam to wait for Mr. Fife and Mr. Cohn to resolve their dispute before disbursing any funds from the account. (Tr. 1477-78; Div. Ex. 506.) Mr. Putnam followed that advice. At that time, Mr. Augenbraun did not opine on whether Mr. Herula should be terminated. (Tr. 2226.)

Mr. Putnam did not request that Mr. Fife move the Brite Business account, and all related accounts out of Raymond James. (Tr. 1222, 1245-46, 1250; Div. Exs. 277, 435, 506) Mr. Putnam did not fire Mr. Herula because he believed: (1) the issue was resolved rapidly; (2) the unauthorized letter on Raymond James letterhead was not of the same nature as the Lanciano

[42] It would have been significant for Raymond James to close a "good account like Brite Business." (Tr. 2006.) Mr. Putnam sent a copy to Mr. James because Mr. Cohn's correspondence incorrectly indicated that Mr. Cohn sent Mr. James a copy of his letter. (Div. Ex. 506.) Mr. Ullom did not send Mr. Putnam a second letter from Mr. Cohn dated July 12, 2000, or his response to the letter. (Tr. 1213-24; Div. Ex. 153.)

letter; and (3) Mr. Herula did not understand that this type of letter had to be approved. (Tr. 2018, 2105.) Mr. Putnam believed he and Mr. Ullom had educated Mr. Herula after the Lanciano letter but that, perhaps, he was not clear enough about correspondence so he gave him Mr. Herula another chance. (Tr. 2018.) Mr. Putnam did not prohibit Mr. Herula from sending out correspondence, examine the Brite Business account, or restrict Mr. Herula's activities with Brite Business. (Tr. 2019.) Mr. Putnam had Mr. Ullom tell Mr. Herula that he would be fired if there were any more unauthorized correspondence. (Tr. 2017, 2105.) On July 19, 2000, with Mr. Putnam and Mr. Augenbraun's knowledge, Mr. Ullom approved an LOA that transferred $1.5 million and $5.5 million from the Brite Business account to Mr. Blackburn that would "retire Cohen's interest with Blackburn." (R.J. Ex. 2651, July 19, 2000, e-mail at 2:26 p.m.) Mr. Ullom was the only person at Raymond James, other than Mr. Herula, who had any contact with Mr. Cohn. (Tr. 1485.) Mr. Putnam approved the transfer believing it was part of resolving the Four Star situation. (Tr. 2023-24; Div. Ex. 203.) On July 19, 2000, Mr. Ullom represented to Mr. Augenbraun that the Four Star matter was resolved. (Tr. 2264; R.J. Ex. 2085.)

Mr. Ullom did not tell Mr. Putnam or Mr. Augenbraun, that Mr. Cohn complained again, in August 2000, that significant funds in the Brite Business account belonged to Four Star. (Tr. 2264; Div. Exs. 155, 156, 157.) Mr. Cohn included a March 8, 2000, letter on Raymond James letterhead that made the same commitments to Mr. Blackburn as were contained in the Lanciano letter. (R.J. Ex. 2087.) Mr. Ullom did not inform Raymond James that he had received an August 10 letter from Mr. Cohn, but he sent the letter to Mr. Fife and discussed it with Mr. Fife and Mr. Cohn. (Tr. 1487.) On November 16, 2000, Mr. Ullom approved an LOA transferring $850,000 from the Mary Lee Capalbo, Esq., Special Account to Mr. Cohn. (Div. Ex. 93; R.J. Ex. 2089.) Mr. Ullom did not inform Raymond James that he entered a new independent contractor agreement with Mr. Herula on November 9, 2000, increasing the pay outs to Mr. Herula and adding a new category, "Financing Deals and Fees of $250,000 or more," which referenced Brite Business and others. (Tr. 1506; R.J. Ex. 2007.)

On January 10, 2001, Mr. Cohn made a third demand that Raymond James hold funds of Brite Business and affiliates until Four Star's claims were satisfied. In this letter, Mr. Cohn noted that Mr. Herula had represented that Raymond James was making partial payments. (R.J. Ex. 2097.) With the letter, Mr. Cohn sent a November 1, 2000, communication from Mr. Herula stating that he was transmitting $1.5 million from the Brite Business account to Abbot Capital, a Four Star subsidiary. (R.J. Exs. 2092, 2097.)

No one told Mr. DiGirolamo that Four Star had made a claim on funds in a Raymond James account, and he was not involved in discussion on whether Mr. Herula should have been terminated. (Tr. 2484.)

7. Seaview Development & Holdings Ltd. (Seaview) 2000 Letter

On October 17, 2000, Mr. Herula provided Mr. Fife with a letter, on Raymond James letterhead, stating that Seaview had been a substantial nine-figure asset management account with Raymond James. (R.J. Ex. 2090.) The representation was false. Seaview never had an account with assets in nine figures, nor was it engaged in trading or other asset management activities. (Tr. 1508.) Mr. Herula did not submit a copy of the letter to the correspondence file

of the Cranston branch office. (Tr. 1508-09.) On October 18, 2000, Ms. Capalbo, as agent for Mr. Fife and Brite Business, transferred $25,000 from the Mary Lee Capalbo, Esq., Special Client account to the Seaview account. (Tr. 1509; R.J. Ex. 2091.) Mr. Ullom approved the transfer and received ninety percent of the $25,000, which was used to pay Seaview's IMPAC fee. (Tr. 1509.)

Brite Business Accounts at Raymond James

Mr. Fife and others used the following five brokerage accounts at Raymond James to conduct fraudulent activities:

Brite Business Corp. Account, No. 58003682 (Brite Business account);
Brite Business Special, Account, No. 58005252;
Mary Lee Capalbo, Esq., Special Client Account, No. 4911444;
Seaview Development & Holding Ltd., Account, No. 53902669; and
Seaview Development & Holding Ltd., Special Account, No. 57038258.

Mr. Herula was the account executive on each of these accounts.[43] (Tr. 1140-41, 1569-70, 2965-69; Div. Ex. 403.) All the transfers from these Raymond James accounts had properly executed LOAs. (Tr. 965-66.) Trudy Bixby, vice president of the Customer Accounts Department (Customer Accounts) at R.J. & Associates during the relevant period, testified that Customer Accounts followed the procedures in place at the time for all disbursements from the Brite Business account and related accounts. (Tr. 2751, 2790-91.) The multi-million dollar size of the deposits and transfers did not give Mr. Putnam pause, because Brite Business was a large entity doing financing. (Tr. 2100.)

According to the Division, during the relevant period, these five accounts disbursed over $47 million as follows: Mr. Herula and Ms. Capalbo received over $8.5 million; Mr. Fife received almost $7.5 million; Mr. Sullivan received $350,000; over $29 million went back to investors; and Raymond James received almost $1.8 million in margin interest and about $51,156 in charges and fees.[44] (Tr. 946-52; Div. Exs. 99, 484.) The funds that were disbursed to Mr. Herula and Ms. Capalbo went to personal bank accounts and were used for personal and business expenses. (Tr. 951.)

According to Raymond James, the five accounts received total inflows of $69,056,826 and had total outflows, not including income/expenses and fees, of $69,012,288. (Tr. 2946; R.J. Ex. 2422 at 2.) Almost $51 million of the total outflows went to non-Raymond James accounts, $17 million went to Raymond James accounts and approximately $54,000 in cash disbursements went to non-Raymond James entities. (R.J. Ex. 2422.)

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[43] The Malcolm & Ursula Monlezun Account, No. 44902174 was also involved, in that it transferred funds into the Mary Lee Capalbo, Esq., Special Client Account.

[44] The Division's witness was unaware that Mr. Monlezun received $4,207 in 1999, apparently interest while his funds were in a money market fund. (Tr. 976; Div. Ex. 81.)

1. Brite Business Corp. Account, No. 58003682 (Brite Business account)

According to the Division, the Brite Business account received $46 million in investor funds from the following sources: (Tr. 900; R.J. Ex. 2422.)

Mr. Al Bloushi	$5 million on October 19, 1999;
Beehive/Britt	$10 million on December 7, 1999;
Four Star	$7 million on March 9 & 10, 2000;
Trigon	$10 million on March 23, 2000;
Rheaume/Mr. Fitzhenry	$12.5 million on March 28, 2000; and
Other	$1.5 million on October 10, 2000.

(Div. Ex. 99.)

Funds were transferred from the Brite Business account to the following accounts within Raymond James: (1) the Mary Lee Capalbo, Esq., Special Client account; (2) the Seaview Development & Holdings Ltd. account; (3) the Seaview Development & Holdings Ltd. Special account; and (4) the Brite Business Corp. Special account 5800-5252.[45] Mr. Monlezun's $1 million investment went first into the Malcolm & Ursula Monlezun account 4490-2174, and then into the Mary Lee Capalbo, Esq., Special Client account.[46] (Id.) Mr. Fife authorized disbursements from the Brite Business account and the Seaview accounts and from the Mary Lee Capalbo, Esq., Special Client. (Tr. 936.)

The Brite Business account disbursed $25,000 on November 19, 1999, and $225,000 on November 29, 1999. (R.J. Ex. 2342 at FW 012844.) Raymond James received $25,000, and sent ninety percent to Foxhill. (Tr. 1413.) Mr. Ullom testified that the IMPAC fee was $25,000, yet he co-signed a letter with Mr. Herula to Brite Business on November 29, 1999, acknowledging receipt of a $250,000 IMPAC fee.[47] (Tr. 1369; R.J. Ex. 2031.) Mr. Ullom did

[45] Mr. Ullom approved Mr. Fife's application to open the Seaview account on August 17, 2000. (Div. Ex. 157.) Mr. Ullom did not inform Mr. Putnam that he had approved opening another account for Mr. Fife. (Tr. 1497.) The Division maintains that Mr. Fife also carried out a fraudulent trading program through Seaview. (R.J. Ex. 2642.)

[46] Mr. Fife opened the Seaview Development & Holdings, Ltd. account in the Cranston branch office on August 17, 2000. (Div. Ex. 159.)

[47] A letter on Foxhill letterhead bearing Mr. Ullom's signature was sent by facsimile from the Cranston branch office on March 6, 2000. Mr. Ullom believes the letter is a forgery. (Tr. 1445.) The letter stated that Mr. Herula, a financial consultant in good standing with Foxhill, had been paid the first installment under an IMPC financial agreement with Brite Business. (R.J. Ex.

not disclose to Raymond James that Brite Business paid Foxhill $250,000. (Tr. 1414.) Mr. Ullom approved Mr. Fife's LOA for transfer of $225,000 to the Mary Lee Capalbo Attorney at Law account at Fleet Bank for legal and advisory services. (Tr.1373; R.J. Ex. 2033.) On the same day, the same Mary Lee Capalbo Attorney at Law account at Fleet Bank sent Foxhill $90,000, which Mr. Ullom testified was forty percent due under the terms of Mr. Herula's employment contract. (Tr. 1373-74; Div. Ex. 123, R.J. Ex. 2033.) Mr. Ullom does not recall "putting the two together": (1) his approval of a $225,000 disbursement from the Brite Business account on November 29, 1999; and (2) a $90,000 check dated November 29, 1999, to Foxhill, a company he co-owned.[48] (Tr. 1375.)

2. Mary Lee Capalbo, Esq., Special Account, No. 4911444

On March 28, 2000, shortly after Mr. Putnam placed restrictions on the Brite Business account, Ms. Capalbo opened the Mary Lee Capalbo, Esq., Special Client account, 49114444, at Raymond James. (Div. Ex. 142.) An account number that began with No. 4911 indicated that the principal party opening the account had a relationship with an employee of Raymond James (employee related account). (Tr. 1151.)

The Mary Lee Capalbo, Esq., Special Client account received and disbursed a total of $21,441,665. (Div. Ex. 486A.) Raymond James received proper LOAs for all transfers from the Mary Lee Capalbo, Esq., Special Client account. (Tr. 965.)

3. Seaview Development & Holding Ltd., Account No. 53902669

The Seaview Development & Holdings Ltd. account received and disbursed $36,699. Some $35,000 was received from the Mary Lee Capalbo, Esq. Special Client account at Raymond James, and $35,990 was disbursed to a Seaview account controlled by Mr. Fife at Bank of America. (Tr. 922-23; Div. Ex. 103, 487.)

4. Seaview Development & Holding Ltd., Special Account, No. 57038258

2064.) Mr. Ullom testified that two letters stating that Mr. Herula earned a quarterly IMPAC fee of $250,000 sent by facsimile from the Cranston office were also forgeries but he admits signing a letter on March 10, 2000, approving the transfer of $10,000 from Mr. Herula's account to purchase a house. (Tr. 1447, 1450; R.J. Exs. 2065, 2066, 2067.)

[48] Mr. Ullom signed a branch office compliance report on November 30, 1999, in which he verified that "no personnel in [the Cranston] branch office have accepted client checks made payable to a Financial Advisor or FA's support company." (R.J. Ex. 2553 at FW 025196.) Mr. Ullom made the same representation following receipt by Foxhill of two $50,000 checks: in August 2000, and the other in October or November 2000. Mr. Ullom acknowledges that it was inappropriate for a registered representative to receive funds from a client where the broker-dealer had no knowledge and the registered representative had not filed an outside activity report. (Tr. 1404-05.)

The Seaview Development & Holdings Ltd Special account received and disbursed almost $1.2 million. (Div. Ex. 488A.) The account received deposits of $675,000 from the Mary Lee Capalbo, Esq. Special Client account and $513,305 from the Brite Business Special account at Raymond James. (Div. Exs. 104, 488.) Mr. Fife approved transfer of $1.2 million to a Seaview account at Chase Manhattan bank and $150,000 to International Fisheries.

2000 Audit of the Cranston Branch Office

During the relevant period, Raymond James conducted a surprise compliance audit at its branch offices annually and at its satellite offices every other year. Raymond James's records did not show that the Cranston branch office had any satellite offices. (Tr. 3090.) Neither Raymond James's internal auditors nor any compliance representative visited the Cranston branch office between the audit conducted on November 15, 1999 (1999 audit) and the audit on September 19, 2000 (2000 audit). (Tr. 1278.)

Thomas Wegner (Mr. Wegner) conducted the 2000 audit of the Cranston branch office. Mr. Wegner was a registered representative with Raymond James and worked for Independent Auditing & Consulting (IAC). (Tr. 3054.) IAC is an independent contractor hired by Raymond James to conduct audits. (Tr. 3055.) In 2000, IAC charged Raymond James a flat fee of $475 per branch office audit. IAC could request additional compensation if an audit went longer than one day or if the audit involved unforeseen circumstances. (Tr. 3093.) IAC took a $50 override and paid Mr. Wegner $425.[49] Typically a branch office audit takes five or six hours. (Tr. 3067.) Mr. Wegner completed the Cranston branch office audit in one day. Mr. Wegner submitted his report to the Compliance Department, which issued a final report to Mr. Ullom. A copy of the final report was also sent to Mr. Putnam. (Tr. 3091-92; R.J. Ex. 2563 at 3762-63.)

Through IAC, Mr. Wegner received a pre-audit packet from Raymond James in preparation for the audit. Mr. Wegner's audit had three components: (1) the compliance interview with the branch manger or the person in charge the day of the audit; (2) review of information made public; and (3) suitability of transactions. Another emphasis was to examine the flow of funds. (Tr. 3024-25.) Mr. Wegner also reviewed the MARS reports to assess whether the branch manager was reviewing them. (Tr. 3171.)

Mr. Ullom was absent, so Jason Ullom, deputy branch manager, met with Mr. Wegner. (Tr. 1565-66, 3028; Div. Ex. 302.) Mr. Wegner used a checklist of questions in conducting the audit. (Tr. 3020; R.J. Ex. 2563 at 3764.) The Audit Summary consisted of eight pages of questions with boxes for answers under columns headed "S" for satisfactory, "U" for unsatisfactory, and "N" for not applicable. (Tr. 3030.) Jason Ullom answered the Audit

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[49] Mr. Wegner, age thirty-nine, holds a degree in finance from Mercer University and a Masters in Business Administration from the University of Denver. (Tr. 3014.) Mr. Wegner conducted about 250 audits for Raymond James prior to the 2000 audit of the Cranston branch office. (Tr. 3043.) Mr. Wegner, a resident of Atlanta, Georgia, pays his expenses, including travel. (Tr. 3063.) Conducting audits for Raymond James is Mr. Wegner's primary source of income. (Tr. 3062.)

Summary. The Audit Summary used in the 2000 audit did not contain the questions about rogue brokers that had been part of the 1999 audit summary. (Tr. 3134-35; R.J. Exs. 2560, 2563.)

Auditors do not interview individual registered representatives as part of an audit. (Tr. 2926.) The audit includes a four-page Financial Advisor Annual Compliance Interview that has forty-six questions. (R.J. Ex. 2563.) Mr. Wegner left Financial Advisor Annual Compliance Interview questionnaires for David Ullom, James Crowley, Dennis Herula, and Jeffrey Toth, because they were not in the office on the day of the audit. (Tr. 3033-35; R.J. Ex. 2563 at 3772.) The forms were to be filled out and returned to the Compliance Department. Mr. Toth, Mr. Crowley and Mr. Ullom returned their forms, but Mr. Herula did not. (Tr. 3035.) It is not Mr. Wegner's responsibility to check on the accuracy of the representations made by the branch manager or deputy branch manager. (Tr. 3074.)

Mr. Wegner did not know where Mr. Herula, Mr. Crowley, or Mr. Toth regularly worked. (Tr. 3090-91.) Jason Ullom told Mr. Wegner that all the registered representatives worked from the branch office, which was false. (Tr. 990-91, 2016-17, 2464, 3030-31; R.J. Ex. 2563 at 3770.) Mr. Wegner knew that Mr. Ullom, Mr. Crowley, and Mr. Herula had outside activity forms on file with Raymond James. Mr. Herula's form was for fund raising consultation for a charitable foundation, Angels of the Sea. (R.J. Ex. 2563 at 3653.) Neither Jason Ullom nor anyone else at Raymond James informed Mr. Wegner that Mr. Herula was conducting outside business activity for Brite Business. (Tr. 3051-52, 3076, 3080; R.J. Ex. 2563 at 3753.)

The Cranston branch office's correspondence files, one by client and one by branch, contained a couple of pieces of correspondence for each month. (Tr. 2505, 3041.) The files did not have copies of any of the unauthorized correspondence sent by Mr. Herula in 2000. (Tr. 3043, 3092-93.) Raymond James relied on the representations by registered representatives and branch managers, and customer feedback, to assure that the branch office files contained all business correspondence from registered representatives who worked outside the branch office. (Tr. 2346-48.) Based on what he saw in the correspondence files, Mr. Wegner determined that the Cranston branch office was keeping correspondence for a three-year period. This included hard copies of e-mails. (Tr. 3044, 3055-56.)

An NASD Regulatory and Compliance Alert, promulgated in June 1997, recommended the review of all operational bank accounts maintained in branch offices as a "best practice." (Tr. 3152-53; Div. Ex. 337.) In keeping with Raymond James's procedures in place at the time, Mr. Wegner did not review the Cranston branch office operating account so he was unaware of the 2000 bank statements for the Foxhill account. (Tr. 1042, 1047, 1280-81, 1570-71, 2345, 3037.) Because of this omission, Raymond James did not know that Mr. Herula gave Mr. Ullom: a check from Ms. Capalbo's account at Fleet Bank, payable to Foxhill, for $90,000 on November 29, 1999; a check payable to Foxhill for $50,000 from the Mary Lee Capalbo Special Client Account on August 18, 2000; and that Mr. Herula wired $50,000 to the Foxhill account on October 12, 2000. (Tr. 1038-39; Div. Exs. 123, 160, 232 at FXHL 40.) Mr. Ullom deposited the checks in the Foxhill account that was used to operate the Cranston branch office. (Tr. 1040; Div. Exs. 229 at FXHL 115, 232 at FXHL 34.) Mr. Ullom received some, or all of the money, when Foxhill declared a bonus. (Tr. 1301.)

In the 2000 audit, Mr. Wegner, following Raymond James procedures, did not examine the computers used by registered representatives or look at e-mail accounts.[50] (Tr. 3081.) Raymond James's surprise audit of the Cranston branch office on September 19, 2000, did not raise any concerns about Mr. Herula's activities.

[50] As the result of new policies: (1) beginning in 2001, auditors began reviewing the branch operating account; (2) beginning in 2002 or 2003, auditors began looking at the contents of computers of registered representatives; and (3) beginning in 2003, Raymond James began examining unregistered locations where registered representatives conducted business activities. (Tr. 2516, 2939-40, 3037, 3061, 3154.)

Expert Testimony

1. Thomas P. Forde (Mr. Forde)

Raymond James presented Mr. Forde as an expert on the propriety of Raymond James's systems of supervision.[51] (Tr. 3186.) In Mr. Forde's opinion, Raymond James and Robert Thomas (Mr. Forde used Raymond James collectively): (1) satisfied the requirements of NASD's Rule 3010, which required, among other things, that Raymond James have written supervisory procedures in place that address how it reasonably supervised the activities of registered representatives; (2) reasonably implemented those supervisory procedures; and (3) had an appropriate system of supervision, which it implemented with respect to enhanced or special supervision. (R.J. Ex. 2665 at 11-14.) Mr. Forde testified that Raymond James had policies in place for heightened supervision and it acted appropriately in terms of heightened supervision for Mr. Herula and Mr. Ullom. (R.J. 2665 at 14-16.) He believes that "Mr. Herula's activities did not rise to the level that [Raymond James] felt it was necessary to place him on enhanced supervision because at the time the full seriousness of the situation was not known." (R.J. Ex. 2665 at 16.) Mr. Forde acknowledges that Raymond James learned of Mr. Ullom's conduct due to the Commission's investigation and based on this information, it put Mr. Ullom on heightened supervision and ultimately fired him. (R.J. Ex. 2665 at 15.)

Mr. Forde believes that an account holder has an unfettered right to funds in the account and a broker-dealer cannot reject an account holder's request to transfer assets. (Tr. 3173; R.J. Ex. 2665 at 17-18.) Mr. Forde has never heard of any broker-dealer with procedures that protect the clients of account holders at the broker-dealer, and he believes it would be inappropriate for Raymond James to question the purpose of fund transfers. (R.J. Ex. 2665 at 19.) Mr. Forde finds that, from 1999 through the present, Raymond James had reasonable procedures in place for the disbursement of funds to third-party and related accounts, and it reasonably implemented those procedures.[52] (R.J. Ex. 2665 at 16, 21.) An LOA existed for, and Mr. Ullom approved, every transfer of funds that Mr. Forde reviewed. (R.J. Ex. 2655 at 17, 19.) Mr. Forde knows of few firms that contact the account holder twice to confirm a transfer to a third-party account. (R.J. Ex. 2665 at 17.)

Mr. Forde believes that Raymond James appropriately supervised Mr. Herula. He believes that Mr. Herula was absent from the Cranston branch office and wrote unauthorized correspondence, but Mr. Forde does not agree that Mr. Herula worked at an off-site location because he was not conducting Raymond James business. (Tr. 3117; R.J. Ex. 2665 at 24.) Mr. Forde finds Raymond James's procedures, past and present, for determining whether a registered representative is working off-site to be reasonable. (R.J. Ex. 2665 at 24, 27.)

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[51] Mr. Forde, a 1965 graduate of St. John's University, was a supervisor with the NASD from 1968 until 1991. He was Compliance Director at First Union Brokerage Services, Inc., from 1991 to 1994. From 1994 to 2000, Mr. Forde was Director, Regulatory Compliance Consulting Group at PricewaterhouseCoopers LLP. (R.J. Ex. 2665.)

[52] Mr. Forde characterizes Raymond James's procedures as more stringent than those employed generally in the industry. (R.J. Ex. 2665 at 18, 21.)

Mr. Forde considers it reasonable that the 2000 audit did not examine the operating account of the Cranston Branch office. In his view, there was no regulatory requirement that the operating account be reviewed, and Robert Thomas's audit procedures did not require such review. However, when the compliance departments merged, Raymond James adopted the procedure that had been in place at IMR. (R.J. Ex. 2665 at 29.)

Mr. Forde believes that during the relevant period, Raymond James had supervision policies and procedures in place that exceeded the industry standard in many areas, and he knew of no firm that had more stringent disbursement procedures. (Tr. 3160-62.)

2. Harold F. Corrigan (Mr. Corrigan)

Raymond James presented Mr. Corrigan as an expert on the propriety of the conduct of Raymond James's management in discharging their supervisory responsibilities.[53] (Tr. 3186.) Mr. Corrigan saw nothing in the materials he reviewed that would have informed Raymond James of Mr. Herula's conduct. (R.J. Ex. 2666 at 25.) Mr. Corrigan believes that a system of supervision cannot function when a branch manager deliberately acts to circumvent the firm's procedures. (R.J. Ex. 2666 at 23-24.) Mr. Corrigan believes Raymond James's management, above the branch manager level, acted appropriately and reasonably with respect to Raymond James's treatment of: Brite Business's original proposal; Brite Business's purchase of Treasuries on margin; and handling of the Lanciano letter.

Mr. Corrigan finds it reasonable for Raymond James to have left to Mr. Ullom the tasks of investigating the Lanciano letter and assuring that similar unauthorized correspondence did not occur. (R.J. Ex. 2666 at 17.) Mr. Corrigan finds that Raymond James acted reasonably in May 2000 to reports that representatives of Brite Business were touting a transaction to investors that involved a $100 million fund in a Raymond James Trust. His reason is that Raymond James could not supervise the statements of persons outside the company. (R.J. Ex. 2666 at 19.) Mr. Corrigan does not fault Raymond James's conduct in response to the Four Star letter.

Mr. Corrigan testified that Raymond James had a very strong system of approving disbursements because it required approval beyond the branch manager. (R.J. Ex. 2666 at 25.) Mr. Corrigan considers that no misappropriation of funds occurred because all transfers were authorized by the account owner.

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[53] Mr. Corrigan graduated from Adelphi University, served in the U.S. Marine Corps, and worked at Merrill Lynch for thirty-five years, retiring as First Vice President and Managing Director. Mr. Corrigan now owns and operates Candlewood Consultants Corp. (R.J. Ex. 2666.)

3. Lorena J. Kern (Ms. Kern)

Mr. Putnam presented expert testimony from Ms. Kern.[54] (Putnam Ex. 1118.) Ms. Kern testified: (1) that it was reasonable for Mr. Putnam to rely on Mr. Ullom; and (2) that Raymond James had a reasonable system of supervision to supplement the branch manager's front-line supervision. That supplemental supervisory system consisted of written supervisory procedures, an effective and functioning compliance department, and a method of effective and substantive review for exception reports. (Tr. 3454-55; Putnam Ex. 1118.) Ms. Kern considered it critical that senior management knew of Mr. Herula's outside activity concerning Brite Business. Mr. Kern testified that Mr. Putnam responded reasonably to the red flag raised by the unauthorized correspondence discovered in March 2000, and that there were no other red flags to alert Mr. Putnam to Mr. Herula's illegal activities. (Tr. 3461, 3484; Putnam Ex. 1118.) Ms. Kern knows of no way Mr. Putnam could have checked that Mr. Ullom was in fact reviewing Mr. Herula's business correspondence. (Tr. 3481-82.) Ms. Kern's position is that no reasonable system of supervision would have revealed this fraud where the registered representative and branch manager acted in concert. (Putnam Ex. 1118.)

Record Retention for Broker-Dealers

During the relevant period, Raymond James's written procedures on advertising and communications provided that copies of correspondence with Branch Manager approval should be maintained in the branch's correspondence file, as well as the client file, for a minimum of three years. (Tr. 2392-93, 2448; R.J. Ex. 2640 at 011961.)

Eugene Fredriksen (Mr. Fredriksen) was the assistant vice president of information security at R.J. & Associates from May 1999 through 2000.[55] (Tr. 3208.) R.J. & Associates operates the centralized Information Technology Department (IT) for all units of the holding company. (Tr. 3200.) Mr. Fredriksen testified that it was Raymond James policy for each registered representative to receive a Raymond James e-mail account. (Tr. 3268, 3316-17.) [56]

[54] Ms. Kern has a Bachelor of Arts from Randolph-Macon Women's College, a Master of Arts from the University of North Carolina, and a Juris Doctor from Fordham Law School. From 1983 to 1988, Ms. Kern was with Dean Witter Discover Co., and from 1989 until 2003, she was Director of Compliance at Morgan Stanley Dean Witter. Ms. Kern is currently a partner with Ferguson Pollack Kern Consulting. (Tr. 3449; Putnam Ex. 1119.)

[55] Mr. Fredriksen became the holding company's chief security officer and Vice President, Technology Risk Management in February 2005. He graduated from Southwestern University in Tucson, Arizona, and has twenty years experience with the Eaton Corporation and the American Family Insurance. (Tr. 3195, 3200-01, 3205-06.) The 2004 Computer Security Institute's annual conference named Mr. Fredriksen one of the top five information executives. (Tr. 3196.)

[56] According to Mr. Ullom, each registered representative in the Cranston branch office had an assigned Raymond James e-mail address and was assigned a computer owned by Foxhill. Mr.

Registered representatives could use their Raymond James e-mail address to access their e-mail accounts from home computers.[57] (Tr. 3326.) Raymond James's policy was that all business should be conducted using a Raymond James account. However, there was no technology to prevent a registered representative from using a personal e-mail account to conduct business, or to copy and send Raymond James e-mails via a personal account. (Tr. 3363-64.) In 1999 and 2000, there was no technology available to prevent someone from using a personal e-mail account to conduct Raymond James business on a computer in a Raymond James branch office. (Tr. 3268-69.)

Mr. Fredriksen believes that the Commission's 1997 Release on Rule 17a-4 was: a codification of information given in a 1993 no-action letter; expanded the scope of the term "business records"; and marked the first written Commission directive that e-mails were business records that broker-dealers were required to retain. (Tr. 3219-22; R.J. Ex. 2618 at 10.) According to Mr. Fredriksen, in 1999 persons in the industry were concerned about: (1) the scope of the requirement in terms of "[w]hich e-mail in which context;" and (2) while the ability to store the material existed, the "front-end" technology of monitoring, scanning, cataloging, indexing, and archiving a thousand e-mails a minute did not exist or was still in its infancy.[58] (Tr. 3232, 3236-37, 3239, 3244-45.) Raymond James generates approximately 150 million e-mails annually. (Tr. 3228-29.)

From 1997 until May 1999, Raymond James's controls over the retention of e-mails consisted of: (1) backup tapes on its e-mail servers; and (2) a policy that required the branch manager to review, and to save at the branch office, all business-related e-mails generated in the

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Ullom also testified that the registered representatives and others in the Cranston branch office had private e-mail addresses, but they were not approved for use in the office. (Tr. 1271.)

[57] Mr. Fredriksen's testimony contradicts the following information that the Division received from Raymond James concerning e-mail retention.

> Prior to January 1, 2001, only some branch office personnel were assigned RJFS mailboxes. Others maintained mailboxes with other e-mail service providers and any e-mail sent to or received from such persons would not be captured on the backup tape. E-mails sent by branch office personnel who had been assigned a RJFS mailbox would be saved on the backup tape; however, e-mails they received that had been opened and downloaded from the server to their desktop were automatically deleted from the server and, therefore, not saved on the daily backup tape (any e-mails sent to or received from the home office, however, would still be maintained on the server and captured). (footnote omitted.)

(Tr. 3320; Div. Ex. 313 at 27.)

[58] The "back-end" technology of storing e-mails had been around for only a couple of years. (Tr. 3236.) The 1997 Release required that the storage be done in a write once, read many times format (WORM), which had been available for some time. (Tr. 3237-38.)

branch. (Tr. 3283-84.) These two measures continue in 2005; however, the home office in St. Petersburg, Florida, did not, and does not, print out e-mails. (Tr. 3285, 3288.)

E-mails sent from computers in the Cranston branch office are handled by one of about twenty e-mail servers at R.J. & Associates's data center in Florida. (Tr. 3261, 3264.) Similarly, all incoming e-mails to a Raymond James's e-mail account are received and held by one of these servers, until they are opened by the addressee. (Tr. 3621.) These servers were used for all of the holding company's business units. (Tr. 3366.) The backup tape system Raymond James used in 1999 and 2000 did not capture e-mails that were received after 6:00 a.m. and opened before 6 p.m.[59] (Tr. 3323-24.) E-mails sent by registered representatives using personal accounts or e-mails sent to registered representatives' personal accounts from non-Raymond James accounts are not backed up. (Tr. 3329.) In October 1998, Raymond James suspended its policy of overwriting or recycling e-mail server back-up tapes every ninety days and began saving back-up tapes for three years in a secure location. (Tr. 3259, 3262.) Since October 1998, Raymond James has had three years of e-mails back-up tapes preserved and organized.[60] (Tr. 3281.) Mr. Fredriksen considers that in 1998 this was the most robust e-mail retention system available. (Tr. 3362.) Raymond James's back-up tapes were not WORM compliant, because Raymond James believes the technology did not exist in 1998. (Tr. 3276.) Mr. Fredriksen did not see corruption of back-up tapes as a problem; however, Raymond James informed the Division in 2003 that:

> Inherent in the restoration process is the probability that some of the database on any given day will be corrupted. We are told that 90 percent of the time the database is corrupted. This requires the IT Department to run a utilities program to fix the corruption.

(Tr. 3375-76; Div. Ex. 308.)

Raymond James knew during 1999 and 2000 that the Commission required retention of business-related correspondence for three years, either in hard copy or electronically, and that the Commission never formally relaxed or modified the 1997 Release. (Tr. 3236, 3350.) The problem, in Mr. Fredriksen's view, was either archiving all e-mails, which was thought to be prohibitively expensive, or seeking guidance on the meaning of the term "business as such." (Tr. 3347.) Mr. Fredriksen thought the Commission was committed to working with the industry to deal with the issues and that the Commission indicated flexibility in the timetable for implementing the 1997 Release because of industry concerns. (Tr. 3242, 3248.) Mr. Fredriksen believes that the Commission caused the industry to believe that it would not enforce Rule 17a-4,

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[59] The servers are backed up daily between 6:00 p.m. and 6:00 a.m. Technology existed that would have saved the e-mails that came into the server and were opened during business hours, but either Raymond James's software did not have the functionality or, if it did, Raymond James did not utilize it. (Tr. 3325.)

[60] The tapes are kept in an off-site location in Florida, under a twenty-four-hour monitoring system, access is limited, and they are numbered and bar coded. Raymond James has a master documentation system and can recall a tape in twenty-four hours. (Tr. 3270-71.)

as interpreted in the 1997 Release, while dialogue with the industry was ongoing. For example, in May 2001, high-level brokerage industry representatives met with the Commission's staff to discuss the compliance burdens imposed by Rule 17a-4. (Tr. 3250, 3349; R.J. Ex. 2661.)

However, in November 2002, five securities firms paid fines totaling $8.3 million to settle allegations of deficient e-mail retention. (Tr. 3251-52; R.J. Ex. 2662.) At the time, the Director of the Commission's Division of Market Regulation acknowledged some expectation of prosecutorial discretion while the Commission engaged in talks with industry representatives but, according to the Director, the five firms in the settlement were egregious situations, in that some of them had no e-mail retention policies whatsoever. (R.J. Ex. 2662.)

Mr. Fredriksen notes that Raymond James has spent over $2.5 million from 1999 to the present on tapes to comply with the 1997 Release.[61] (Tr. 3273-75.)

In 1999, Raymond James instructed Mr. Fredriksen to take steps to address the 1997 Release and he did so. (Tr. 3256-57.) In May 2000, at Mr. Fredriksen's recommendation, Raymond James contracted with Syntegra, formerly Control Data, at a cost of more than $1.4 million to centrally manage e-mail traffic; assure that what was being saved was virus free; and archive e-mails and route them to a disk in a WORM format that satisfied the 1997 Release. (Tr. 3288-300; R.J. Ex. 2582.) In Mr. Fredriksen's opinion, there was no better technology to retrieve e-mails that fit Raymond James's needs in 2000 than Syntegra. (Tr. 3378.) By the end of 2000, Raymond James had a fully automated e-mail archival system in place. (Tr. 3259.) Implementation of the Syntegra systems in December 2000, gave Raymond James three "redundant" or partially duplicative systems of e-mail retention. (Tr. 3301-03.) These consisted of: (1) back-up tapes; (2) the firm policy that required that business e-mails be printed out in hard copy and filed; and (3) Syntegra. (Tr. 3302-04.) Mr. Fredriksen believes Raymond James was the first broker-dealer to archive e-mails firm-wide in a WORM technology. (Tr. 3301.) According to Mr. Fredriksen, there was no technology available in 1999-2000 that would have prevented an individual from deleting an e-mail from the system by "double deleting." (Tr. 3362.)

In 2004, Raymond James contracted with Centra at a cost of $1.5 million for a second-generation e-mail retrieval system in response to business needs and new technology. The progression from back-up tapes to Syntegra to Centera has cut the time for retrieving e-mails from days to minutes. (Tr. 3377.)

Raymond James estimates it has spent approximately $6 million solely to accomplish e-mail retention. Raymond James has spent considerably more to comply with the 1997 Release than firms who chose not to comply and entered settlements or firms that waited until 2003 to comply. (Tr. 3309-30.)

Salvatore Pallante (Mr. Pallante)[62]

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[61] According to counsel, settlements with firms who did not comply have been in the $500,000 to $800,000 range.

Mr. Pallante, who retired in 2004 as the New York Stock Exchange's (NYSE) Executive Vice President, Member Firm Regulation, testified for Raymond James. (R.J. Ex. 2667 at 4.) Even before the 1997 Release, the NYSE took the position that any record that pertains to a broker-dealer's business, including e-mails, had to be retained. (Tr. 3386.) Mr. Pallante believes the 1997 Release was the first time the Commission stated in writing that e-mails relating to business must be retained. (Tr. 3384-85; R.J. Ex. 2618 at 14.) The NYSE and the Commission received a lot of "push-back" from the industry for taking this position. (Tr. 3386.) In Mr. Pallante's view, the issue has been how the regulators were going to enforce Exchange Act Rule 17a-4. (Tr. 3386-95.)

In the fall of 2000, NYSE examiners observed that a large broker-dealer was not retaining electronic communications, and the e-mails that were being retained were not in a WORM format. This was a violation of Exchange Act Rule 17a-4 and the Commission's 1997 Release. Following its standard operating procedures, the NYSE contacted the firm and was told that Commission examiners had brought similar findings to the firm's attention and that the firm had responded to the Commission. (R.J. Ex. 2667 at 15-16.) Mr. Pallante then called the Associate Director of the Commission's Division of Compliance, Inspections, and Examinations (OCIE), who told him that OCIE was not recommending enforcement action based on such findings. He was also told that the Commission's policy group in the Division of Market Regulation was looking into e-mail issues and discussing them with the industry. (Tr. 3399; R.J. Ex. 2667 at 17.) Mr. Pallante was aware that the industry was seeking relief from the requirements of Rule 17a-4 from the Commission and that the Commission's staff appeared sympathetic. (Tr. 3391-92.)

Between the fall of 2000 and the end of 2001, the NYSE's Division of Member Firm Regulation referred about twelve instances of e-mail retention deficiencies to the NYSE's enforcement division.[63] (Tr. 3390.) Mr. Pallante was somewhat taken aback when the Director of the Commission's Division of Market Regulation called him in the spring of 2001 and requested that the Division of Member Firm Regulation withhold making any enforcement referrals on e-mail findings and record retention; and withdraw any referrals that it had made to the NYSE's enforcement division because she wanted to be acting in good faith with the industry while discussions were ongoing. (Tr. 3393, 3401-04; R.J. Ex. 2667 at 21-23.) Mr. Pallante believes that the industry was annoyed by the NYSE's aggressive attempts at enforcement and complained to the Commission. (Tr. 3390, 3401; R.J. Ex. 2667 at 21.)

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[62] Mr. Pallante, a graduate of Brooklyn College, worked for New York Stock Exchange (NYSE) from 1973 until he retired in 2004. From 1990 until 2004, Mr. Pallante was Executive Vice President, Member Firm Regulation. (R.J. Ex. 2667 at 4.) With 360 people, Member Firm Regulation is the largest of the NYSE's three regulatory divisions. The NYSE works very closely with the Commission and the NASD and considers that it takes an aggressive approach to regulation. (R.J. Ex. 2667 at 8.)

[63] Mr. Pallante knew that the Commission's staff was speaking with the industry, and that the NASD was not addressing the issue. (R.J. Ex. 2667 at 18-19.) He does not recall that any firms were retaining documents in an electronic format. (R.J. Ex. 2667 at 19-20.)

Mr. Pallante confirmed that the Director of OCIE agreed with the information he had received from the Director of Market Regulation because Mr. Pallante was concerned that OCIE examiners might be critical if the NYSE stopped referring findings of violations to the NYSE's enforcement unit. (Tr. 3402-04; R.J. Ex. 2667 at 23-24.) To memoralize the understanding, Mr. Pallante wrote a letter to the Director of Market Regulation, with a copy to the Director of OCIE, stating that consistent with the request he would not refer future e-mail retention violations to enforcement and he would withdraw the referrals he had already made. (Tr. 3405; R.J. Ex. 2667 at 24-25.) In public statements following these events, Mr. Pallante would state that the NYSE was finding violations but was not taking enforcement action pending the outcome of discussions the Commission was having with the industry. (Tr. 3406-08.) Later, Mr. Pallante received a draft proposal to relax the rules on retaining records pertaining to business records, such as e-mails. The draft was never implemented. (R.J. Ex. 2667 at 26.)

In Mr. Pallante's view, the Commission's posture changed and it began taking an aggressive approach with respect to e-mails and missing records after e-mails provided the "smoking gun" in New York Attorney General Eliot Spitzer's legal action, joined in by other regulators, against five Wall Street firms in late 2002. (Tr. 3409-10; R.J. Ex. 2667 at 27-28.) Mr. Pallante considers it unreasonable for the Division to bring an enforcement action alleging e-mail retention in 1999 and 2000 in view of the directions Commission staff gave the NYSE and the industry. (Tr. 3411-13; R.J. Ex. 2667 at 29.)

Charles Weeden (Mr. Weeden)

Mr. Weeden, an expert called by the Division, testified that the fact that a communication was in e-mail format did not change the existing retention obligation. The obligation that broker-dealers maintain copies of e-mails in a hard-copy document, on microfiche or microfilm, predated, and was not changed by, the 1997 Release.[64] (Tr. 3553-54.) The 1997 Release, with twelve required elements, was the first Commission release that addressed e-mails. (Tr. 3553, 3559-60.) According to Mr. Weeden, in 1999 and 2000, most compliance officers did not distinguish e-mails from hard copy communications; however, some in the industry argued that e-mails were not covered by Rule 17a-4 because they were akin to phone calls. (Tr. 3555.)

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[64] Mr. Weeden is an expert on the issue of the e-mail retention requirements of Exchange Rule 17a-4 and the technology available in 1999 and 2000. (Tr. 3523-24.) Mr. Weeden is the president of 17a-4, LLC, an e-mail consulting company. (Tr. 3514.) Mr. Weeden graduated from the University of California at Berkeley, California, in 1974 and attended Fordham Law School. He began his career with Weeden & Company, an equity and fixed-income trading company. (Tr. 3505-06.) In 1978, Mr. Weeded helped form a start-up company, QV Trading Systems, that marketed the electronic trading system. In 1991, he began a second start up, Document Technologies, a company that developed software to support filing reports electronically with the Commission. Document Technologies developed a software product, EdgarEase, that Mr. Weeden estimates was used by half the filings submitted to Electronic Data Gathering and Retrieval (EDGAR). (Tr. 3506-13.)

Mr. Weeden determined that in the late 1990s, the marketplace provided products from well-established vendors that allowed broker-dealers to fully comply with the 1997 Release with respect to e-mail retention. (Tr. 3516.) Mr. Weeden's testified that in August 1997 there were at least three credible software products available to electronically archive e-mails in WORM technology. (Tr. 3588.) Those products were: Assentor from SRA; Enterprise Vault originated by Digital Equipment and, later acquired by Compaq and then KVS; and XVMail or XVault now known as EMailXtender. (Tr. 3525, 3532, 3599, 3602-03, 3636.) SRA and Compaq were supported by established public companies, while EMailXtender was a recent start-up. Mr. Weeden thinks it was unreasonable to expect one product to accomplish three functions; however, he acknowledges that Assentor would not solve virus problems and management, as well as archiving. (Tr. 3613-14, 3616.) However, Assentor was a viable e-mail retention product available in 1999 that could have been used to comply with Rule 17a-4. (Tr. 3635.) According to Mr. Weeden, most of the industry people he spoke with did not consider the three vendors Raymond James considered in 1999. (Tr. 3616.) Mr. Weeden does not consider back-up tapes an archiving method because archiving involves saving to a non-rewriteable media. (Tr. 3619.)

Mr. Weeden does not know which Microsoft Exchange version that Raymond James used in 1999-2000, but a journaling capability was an option on the Microsoft Exchange platform and it would have allowed Raymond James to archive e-mails without buying an expensive new software product.[65] (Tr. 3535, 3623.) Journaling would not accomplish full text indexing that Rule 17a-4 required, however, and Raymond James would have had to purchase additional software to satisfy that requirement. (Tr. 3541.)

Mr. Weeden believes that Raymond James could have preserved e-mails that were opened during the business day on the server by exercising another configuration option available on the Microsoft Exchange software. (Tr. 3543-44.)

In December 2002, Mr. Weeden was of the view that a majority of broker-dealers had something in place to address e-mail archiving but he estimated that less than half were compliant with Commission regulations. (Tr. 3548; R.J. Ex. 2671.) On February 24, 2005, Mr. Weeden opined that Raymond James was partially, but not fully, compliant with Rule 17a-4 from 1999 through 2000. (Tr. 3544.) Mr. Weeden is complimentary of the Commission's efforts and considers that Rule 17a-4 has established a model for compliance within numerous regulated industries. (Tr. 3632.)

CONCLUSIONS OF LAW

I deny Raymond James's contention that an administrative law judge does not have authority to order sanctions because the Commission's appointment procedures violate the

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[65] Journaling sends a copy of every e-mail that goes to a server to a separate mail box. (Tr. 3535.) It is superior to backing up the servers because it copies all e-mails that are opened during business hours, and does not permit someone to double delete. (Tr. 3535.) The journaling mailbox gets large so the contents are usually stored on tape or to a WORM device. (Tr. 3538-40.)

Appointments Clause of the U. S. Constitution, art. II, clause 2. (R.J. Post-Hearing Br. 2 n.1; R.J. Prehearing Br. § III.G.)

The Constitutional arguments are perhaps more properly addressed to the Commission who assigned the case to an administrative law judge. However, pursuant to Section 4A of the Exchange Act, the Commission can delegate authority to an administrative law judge to make an initial decision, which includes sanctioning, in any proceeding in which the administrative law judge presides in which a hearing is required to be conducted in conformity with the Administrative Procedure Act, 5 U.S.C. § 557, unless all the parties waive the initial decision and the Commission does not order that one be prepared, and in any other proceeding in which the Commission directs the judge to make an initial decision. 17 C.F.R. § 200.30-9. The OIP ordered that a hearing be held before an administrative law judge who shall also issue an initial decision. The Commission is not bound by the initial decision. Under the Commission's Rules of Practice, the Commission may affirm, reverse, modify, or set aside or remand an initial decision and may make any findings or conclusions that, in its judgment, are proper on the basis of the record. 17 C.F.R. § 201.411.

1. Supervision of Mr. Herula

Arguments of the Parties

The Division maintains that Raymond James failed to adequately supervise Mr. Herula because its agent, Mr. Ullom, failed to do so. The Division argues that it is insufficient for a broker-dealer to establish a system of supervisory procedures that relies solely on supervision by branch managers, and that Raymond James was required to provide checks to ensure that the first-line supervisor was functioning adequately. The Division contends that broker-dealers conducting business through off-site offices cannot adequately discharge their supervisory obligations when there is no inspection of off-site locations. The Division charges that Raymond James had essentially no policies or procedures in place for supervising registered representatives working outside the branch office. (Div. Post-Hearing Br. 91.) It claims that Raymond James failed to keep track of who was working off-site, or how they were being monitored. The Division claims that Raymond James had no systems in place to ensure that Mr. Ullom was examining Mr. Herula's off-site office, monitoring Mr. Herula's correspondence, or providing additional scrutiny once red flags were discovered as to Mr. Herula's unauthorized activities. (Div. Post-Hearing Br. 87.)

The Division further alleges that Raymond James acted unreasonably by failing to take adequate steps to investigate or terminate Mr. Herula's illegal activities until approximately $16.4 million in investor funds were misappropriated or otherwise dissipated. The Division faults Raymond James for: (1) not reviewing the operating account as part of the Cranston branch office audit; (2) not having written procedures for placing registered representatives on heightened supervision, and for not placing Mr. Herula on heightened supervision; and (3) not investigating transfers from the Brite Business account to the employee-related Mary Lee Capalbo Esq., Special Client account. (Div. Post-Hearing Br. 93-95.)

The Division views the three procedures that Raymond James claims to have used to ensure compliance – the internal audit, the monthly compliance reports, and exception reports – as largely ineffective. It notes that: (1) the internal audit and the monthly compliance reports place undue reliance on self-reporting; (2) the internal auditor lacked information or resources necessary to perform a meaningful audit; and (3) no one in the compliance department reviewed the exceptions reports for accuracy and there is no evidence that the majority of suspicious trades that appeared on the exceptions reports were reviewed. (Div. Post-Hearing Br. 87.)

Next, the Division argues that Mr. Putnam, Mr. Ullom, and other Raymond James executives failed to respond reasonably to the following events that raised red flags suggesting that Mr. Herula was engaged in inappropriate activities. (Div. Post-Hearing Br. 29, 88-90.)

1. Expressions of concern by Mr. James, Mr. Augenbraun, Mr. DiGirolamo, Mr. Ness, Mr. Maynard, Mr. Walsh, and unnamed members of the C&S Committee about Raymond James's involvement with Brite Business. (Div. Post-Hearing Br. 5-8.)

2. The negative reaction of the ad hoc committee following the meeting in October 1999, as to participation by Raymond James in a proposal by Brite Business. (Div. Post-Hearing Br. 8-12.)

3. The fact that Mr. Herula continued to urge Raymond James to stay involved and consider proposals from Brite Business after the ad hoc group came to a consensus that it would not do the transaction Brite Business proposed. (Div. Post-Hearing Br. 12-13.)

4. The suspicions of persons at Raymond James and affiliates in November 1999 on learning that Mr. Herula and Mr. Ullom had falsely represented that First Union Bank had agreed to the Brite Business transaction. (Div. Post-Hearing Br. 13-17.)

5. The purchase on margin of approximately $115 million of U.S. Treasuries by Brite Business in December 1999 that made no economic sense. (Div. Post-Hearing Br. 17-22.)

6. Expressions of concern by members of the C&S Committee, in particular Mr. James and Mr. DiGirolamo, when the committee considered the Brite Business purchase of U.S. Treasuries on margin in December 1999. (Div. Post-Hearing Br. 22-25.)

7. The skepticism of Mr. Putnam and Mr. Augenbraun following the meeting with Brite Business in January 2000, and their recommendation that Raymond James not become involved further in the transaction that Brite Business was proposing. (Div. Post-Hearing Br. 25-26.)

8. In January 2000, Mr. Ullom became aware that Mr. Herula had sent an e-mail from his Raymond James account soliciting an investor to deposit $100 million at Raymond James. Mr. Herula signed the e-mail as a Raymond James representative and stated that Brite Business agreed to ensure a ten percent return on the investment.

9. In January 2000, Mr. Putnam learned of the Provident letter that Mr. Herula wrote in December 1999 on Raymond James letterhead stationery seeking Provident's involvement in a reverse-repurchase agreement for Brite Business. Mr. Putnam considered the use of letterhead questionable. (Div. Post-Hearing Br. 26-27.)

10. On or about February 29, 2000, a week prior to their maturity, Mr. Herula sold the $115 million in Treasury bills for Brite Business. The timing of the transaction made no sense to Mr. Putnam or Mr. Zank of R.J. & Associates. (Div. Post-Hearing Br. 27-29.)

11. Beginning in December 1999, until he was fired in December 2000, Mr. Herula worked out of an apartment in Cranston that had a computer, a fax machine, a copier, a scanner, telephones, and copies of correspondence. No one at Raymond James ever inspected this office. Beginning in October 2000, Mr. Herula began working at an office he set up in his home in Tiburon, California. (Div. Post-Hearing Br. 30-32.)

12. From January 2000 through March 2000, Mr. Herula signed an e-mail as a Raymond James registered representative using his Raymond James account, soliciting an investor to deposit $100 million at Raymond James in connection with Brite Business. Mr. Herula forwarded the e-mail to Mr. Ullom. In the same period, Mr. Herula engaged in correspondence with Mr. Al Bloushi in which he made false representations. (Div. Post-Hearing Br. 32-36.)

13. In March 2000, Mr. Putnam, Mr. Ullom, and others at Raymond James and its affiliates, learned that Mr. Herula was sending or had sent the Lanciano letter, a misleading piece of correspondence on Raymond James stationery, to a potential investor soliciting funds for deposit at Raymond James. In this same period, Mr. Herula authored similar correspondence to Mr. Fitzhenry. (Div. Post-Hearing Br. 37-41.)

14. The unexplained activity in the Brite Business and Mary Lee Capalbo accounts, which included multi-million dollar deposits promptly followed by transfers to related and third-party accounts, coupled with the suspicious nature of Brite Business's balance sheet enhancement program, and its purchase of Treasuries, constitute indicia of money laundering that should have triggered further investigation. (Div. Post-Hearing Br. 30-32.)

15. In May 2002, Mr. Putnam and others at Raymond James and its affiliates learned through Mr. Ness at R.J. Trust that individuals in Cleveland, Tennessee, supposedly associated with Brite Business were, misrepresenting Raymond James's role in Brite Business's activities. (Div. Post-Hearing Br. 48-49.)

16. In July and August 2000, Raymond James received notice from Four Star demanding return of approximately $12 million it claimed to have deposited in the Brite Business account. Mr. Putnam and Mr. Ullom also learned that contrary to his representations, Mr. Herula had sent additional unauthorized correspondence on Raymond James letterhead, the Blackburn letter, making similar representations to the Lanciano letter, as a means of soliciting funds for Brite Business. (Div. Post-Hearing Br. 49-54.)

17. Mr. Putnam considered terminating Mr. Herula and closing the Brite Business account no later than July 13, 2000, but he did not do so until December 2000. (Div. Post-Hearing Br. 90.)

Finally, the Division argues that Mr. Putnam had actual knowledge of multiple red flags that alerted him to Mr. Herula's suspicious activities, yet he failed to respond to them. (Div. Post-Hearing Br. 96.) The Division argues that Mr. Putnam cannot excuse his failure to supervise Mr. Herula by claiming that he relied on Mr. Ullom because: (1) Mr. Putnam did not develop a system to ensure that Mr. Ullom was monitoring Mr. Herula; (2) Mr. Putnam should have known that Mr. Ullom's supervision of Mr. Herula was deficient; and (3) as the president of a corporate broker-dealer Mr. Putnam was ultimately responsible for all the firm's requirements. (Div. Post-Hearing Br. 98.)

Raymond James represents that throughout the relevant period it had procedures and systems in place that were reasonably designed to prevent and detect securities law violations. Raymond James insists that these supervisory procedures were in accord with NASD Conduct Rule 3010-Supervision. Raymond James argues that the failure to detect wrongful conduct does not by itself establish a failure to supervise. Raymond James maintains that it reasonably discharged its supervisory duties and obligations and had no reasonable cause to believe that the procedures and systems were not being followed. Raymond James argues, further, that a broker-dealer's branch manager is its first line of defense and that its reliance on Mr. Ullom was reasonable. (R.J. Post-Hearing Br. 34-35.) According to one Raymond James expert, the branch manager is responsible for making sure that everything is done properly and that nothing unauthorized is released. (R.J. Ex. 2666 at 22.) Raymond James notes that when it hired Mr. Ullom to manage the Cranston branch office, he had no prior record of supervisory problems. Mr. Ullom was an experienced manager, and Mr. Putnam had known him for many years. Raymond James cites expert testimony to support its position that broker-dealers customarily rely on branch managers to enforce their supervisory rules and regulations.

Raymond James insists that it had no cause to believe that its supervisory procedures were being violated. It cites various written materials such as operations manuals, newsletters, an Intranet digest that addressed compliance, a dedicated compliance staff, and training for its twenty-eight compliance professionals. (R.J. Post-Hearing Br. 35-39.) Raymond James stresses its efforts at oversight including over seventy types of exception reports, branch office compliance reports, and branch audits.

Raymond James denies the existence of any red flags that would have put it on notice of Brite Business's prime bank scheme. Raymond James rejects the Division's inference that Raymond James let Brite Business pursue the balance sheet enhancement program it proposed in October 1999 when it allowed Brite Business to purchase United States Treasuries in December 1999. Raymond James argues that the Division has mischaracterized both the reactions of the ad hoc committee and the C&S Committee's questions about Brite Business. According to Raymond James, if Mr. Putnam had been present at the C&S Committee meeting, he would have been able to answer the questions.

Raymond James insists that, during the relevant period and at present, its procedures for: (1) supervising off-site locations; (2) reviewing branch office operating accounts; (3) disbursing or transferring funds from accounts; and (4) placing registered representatives on heightened supervision, met or exceeded industry standards. (R.J. Post-Hearing Br. 44-56.) Raymond James reiterates, as it did throughout the hearing, that a broker-dealer's duty of supervision is imposed to protect the investing public and is owed only to its customers, not to third parties. In support, it refers to NASD Rule 3010.

Raymond James maintains that it was deceived about the nature of Mr. Herula's outside business activities, that these activities did not involve Raymond James's business, and did not trigger any supervisory responsibility for the firm. (R.J. Post-Hearing Br. 60.) It notes that the NASD has addressed the issue of "non-member business conducted by an associated person" in Rules 3030 and 3040. An associated person may be involved in non-member business in two categories: outside business activities and private securities transactions. According to Raymond James, by definition then, a registered representative's outside business activity is not the business of the member firm. (R.J. Post-Hearing Br. 61.)

Mr. Putnam maintains that the Division's so-called red flags did not suggest the fraud that occurred. Mr. Ullom, the key in a reasonable system of supervision, was actively involved in the fraud and withheld critical information from Mr. Putnam and Raymond James.

Mr. Putnam argues that several issues must be considered when assessing the reasonableness of his supervision of Mr. Herula. Mr. Putnam denies that he was responsible for the adoption and implementation or design of Raymond James's supervisory procedures in his position as president and chief operating officer. The CEO of Raymond James did not delegate responsibility for the adoption and implementation of the firm's compliance procedures or responsibility for the firm's supervisory system to him. Second, Mr. Putnam delegated to Mr. Ullom the job of gathering all Mr. Herula's correspondence, placing Mr. Herula under close scrutiny, and reporting any problems. Mr. Putnam had a reasonable expectation that Mr. Ullom would do as he was directed.

Mr. Putnam argues that Brite Business's balance sheet enhancement program and strategy described in October 1999 did not give him reasonable cause to understand that Mr. Herula was associated with a suspicious business entity. Mr. Putnam maintains that no one at Raymond James expressed a view that Brite Business was acting illegally or fraudulently, or that Raymond James should not consider doing any kind of business with Brite Business. (Putnam Post-Hearing Br. 49.)

Mr. Putnam contends that, given the circumstances, his actions fell within the zone of reasonableness at all times. Mr. Putnam denies the existence of any red flags other than the Lanciano letter. He argues that he did not ignore Mr. Herula's unauthorized communications; rather, he maintains that he took significant steps to prevent any recurrence.

Conclusions

Section 15(b) of the Exchange Act provides that the Commission may sanction any person associated with a broker or dealer or the broker-dealer itself, if it finds that such person or broker-dealer "failed reasonably to supervise**,** with a view to preventing violations of [the securities laws], another person who commits such a violation, if such other person is subject to their supervision." Exchange Act Section 15(b) further provides that no person shall be deemed to have failed reasonably to supervise if: (1) procedures, and a system for applying those procedures, have been established, which would reasonably be expected to prevent and detect any such violation; and (2) the person has reasonably discharged the duties and obligations incumbent upon him by reason of [his firm's] procedures and system and had no reasonable basis for believing that those procedures were not being followed. Arthur James Huff, 50 S.E.C. 524, 526-28 (1991). Ultimately, the test is whether the supervision was reasonable under the circumstances. Kevin Upton, 52 S.E.C. 145, 153 (1995); Albert Vincent O'Neal, 51 S.E.C. 1128, 1135 (1994). Section 203(f) of the Advisers Act, incorporating Section 203(e)(6) by reference, contains similar language.

The fact that Raymond James's CEO did not formally delegate to Mr. Putnam responsibility for the design, adoption and implementation of Raymond James's supervisory procedures does not change the fact that Mr. Putnam was responsible for supervising Mr. Herula. Mr. Putnam controlled Mr. Herula's activities. From August 1999 until at least February 2000, Mr. Carreno reported to Mr. Putnam. Raymond James's Compliance Manual showed Mr. Putnam had responsibility for hiring financial advisers within branch offices, and for sales management branch management oversight. (Div. Ex. 325 at 5978, 5980.) Mr. Putnam had the power to fire Mr. Herula, which he did, finally, in December 2000. (Tr. 1623, 1993.) I find that Mr. Putnam was Mr. Herula's supervisor throughout the relevant period. Huff, 50 S.E.C. at 532, (the most probative factor as to whether a person is responsible for actions of another is the power to control another's conduct); John H. Gutfreund, 51 S.E.C. 93, 111 n.21, 113, (1992) (president of a broker-dealer is responsible for compliance and supervisor is person with authority or ability to affect employee's conduct) (settled order).

During the relevant period, Raymond James did not have procedures in place which would reasonably be expected to prevent and detect antifraud violations by its registered representatives or a system for applying those procedures. Furthermore, neither Raymond James nor Mr. Putnam reasonably discharged the duties and obligations incumbent upon them by reason of the procedures and systems that existed.

At the time Robert Thomas and IMR merged in January 1999, each company had separate and different compliance programs. After the firms merged, Raymond James operated two separate compliance programs for several months. During these months, the separate programs were headed by two different compliance directors. The two compliance departments merged in March or April 1999, under the leadership of Mr. DiGirolamo. A new compliance manual for the merged company was not produced until May 2000. (Tr. 2361-62.) It appears that in March 2000, Raymond James did not have specific heightened supervision policies but it did have procedures to deal with extraordinary situations, which Mr. Carreno called enhanced supervision. (Tr. 2339, 2362.) Mr. Putnam indicated that under Raymond James's procedures at the time of the Lanciano letter, the branch, not the individual, was placed on heightened supervision. (Tr. 2020). A meeting was held every quarter to review either the individual or

branch where someone was in heightened supervision status. (Tr. 1962, 2021-22.) The process is not structured to disclose outside business activities. (Tr. 2021.) The evidence is that Raymond James's first written heightened supervision polices for registered representatives occurred in October 2001. (Tr. 2936-38; Div. Ex. 508, R.J. Ex. 2536E.)

Mr. Forde, an expert witness for Raymond James, testified that after January 1999, Robert Thomas and IMR retained their individual compliance procedures until "the firms' compliance departments reviewed and tried to get the compliance functions and supervisory procedures together, which probably didn't happen until sometime – I think it was '01." (Tr. 3133.) As a result, for at least four or five months during the relevant period, Raymond James did not have in place clear, reasonably effective supervisory policies and procedures, or a system for implementing those policies and procedures, for supervising its registered representatives. My conclusion is derived from the totality of the evidence, but in particular: (1) Mr. DiGirolamo's testimony that he implemented a policy of auditing branch operating accounts; however, Mr. Wegner testified that he did not audit the operating account at the Cranston branch office in October 2000 because the policy did not become effective until the 2001 Cranston branch audit;[66] (2) general confusion among the witnesses as to whether Raymond James had policies to deal with rogue brokers and procedures for placing registered representatives in heightened supervision status, and, if any policies and procedures existed, what they were; and (3) similar general confusion on what was required of people who worked regularly away from their assigned office. (Tr. 2461-62, 2516.)

The evidence does not support Raymond James's and Mr. Putnam's position that they reasonably relied on Mr. Ullom to carry out their supervisory responsibilities. The Commission has repeatedly warned that procedures that rely solely on supervision by branch managers are insufficient. Rita H. Malm, 52 S.E.C. 64, 70 (1994); Donald T. Sheldon, 51 S.E.C. 59, 79 (1992), aff'd, 45 F.3d 1515 (11th Cir. 1995); Prudential-Bache Sec., Inc., 48 S.E.C. 372, 400 (1986).

Raymond James retained Mr. Ullom as a supervisor knowing that he settled a proceeding with the Commission in which Mr. Ullom was found to have: (1) given false information to a state securities examiner; (2) directed an employee of an investment adviser he co-owned to alter documents that Mr. Ullom submitted to state authorities; and (3) filed a Form ADV with the Commission that contained false information. (R.J. Ex. 2022.) The settlement found that Mr. Ullom violated the Advisers Act; willfully aided and abetted violations by the investment adviser; and caused the investment adviser's violations. It was patently unreasonable for Raymond James to rely on Mr. Ullom in a position, which the experts agree was Raymond James's "first line of defense," and someone Raymond James relied on to make sure everything

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[66] I reject Mr. Forde's expert opinion that it was reasonable for Raymond James not to have included a review of the operating account for the Cranston branch office as part of its branch audit procedures in 2000. It is common sense that a broker-dealer needs to review the objective evidence contained in the operating account for the branch office when assessing whether an independent contractor who conducted branch operations has observed correct supervisory procedures.

was done properly, when in 1995 Mr. Ullom deliberately submitted false information to securities regulatory agencies. See Consol. Inv. Servs., Inc., 52 S.E.C. 582, 587-88 (1996) (hiring registered representative subject to NASD complaint required heightened supervision); O'Neal, 51 S.E.C. at 1129-33 ("disquieting history" of registered representative relevant in failure to supervise case).

In addition to adopting effective procedures for supervision, broker-dealers must also "provide effective staffing, sufficient resources, and a system of follow up and review to determine that any responsibility to supervise delegated to compliance officers, branch managers, and other personnel is being diligently exercised." Mahon, Nugent & Co., 47 S.E.C. 862, 867 (1983) (settled order). The system must provide sufficient checks "to insure that the first line of compliance, the branch manager, [is] functioning adequately." Shearson Lehman Brothers, Inc., 36 SEC Docket 1075, 1083 (Sept. 24, 1986) (settled order). "The need for central control increases, not decreases, as the branch offices become more numerous, dispersed, and distant." Shearson, Hamill & Co., 42 S.E.C. 811, 843 (1965).

Raymond James's Compliance Department relied on the branch manager's monthly compliance reports, the annual internal audit, and exception reports as tools to accomplish supervision. Each of these instruments is a valid means of supervision, but Raymond James failed to use them in a reasonable or effective manner. Mr. Ullom submitted compliance reports monthly to the Compliance Department. There is no evidence that Raymond James independently verified the contents of the reports. This case provides ample evidence that a monthly compliance report submitted by the branch manager representing that he has discharged his responsibilities, which is not subject to any verification, is a self-serving document without any value. It was unreasonable for Raymond James to accept that the information in Mr. Ullom's monthly compliance report was true without any type of verification.

Under the circumstances, Raymond James's internal compliance audit of the Cranston branch office in 2000 was not an effective procedure to prevent and detect violations. Raymond James's characterization of the process as "an audit" is a misnomer. Raymond James did not reasonably prepare Mr. Wegner for the audit. According to Mr. Wegner, who I find to be a knowledgeable and credible witness, much of the audit was "just a review of procedures and systems in place at the branch." (Tr. 3025.) Mr. Wegner testified that he would have liked to have known any concerns regarding the branch office he was auditing and would have given emphasis to those areas during the audit. Raymond James did not inform Mr. Wegner that Mr. Herula had a business relationship with Brite Business, that Mr. Herula had sent out unauthorized correspondence, or that Mr. Herula worked outside the Cranston branch office throughout 2000. (Tr. 3065-66, 3079.) Mr. Wegner testified that he would have liked to have known that Mr. Herula was working for Brite Business. (Tr. 3080.) In addition, Mr. Wegner was not aware that: (1) a third party had made a claim for the funds in an account where Mr. Herula was the registered representative (the Four Star letter); (2) the president of Raymond James had put a restriction on the Brite Business account where Mr. Herula was the registered representative; or (3) Mr. Herula was almost fired in July 2000 for sending unauthorized correspondence. (Tr. 3066-67.) Mr. Wegner believes that anything that resembles a complaint should be in the branch office compliant file, however; the Four Star correspondence was not in the file. (Tr. 3080.)

Because Mr. Wegner did not know that Mr. Herula did not come to the office throughout 2000, he accepted Jason Ullom's false answer that no registered representatives worked outside the Cranston branch office. Mr. DiGirolamo did not think notice of problems with unauthorized correspondence was necessary if the branch manager believed the problem had been resolved.[67] (Tr. 3078, 3080.) Mr. Wegner was unaware, and could not report, that Mr. Herula never returned the Financial Advisor Annual Compliance Interview questionnaire he left for him because, under Raymond James's procedures, Mr. Wegner's responsibility for the audit ended when he submitted his report to the Compliance Department. (Tr. 3033-35, 3068.)

Raymond James did not follow NASD Notice to Members 98-38 (Notice 98-38), issued May 1998, which states that a member's supervisory responsibility includes maintaining a record of the location of all unregistered offices. Notice 98-38 cites NASD Rule 3010(c) as requiring that members conduct inspections of unregistered locations in accordance with a regular schedule. (Div. Ex. 336.) Raymond James's expert testified that he saw nothing to indicate that Raymond James had an inspection schedule. (Tr. 3127.) The evidence is that Raymond James did not have accurate information about the actual work locations of the approximately five or six registered representatives assigned to the Cranston branch office. Jason Ullom told Mr. Wegner that there were no registered representatives working outside the office. (Tr. 3030) Mr. Ullom, however, testified that three of the six registered representatives, excluding Mr. Herula, did not regularly work at the Cranston branch office. (Tr. 1031-32.) Even accepting that NASD's notices to members are advisory, given Raymond James's large number of widely dispersed registered representatives, I find that it should have maintained a record of those who operated regularly from unregistered locations and inspected those locations on a regular schedule.

At a minimum, the following matters should have alerted Raymond James to possible illegal conduct and required more investigation than Raymond James provided: (1) the Provident letter in January 2000; (2) the Lanciano letter in March 2000;[68] (3) oral reports from sources outside Raymond James in May 2000, that Brite Business representatives were using Raymond James's name in solicitations; and (4) the Four Star correspondence received in July/August 2000. The Commission has stated that "it is especially imperative in organizations that those in authority exercise particular vigilance when indications of irregularity reach their attention."

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[67] According to Mr. DiGirolamo, senior management would not involve compliance where it had resolved an issue. (Tr. 2541.) Mr. DiGirolamo and Mr. Runkle testified that where managers believe they have solved problems of registered representatives sending out unauthorized correspondence, the managers do not necessarily have to mention the problems to the Compliance Department so that auditors would be aware of the situation. (Tr. 2505-06, 2512, 2928.) Mr. Runkle, a graduate of the University of South Florida, was associate director of Raymond James's Compliance Department from December 1999 until he became the chief compliance officer in May 2004. (Tr. 2865-66.)

[68] Raymond James's expert Mr. Forde admits that the Lanciano letter raised a red flag about Mr. Herula's conduct and was the second occasion in which Mr. Herula made highly inappropriate representations on behalf of Raymond James. (Tr. 3141.)

Shearson Lehman Hutton, Inc., 49 S.E.C. 1119, 1124 (1989) (citing Wedbush Sec., 48 S.E.C. 963, 967 (1988)). The evidence, however, does not support the Division's position that some of the other situations were red flags. The unanimous evidence is that no one at Raymond James, except Mr. Ullom who is not credible, saw a connection between the transactions Brite Business proposed and Brite Business's purchase of Treasuries, or suspected that Brite Business was an illegal enterprise.

Based on his demeanor and responses to cross examination, I find that Mr. Putnam gave credible, candid testimony. The record, however, contains no reasonable explanation why Mr. Putnam excused Mr. Herula's violations of Raymond James's rules against unauthorized correspondence as naïve errors when Mr. Herula had more than twenty years of experience in the securities industry. In addition, Mr. Putnam knew that Mr. Herula was raising funds for Brite Business. Given this knowledge, it was unreasonable for Mr. Putnam to accept Mr. Herula's representation that he would not write any additional letters like the Provident and Lanciano letters; to rely completely on Mr. Ullom to ensure that Mr. Herula was in compliance; and to accept, without verification, Mr. Ullom's representations that the oral reports in May 2000 did not involve Brite Business representatives and that the Four Star correspondence was unlike the Lanciano letter. See Shearson Lehman Bros., Inc., 36 SEC Docket 1075, 1085 (Sept. 24, 1986) (the Commission has often expressed its views that a system of supervisory procedures which rely solely on the branch manager is insufficient); Charles Schwab & Co., Inc., Admin. Proc. 3-6222 (Dec. 28, 1983), final, 29 SEC Docket 1070 (Jan. 26, 1984) (It is unacceptable to take an employee's words or explanations when questionable events are looked into).

Mr. Putnam and Mr. DiGirolamo held widely different views on the role of the Compliance Department. These differences prevented implementation of Raymond James's supervisory procedures. Mr. Putnam appears to believe that the Compliance Department operated independently without input from him. (Tr. 2022-23.) In contrast, Mr. DiGirolamo, viewed the Compliance Department's role as a support function for senior management, and that senior management had to approve any disciplinary action. (Tr. 2543-44, 3441; Div. Ex. 325 at 5981.) Mr. Putnam intended to send Mr. DiGirolamo a copy of the Lanciano letter; however, Mr. DiGirolamo never received it. (Div. Ex. 272; Tr. 1962.) Mr. Putnam never told the Compliance Department to place Mr. Herula on heightened supervision because if the Compliance Department "had wanted to put him on heightened supervision, [Mr. DiGirolamo] could do so, you know, if he felt it was appropriate." (Tr. 1962.)

> Well, what normally happens is if compliance finds something that they are concerned enough with, they will want to put someone on heightened supervision. If someone gets a major complaint, you know, the compliance people will put people on heightened supervision. If they want to discuss that with us as sales supervisors, they'll come and discuss it with us.

(Tr. 1962.) Mr. Putnam does not explain how the Compliance Department would have been alerted to the facts showing that Mr. Herula required heightened supervision if he, as Mr. Herula's supervisor, did not inform the Compliance Department of Mr. Herula's conduct.

Mr. Putnam did not inform Mr. DiGirolamo, or anyone in the Compliance Department, about Mr. Herula's unauthorized letters that were in the Four Star correspondence. Mr. Putnam did not suggest closer scrutiny of Mr. Herula's activities because "the internal auditors don't report to me. That is a compliance function, so I would not be telling the internal auditors anything." (Tr. 2022-23.) As a result, Raymond James's Compliance Department was unaware of any questions or concerns regarding Mr. Ullom's supervision of Mr. Herula during the relevant period. (Tr. 2536.) From January through August 2000, Mr. Putnam and Mr. Ullom knew that Mr. Herula sent unauthorized e-mails and at least three pieces of unauthorized correspondence, and Mr. Putnam knew of one suspect oral representation by Brite Business. The Compliance Department detected none of these happenings through its compliance efforts and Mr. Herula's supervisors did not provide it with this information.

The restrictions Mr. Putnam placed on the Brite Business account following the Lanciano letter were meaningless. Mr. Putnam expert viewed them as "simply an informational check." (Tr. 3479.) The record shows nothing that would cause Mr. Putnam to be so confident that he would not seek confirmation that Mr. Herula was being closely supervised. On these facts, Mr. Putnam did not act reasonably. He should have asked the Compliance Department to investigate whether Mr. Herula was acting legitimately and whether Mr. Ullom was closely supervising Mr. Herula.

It is impossible to reconcile the evidence in this record and the expert opinions of Mr. Corrigan, Mr. Forde, and Ms. Kerns, that Raymond James's system of supervision met or exceeded industry standards and/or Raymond James exercised reasonable supervision.[69] The overwhelming evidence requires a different conclusion. Mr. Herula sent out many pieces of unauthorized correspondence on Raymond James letterhead in 1999 and 2000 that went undetected. The head of the Compliance Department was unaware of Mr. Herula or Brite Business. Raymond James knew Mr. Herula was working for Brite Business, yet it took no effective action despite five unauthorized pieces of correspondence and one oral report that Brite Business was using Raymond James's name in solicitation efforts for Brite Business.[70] Mr. Herula never received a letter of caution or a fine for sending unauthorized correspondence even though those sanctions were called for by Raymond James's standards for the treatment of infractions. (Tr. 2565, 2636-37.) Mr. Herula worked at the Cranston branch office infrequently in the first half of 2000 and not at all in the second half of the year, yet the Cranston branch audit conducted in October 2000 indicated he did not work outside the office. The deficiencies in Raymond James's supervisory procedures also include: (1) Mr. DiGirolamo's failure to receive a copy of the Lanciano letter, a significant matter to which there was no follow up; and (2) the Compliance Department's lack of knowledge that Mr. Herula never filed a request to do outside

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[69] Mr. Corrigan claims that Raymond James's systems and procedures were working because Raymond James's senior management was involved in the Lanciano letter. (R.J. Ex. 2666 at 17.) However, Mr. Putnam and Mr. Augenbraun were only involved in the Lanciano letter because an outside person sent a copy to the head of compliance at R.J. & Associates who then forwarded the letter to Mr. Putnam. (Div. Ex. 272.)

[70] The five letters are: the Provident letter, the Lanciano letter, the Fingessa letter, the Fitzhenry letter, and the Four Star correspondence.

work for Brite Business and never returned the Financial Advisor Annual Compliance Interview questionnaire that the auditor left for him in 2000.

The record contradicts Mr. Helck's claim that Raymond James has higher standards than many broker-dealer firms and terminates registered representatives for a variety of reasons, including unprofessional behavior and low production. (Tr. 3433-35.) Mr. Herula worked for Raymond James for over a year with few clients, he was unprofessional and, according to Raymond James, the firm did not profit financially from his endeavors. (R.J. Ex. 2422.)

For all the reasons stated, I find in these circumstances that Raymond James and Mr. Putnam failed to reasonably supervise Mr. Herula, a person subject to their supervision, with a view to preventing or detecting Mr. Herula's violations of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5.

2. Alleged Antifraud Violations

Arguments of the Parties

The Division argues that Raymond James is liable for Mr. Herula's fraudulent actions because Mr. Herula was "acting within the apparent authority of his position as a [Raymond James] representative." (Div. Post-Hearing Br. 78; Div. Reply Br. 1-24.)

Raymond James responds that it did not violate Section 17(a) of the Securities Act or Section 10(b) of the Exchange Act and Rule 10b-5. (R.J. Post-Hearing Br. 1-29; R.J. Proposed Findings 162-71.) Raymond James argues that the antifraud charge is: (1) inconsistent with Commission policy; (2) unwarranted because Raymond James did not commit securities fraud in that it did not engage in the offer or sale of Brite Business securities and did not make representations to defraud investors; (3) barred by Central Bank of Denver v. First Interstate Bank of Denver, 511 U.S. 164 (1994) (Central Bank); (4) barred because federal courts refrain from creating liability that is not specified in the securities statute; and (5) barred because no corporate officers of Raymond James were actors or participants in the fraud. In addition, Raymond James argues that general agency theories do not provide for liability by Raymond James for Mr. Herula's criminal conduct. It contends that the Division failed to prove the requirements of the legal doctrines of respondeat superior and apparent authority.

Conclusions

I reject Raymond James's position that Central Bank eliminated respondeat superior liability and that, in this administrative proceeding, the only liability theory available to the Division is aiding and abetting. I find these arguments to be without merit. Central Bank eliminated the ability of private litigants to bring civil claims for aiding and abetting under the securities laws and, therefore, its holding is limited to private civil actions. See 511 U.S. at 191. For these reasons, it is wholly inapplicable to whether, on these facts, Raymond James violated the antifraud provisions of the securities statutes in a Commission administrative proceeding.

I conclude that the law of agency and the doctrine of respondeat superior are available to find Raymond James liable for Mr. Herula's illegal actions.[71] I conclude that Central Bank did not invalidate the existing law on agency, the doctrine of respondeat superior, or the legal theory of apparent authority. Suez Equity Investors, L.P. v. Toronto-Dominion Bank, 250 F.3d 87, 101 (2d Cir. 2001); Dinco v. Dylex Ltd., 111 F.3d 964, 968 (1st Cir. 1997); AT&T Co. v. Winback Conserve Program, Inc., 42 F.3d 1421, 1430-31 (3rd Cir. 1994).

I reject Raymond James's argument that it would be inconsistent with Commission policy to hold it liable for Mr. Herula's actions. Raymond James fails to cite to any authority that directly supports its position that the Commission has "reserved the use of direct fraud charges against a broker-dealer to those instances in which principals are senior managers of the firm involved in the fraud and the entity is essentially acting as a fraudulent enterprise." (R.J. Post-Hearing Br. 9.) In fact, as the Division correctly points out, corporations, including broker-dealers, have frequently been held liable for the actions of lower-level employees. (Div. Reply Br. 6-7.) (citing AT&T Co., 42 F.3d at 1438 (independent contractor sales representatives); Hollinger v. Titan Capital Corp., 914 F.2d 1564, 1567, 1578-79 (9th Cir. 1990) (registered representative); Hunt v. Miller, 908 F.2d 1210, 1216 n.15 (4th Cir. 1990) (broker); King v. Horizon Corp., 701 F.2d 1313, 1314, 1318-19 (10th Cir. 1983) (sales representative); Henricksen v. Henricksen, 640 F.2d 880, 881, 887-88 (7th Cir. 1981) (registered stockbroker); Paul F. Newton & Co. v. Texas Commerce Bank, 630 F.2d 1111, 1118-19 (5th Cir. 1980) (registered representative); Marbury Mgmt., Inc. v. Kohn, 629 F.2d 705, 715-17 (2d Cir. 1980) (broker-trainee); Holloway v. Howerdd, 536 F.2d 690, 694, 696 (6th Cir. 1976) (registered agent); Lewis v. Walston & Co., Inc., 487 F.2d 617, 625 (5th Cir. 1973) (registered representative); Armstrong, Jones & Co. v. SEC, 421 F.2d 359, 362 (6th Cir. 1970) (salesmen); SEC v. Currency Trading Int'l, No. CV 02-05143PA, 2004 WL 2753128, at *11 (C.D. Cal. Feb. 2, 2004) (brokers); Kravitz v. Pressman, Frohlich & Frost, Inc., 447 F. Supp 203, 207, 215 (D. Mass. 1978) (broker/registered representative); Merrill Lynch, Pierce, Fenner & Smith, Inc., 13 SEC Docket 646, 651 n.13 (Nov. 9, 1977) (account executives) (settled order)).

Finally, Raymond James argues that it cannot be held liable because Mr. Herula's actions were criminal. As authority for this proposition Raymond James cites Restatement (Second) Agency § 231. However, Section 231 states that "an act may be within the scope of employment although consciously criminal or tortious." (R.J. Post-Hearing Br. 23.) Section 231 also states, an employer will not be "responsible for acts which are clearly inappropriate to or unforeseeable in the accomplishment of the authorized result." Restatement (Second) Agency § 231(a) (1958). Thus, if Mr. Herula's acts, although criminal, were in the scope of his employment or foreseeable in the accomplishment of an authorized result, Raymond James should be held liable. (Id.)

[71] Raymond James did not challenge the Division's assertions that Mr. Herula's independent contractor status is not relevant to whether he was acting within the apparent scope of his authority, and that the Commission does not recognize the concept of independent contractor for purposes of the Exchange Act, William V. Giordano, 61 SEC Docket 453, 458 (Jan. 19, 1996) (settled order). (Div. Reply Br. 16 n.19.) The NASD applies the same supervisory standards to all registered representatives, employees or independent contractors.

I take official notice of the Memorandum and Order by U.S. District Court Judge Mary M. Lisi holding Mr. Herula liable for violating Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5. 17 C.F.R. § 201.323; SEC v. Herula, C.A. No. 02-154 ML (D.R.I. Oct. 17, 2002).[72] Mr. Herula committed these antifraud violations while he was associated with Raymond James as a registered representative. (R.J. Answer; Div. Ex. 82; Putnam Ex. 1116; R.J. Post-Hearing Br. 2.).

It is a well-established principle that a corporation may be held liable for the acts of its agents. See American Soc'y of Mech. Eng'rs, Inc. v. Hydrolevel Corp., 456 U.S. 556, 565-66 (1982). Specifically, a principal is liable for the tortious acts of its agent, even though not authorized, if the agent was acting within the scope of his employment or with apparent authority. Id.; see also Hollinger, 914 F.2d at 1576 & 1577 n.28; Armstrong, Jones & Co., 421 F.2d at 362; Merrill Lynch, Pierce, Fenner & Smith, Inc., 13 SEC Docket 646, 651 n.13 (Nov. 9, 1977); Restatement (Second) of Agency §§ 219, 229, 257, 261, 265 (1958). The Commission has long held the position "that a broker-dealer may be sanctioned for the willful violations of its agents through [common law principles of agency]." Armstrong, Jones & Co., 421 F.3d at 362 (collecting cases); see also Merrill Lynch, 13 SEC Docket at 651 n.13 (citing several Commission enforcement proceedings wherein common law principles of agency were applied); SEC v. Cooper, 402 F.Supp. 516, 525 n.31 (S.D.N.Y. 1975) ("[r]egistrant as a firm can only act through its employees and agents").

For an agent's conduct to be within the scope of employment, it must be the same general nature as that authorized, or unauthorized but similar or incidental to authorized conduct. Restatement (Second) Agency § 229 (1958). An agent's conduct is "incidental" to his

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[72] Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder proscribe fraudulent conduct in connection with the offer, purchase, and sale of securities. These provisions prohibit essentially the same type of conduct. See United States v. Naftalin, 441 U.S. 768, 773 n.4 (1979). To establish violations of Section 17(a)(1) of the Securities Act, Section 10(b) of the Exchange Act, and Rule 10b-5 thereunder, the Division must establish: (1) misrepresentations or omissions of material facts or other fraudulent devices; (2) made in connection with the offer, sale, or purchase of securities; and (3) that the respondent acted with scienter. Scienter is not required for violations of Sections 17(a)(2) or 17(a)(3) of the Securities Act; rather, negligence is sufficient to establish liability. Aaron v. SEC, 446 U.S. 680, 697 (1980); SEC v. Solucorp Indus., 274 F. Supp. 2d 379, 419 (S.D.N.Y. 2003); SEC v. Scott, 565 F. Supp. 1513, 1525-26 (S.D.N.Y. 1983).

Scienter is defined as "a mental state embracing intent to deceive, manipulate or defraud." Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 n.12 (1976). The scienter requirement may be satisfied by a showing of recklessness. Hollinger v. Titan Capital Corp., 914 F.2d 1564, 1568-69 (9th Cir. 1990); David Disner, 52 S.E.C. 1217, 1222 & n.20 (1997) (citation omitted). Recklessness is defined as "an extreme departure from the standards of ordinary care . . . presenting a danger of misleading buyers or sellers that is either known to the [respondent] or is so obvious that the [respondent] must have been aware of it." Sundstrand Corp. v. Sun Chem. Corp., 553 F.2d 1033, 1044-45 (7th Cir. 1977) (citation omitted), cert. denied, 434 U.S. 875 (1977).

authorized duties if it is "foreseeable," meaning it was "a direct outgrowth of the employee's instructions or job assignment." Haddon v. United States, 68 F.3d 1420, 1424 (D.C. Cir. 1995) (quoting Boykin v. District of Columbia, 484 A.2d 560, 562 (D.C. 1984)). Even when an agent acts outside the scope of their employment, a principal may still be held responsible for the agent's actions if a third party relied on the agent's apparent authority. Restatement (Second) § 219(2)(d) (1958).

Liability arises under apparent authority when a principal allows or causes a third person to believe that the agent acted with the principal's authorization. See American Soc'y of Mech. Eng'rs, 456 U.S. at 566; First Interregional Equity Corp. v. Haughton, 805 F. Supp. 196, 201-02 (S.D.N.Y. 1992); Moro-Romero v. Prudential Securities, Inc., 1991 WL 494175, *3 (S.D. Fla. 1991) (unpublished); Restatement (Second) Agency § 261 (1958). The appearance of authorization may be created through silence by the principal, and the principal's authorization or knowledge of the agent's misrepresentations is irrelevant. Moro-Romero, 1991 WL 494175, at *3. The fact that the agent acted entirely for his or her own benefit does not absolve the principal of liability, so long as the third party justifiably relied on the agent's apparent authority. Id. However, the third party has a duty of inquiry if a reasonable person would inquire given the same factual setting. Id.

The initial factual consideration is determining whether Mr. Herula's actions were within the scope of his employment, or whether Raymond James positioned Mr. Herula to portray himself as acting on behalf of Raymond James when he violated the antifraud provisions of the securities statutes.

Purchasing securities and opening accounts for customers at Raymond James was within the scope of Mr. Herula's employment with Raymond James as a registered representative. Raymond James also allowed Mr. Herula to conduct other business activities. The Registered Representative Agreement that established Raymond James's business relationship with Mr. Herula gave him "the right to solicit and engage in the purchase and sale for [Raymond James] approved securities with the general public, and engage in other business activities, except to the extent such activities are subject to the rules, regulations and interpretations of the Regulatory Authorities." (Div. Ex. 111 at 2; Tr. 1036.) Raymond James failed to follow its procedures for approving Mr. Herula's other business activity, which was raising funds for Brite Business. However, Raymond James tacitly approved of Mr. Herula engaging in this "other business activity" because Mr. Putnam and Mr. Ullom, Mr. Herula's supervisors, and Mr. Carenno became aware in approximately October 1999, that Mr. Herula was raising funds for Brite Business and never directed him to cease.

It is rare for a broker-dealer firm, where the registered representatives are employees, to allow registered representatives to engage in any outside business activities.[73] (Tr. 1898.) On its face, Raymond James's allowing Mr. Herula to raise funds for Brite Business created a potential

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[73] Ms. Kern, an expert, testified that at Morgan Stanley Dean Witter, employees were only allowed to work outside on matters that were completely unrelated to the work of the firm. (Tr. 3458.) Morgan Stanley Dean Witter viewed anything that had a financial connection as posing a potential conflict down the road and as a distraction from the business. (Tr. 3458, 3500-01.)

conflict with Raymond James's activities as a broker-dealer. For example, it was not clear to Mr. Putnam whether Mr. Herula wrote the Provident letter acting on behalf of Raymond James or Brite Business. (Tr. 1902.) Mr. Putnam characterized the Provident letter as covering a gray area. (Id.) Soliciting people to open accounts at Raymond James was within the scope of Mr. Herula's employment. Mr. Herula continually held out to Raymond James the possibility that people with substantial assets associated with Brite Business were going to do business with Raymond James.

Mr. Putnam and Mr. Ullom testified that they thought Mr. Herula was raising funds for Brite Business from commercial institutions. The evidence is that Mr. Putnam's and Mr. Ullom's beliefs were wrong and unfounded. There was no written authorization, and thus there is no record of any limitation. Mr. Herula's oral representations and the correspondence in the record indicate that Mr. Herula attempted to raise funds for Brite Business from any source, be it a financial institution or an individual. (Tr. 89-93, 707, 710, 742-43; Div. Exs. 44, 45, 272.) Raymond James did not authorize Mr. Herula to represent that he was acting on behalf of Raymond James when raising funds for Brite Business; however, he did so. Raymond James enabled Mr. Herula to make representations to investors that appeared to be representations by Raymond James.

Raymond James gave Mr. Herula substantial credibility by entering an employment agreement with him in August 1999. Mr. Herula was able to use his status and title as a representative of a major broker-dealer to hold himself out to the public as a person with a position with Raymond James. The evidence is that in 2000 Raymond James depicted itself in advertisements and on the Internet as a diversified financial services holding company managing over $15 billion in assets. (Tr. 232, 453; Div. Ex. 22.) Mr. Herula was allowed to use various means for conducting business that portrayed him as a representative of Raymond James, such as an e-mail address and a desk in a space identified to the public as the offices of Raymond James. Raymond James also supplied Mr. Herula with letterhead stationery that described Raymond James as member of the NASD and the Securities Investor Protection Corporation and listed the address, and telephone and facsimile numbers for the Cranston branch office.

Raymond James's name appeared on the window of the Cranston branch office, which was located in a small commercial mall. (Tr. 90.) Mr. Curl met with Mr. Herula in the Cranston branch office and Mr. Herula sat at a desk that had a sign with his name. (Tr. 91.) Mr. Herula assured Mr. Curl that Mr. Fitzhenry's funds would be safe in a Raymond James account and that they would be invested in United States Treasuries. (Tr. 89-93.) Mr. Curl passed these representations on to Mr. Fitzhenry. (Tr. 230-35.) Mr. Curl received two copies of a letter dated March 10, 2000, on Raymond James letterhead, signed by Mr. Herula as Investment Manager, addressed to Mr. Fitzhenry that made the unauthorized representations and guarantees on behalf of Raymond James as to Mr. Fitzhenry's $12.5 million deposit in the Brite Business account at Raymond James. Mr. Curl received one copy from Mr. Herula at the meeting at the Cranston branch office. He received a second copy by facsimile. (Div. Exs. 45, 498; Tr. 94-95.) Mr. Fitzhenry viewed Mr. Herula's March 10, 2000, letter as being, in fact, from Raymond James. (Tr. 233.)

Mr. Fitzhenry thought his investment was safe because his funds were being deposited with Raymond James to be used to purchase United States Treasuries and Raymond James would return his funds at his request.[74] (Tr. 238-39.) Mr. Fitzhenry thought, at a minimum, he would receive the interest rate on "T-bills" and anything above that would be extra. (Tr. 285.) Mr. Fitzhenry would not have invested $12.5 million without assurances that his funds would be safe at Raymond James and would be returned at his request. (Tr. 233.) This letter, along with another letter from Brite Business, persuaded Mr. Fitzhenry that his funds would be one hundred percent safe. (Tr. 235.) The evidence is that Mr. Fitzhenry and Rheaume Holdings invested $12.5 million in Brite Business on March 27, 2000, based on the false representations Mr. Herula made as a Raymond James Investment Manager. Mr. Fitzhenry had a reasonable basis for his belief that Mr. Herula acted with authorization from Raymond James.

Mr. Herula confirmed information Mr. Monlezun received from people in Texas that he could participate in a pool of funds which would result in a high-yield transaction. (Tr. 711.) Mr. Herula was allegedly an expert, having done similar transactions many times for Raymond James. (Tr. 707.) Mr. Herula contacted Mr. Monlezun and promised fantastic returns and a safe investment. (Tr. 711-12, 729.) Mr. Monlezun transferred $1 million to the Mary Lee Capalbo, Esq., Special Client Account at Raymond James to invest in Brite Business based on false representations and guarantees made by Mr. Herula as a Raymond James Investment Manager. Among other things, Mr. Herula falsely represented that Mr. Monlezun's funds would be safe and that transfers from the account would occur only with Mr. Monlezun's written permission. The fact that Mr. Monlezun believed that high-yield transactions existed, that he had been trying to participate in one for several years, and that he tried to gather other investors to participate, does not change the fact that Mr. Herula, acting with apparent authority from Raymond James, committed fraud in connection with Mr. Monlezun's investment of $1 million in Brite Business.[75]

The evidence is that Mr. Fitzhenry and Mr. Monlezun reasonably believed that Mr. Herula was authorized to act for Raymond James and relied on his fraudulent representations and guarantees apparently made on behalf of Raymond James in making their decisions to invest in Brite Business. Mr. Herula's association with Raymond James gave him the ability: to establish brokerage accounts related to Brite Business; to use Raymond James letterhead stationery to make unauthorized representations and guarantees; to use Raymond James's name, reputation, business address, and communication networks to make his representations appear legitimate and on behalf of Raymond James; and at the same time Raymond James allowed Mr. Herula to raise money for Brite Business. For all the reasons stated, I find Raymond James liable for Mr.

[74] I found Mr. Fitzhenry's testimony to be candid and highly credible. I reject Respondents' assertions that Mr. Fitzhenry's testimony should not be given full credit because Mr. Curl relayed some of the information, and that when he made his investment, Mr. Fitzhenry doubted Brite Business would pay the projected ten percent weekly return. (Tr. 283.)

[75] Raymond James cannot be held liable for Mr. Herula's actions with respect to Mr. Al Bloushi because Mr. Al Bloushi did not rely on representations by Mr. Herula in making his investment in Brite Business.

Herula's violations of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5.

3. E-Mail Retention

Arguments of the Parties

The Division claims that Raymond James violated Section 17(a)(1) of the Exchange Act and Rule 17a-4 because prior to January 2001, Raymond James's systems did not systematically preserve all its branch offices' electronic mail. The Division contends the system omitted: (1) branch office personnel to whom Raymond James did not assign an e-mail account/mailbox; and (2) branch office personnel with mailboxes who opened the message the same day the message was received or who deleted items from their delete file (double delete) the same day the item was sent or received. In the alternative, the Division faults Raymond James for failing to have adequate policies and procedures for making and filing hard copies of business related e-mails. (Div. Post-Hearing Br. 101.)

Raymond James advances five major arguments why the Division has not shown that it willfully committed the alleged books-and-records violations during the relevant period. According to Raymond James, it used the best available methods to comply with the 1997 Release by adopting a paper printout policy, retaining daily e-mail server back-up tapes, and implementing a first-generation computerized e-mail retention and storage system. (R.J. Post-Hearing Br. 64.) Raymond James contends it reasonably relied on Commission staff assurance that the Division would not enforce the 1997 Release in view of discussions, which the participants thought would result in guidance or relief. The technology needed to achieve compliance with the 1997 Release was not available. The 1997 Release is invalid because: (1) the Commission did not comply with the Administrative Procedures Act, the Paperwork Reduction Act, and the Regulatory Flexibility Act; and (2) it conflicts with the Electronic Signatures in Global National Commerce Act. (R.J. Post-Hearing Br. 69-72.)

Conclusion

Section 17(a)(1) of the Exchange Act provides that each member of a national securities exchange, broker, or dealer "shall make and keep for prescribed periods such records, furnish copies thereof, and make and disseminate such reports as the Commission, by rule, prescribes as necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of this title." Exchange Act Rule 17a-4(b)(4), which requires broker-dealers to "preserve for a period of not less than three years, the first two years in an easily accessible place . . . [o]riginals of all communications received and copies of all communications sent . . . by the member, broker or dealer (including inter-office memoranda and communications) relating to its business as such," has been in place for many years. 17 C.F.R. § 240.17a-4(b)(4).

On February 5, 1997, the Commission issued the 1997 Release titled a Final Rule, Reporting Requirements for Brokers or Dealers Under the Securities Exchange Act of 1934. 63

SEC Docket 2298 (Feb. 5, 1997) (1997 Release). The 1997 Release made clear that Rule 17a-4 includes electronic communications and that:

> the content of the electronic communication is determinative, and therefore broker-dealers must retain only those e-mail and Internet communications (including inter-office communications) which relate to the broker-dealer's "business as such."

Id.

The persuasive evidence is that Raymond James assigned mailboxes to all registered representatives and had a policy that all business should be conducted using a Raymond James account. (Tr. 1271, 3268, 3316-17, 3363-64.) The Division's information from Raymond James that "[p]rior to January 1, 2001, only some branch office personnel were assigned RJFS mailboxes" was erroneous. (Tr. 3320; Div. Ex. 313 at 27.)

The evidence is that Raymond James supervisory manuals required that branch offices retain three years' worth of correspondence. (Tr. 2448-50; R.J. Ex. 2533 at 8663.)

It is undisputed that in the relevant time period Commission's staff was (1) informing the industry that Rule 17a-4(b)(4) would be modified, and (2) requesting that the NYSE not enforce the rule. The undisputed testimony of Mr. Pallante, which corroborates Mr. Fredriksen's testimony, is that in 1999 and 2000, senior staff members of the Commission represented to the broker-dealer industry generally and openly that the Commission would likely modify and make less stringent the requirements of the 1997 Release. In these circumstances, it would be patently unfair and unacceptable in view of the senior staff's actions and representations to find that Raymond James did not take steps to comply with Rule 17a-4(b)(4). My ruling does not violate the well settled principle that individual Commission staff members cannot speak for the Commission.

I observed Mr. Fredriksen and find that he gave credible testimony. Nothing in the record contradicts Mr. Fredriksen's representation that Raymond James instructed him as assistant vice president of information security in May 1999 to take steps to have Raymond James comply with the 1997 Release. Furthermore, the evidence is that Raymond James implemented what Mr. Fredriksen recommended as the most appropriate actions to accomplish that objective. (Tr. 3256-57, 3378.) The Division's expert, Mr. Weeden, also gave thoughtful, credible testimony. Mr. Weeden would have made different decisions than Mr. Fredriksen, in terms of software purchases and other actions to comply with the 1997 Release, but he acknowledged that Raymond James had been partially compliant. (Tr. 3544.) The testimony of Mr. Fredriksen and Mr. Weeden is that Raymond James made a good faith effort to comply. It could probably have done more, but there is no evidence of bad faith or lack of effort.

For these reasons, I find that Raymond James did not willfully violate Section 17(a) of the Exchange Act and Rule 17a-4 during the relevant period.

SANCTIONS

The Division requests (1) a disgorgement order, plus prejudgment interest, against Raymond James; (2) imposition of civil penalties against Raymond James and Mr. Putnam; (3) a cease-and-desist order against Raymond James; (4) an order barring Mr. Putnam from associating in a supervisory capacity, or otherwise, with any broker or dealer or investment adviser; and (5) an order requiring Raymond James to retain an independent compliance consultant and prohibiting Raymond James from opening any new branch offices or hiring any new registered representatives until it takes remedial measures. (Div. Post-Hearing Br. 103-19, Div. Reply Br. 59-71.)

Disgorgement and Prejudgment Interest

Section 8A(e) of the Securities Act and Section 21C of the Exchange Act provide for disgorgement, including reasonable interest, in any cease-and-desist proceeding. Section 203(j) of the Advisers Act contains similar language. Disgorgement is an equitable remedy whose purpose is "to deprive a wrongdoer of his unjust enrichment and to deter others from violating the securities laws." SEC v. First City Fin. Corp., 890 F.2d 1215, 1230 (D.C. Cir. 1989). It is settled that the disgorgement figure need only be a reasonable approximation of profits causally connected to the violations and not an exact number. First City, 890 F.2d at 1231. Once the Division shows that its disgorgement figure reasonably approximates the amount of unjust enrichment, the burden shifts to the respondent to clearly demonstrate that the Division's disgorgement figure is not a reasonable approximation. SEC v. Lorin, 76 F.3d 458, 462 (2d Cir. 1996). Any risk of uncertainty as to the disgorgement amount falls on the wrongdoer whose misconduct created the uncertainty. First City, 890 F.2d at 1232.

The Division requests that Raymond James, as Mr. Herula's principal, be held jointly and severally liable for Mr. Herula's antifraud violations and should also be liable for failing to supervise Mr. Herula, thereby failing to prevent those violations. According to the Division, Raymond James should be ordered to disgorge $13,873,858.34, the amount of funds the Division alleges was under Raymond James's control that was not returned to investors. (Div. Post-Hearing Br. 105.) If an insufficient basis exists for disgorgement of this amount, the Division requests disgorgement of $8,530,842.65, the amount Mr. Herula and Ms. Capalbo misappropriated for their personal benefit while the funds were under Raymond James's control. (Div. Reply Br. 61.)

The Division also requests that Raymond James be ordered to disgorge $1,840,976.98 in margin interest, fees, and commissions that Raymond James and its affiliates received from Brite Business investors. (Div. Post-Hearing Br. 107.) Included in this amount is $1,789,820.58 of margin interest earned by R.J. & Associates. (R.J. Ex. 2422.) Finally, the Division cites Rule 600(a) of the Commission's Rules of Practice, 17 C.F.R. § 201.600, that requires payment of prejudgment interest on disgorged sums. (Div. Post-Hearing Br. 107-08.)

Raymond James argues that disgorgement is not available because it received no illegal profits and no unjust enrichment. Raymond James contends that the Division's disgorgement amount is inappropriate because R.J. & Associates, a separate entity, extended the margin loan to Brite Business and earned most of the margin interest. Raymond James claims that it received

no financial benefit from the transaction. (R.J. Post-Hearing Br. 77.) Raymond James also contends that the net margin interest received by R.J. & Associates was $471,823. (R.J. Ex. 2422.) Raymond James arrives at this figure by claiming that R.J. & Associates would have earned $1.2 million on these funds by investing in overnight securities. It also argues that the net total was further reduced because R.J. & Associates borrowed funds from an unrelated bank at a cost of $45,173 and Raymond James paid out an additional $35,603 to the Cranston branch office.[76] (R.J. Ex. 2422.)

From November 2, 1999, through December 15, 2000, the Brite Business and related accounts generated total gross commissions of $54,875.00. (Tr. 2833-34; R.J. Ex. 2660.) Of this amount, $49,008.75 went to the Cranston branch office for distribution to Foxhill, Mr. Ullom and Mr. Herula, Raymond James retained $5,866.25, and R.J. & Associates retained $313.50. (Id.) Raymond James argues that none of these funds came from an illegal transaction. Raymond James concludes that after considering the $2.5 million settlement reached with Rheaume Holdings/Mr. Fitzhenry, it lost almost $2.5 million as a result of the activity in Brite Business and related accounts. (R.J. Ex. 2422.)

The undisputed evidence is that Raymond James retained $5,866.25 in commissions and fees from the Brite Business accounts and that it earned this amount as a result of the fraud in which Mr. Herula participated. (Tr. 2834.) I find that $5,866.25 can be considered as ill-gotten gains or unjust enrichment and Raymond James should disgorge this amount, plus prejudgment interest beginning January 1, 2001, the first day of the month after it terminated Mr. Herula.

I reject the Division's position that as to Raymond James either the $13,873,858.34 or the $8,530,842.65, funds in the Brite Business accounts at the broker-dealer, come within the accepted definitions of ill-gotten gains or unjust enrichment. To gain or be enriched by something, you have to receive a benefit or use it in some way. Raymond James did neither with respect to these funds. Rather, it acted as custodian and followed the directions of Mr. Fife or Ms. Capalbo and transferred the funds to others. Raymond James did not use these funds or receive any benefit from them.

I also find that Raymond James should not be ordered to disgorge the $1,789,821 paid to R.J. & Associates as a result of Brite Business's purchase of Treasuries on margin. The margin loan was made by R.J. & Associates, not Raymond James. (Tr. 2821-22.) R.J. & Associates, a separate business entity, is not a named respondent. There is no evidence that Raymond James made a profit from the transaction. (Tr. 2958; R.J. Ex. 2422.) Moreover, the record does not show that the purchase of Treasuries on margin by Brite Business involved fraud by Mr. Herula. Despite the various creative theories advanced by the Division, there is no legal basis for

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[76] R.J. & Associates had to borrow funds for four days until it could release funds from its reserve account. R.J. & Associates paid Raymond James $35,603 as a result of the borrowing because it had an agreement with Raymond James to pay it 375 basis points on any borrowings in balances carried in its client accounts. Raymond James in turn paid the $35,603 to the Cranston branch office where presumably it was divided among Foxhill, Mr. Ullom and Mr. Herula. (Tr. 2825-28; R.J. Ex. 2659.)

ordering Raymond James to disgorge margin interest received by R.J. & Associates and not Raymond James.

Civil Penalties

Section 21B of the Exchange Act provides that in any proceeding instituted under Section 15(b) of the Exchange Act, the Commission may impose a civil penalty against a person if it finds that the person has willfully violated a provision of the Securities Act or the Exchange Act, or the rules thereunder, or has failed reasonably to supervise within the meaning of Section 15(b) of the Exchange Act.[77] The Commission must also find that such a penalty is in the public interest. Section 203(i) of the Advisers Act contains similar language.

Section 21B of the Exchange Act and Section 203(i) of the Advisers Act identify the following factors for determining whether a penalty would be in the public interest: (1) whether the act or omission involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement; (2) the resulting harm to others; (3) unjust enrichment, taking into account any restitution made; (4) prior violations; (5) need for deterrence; and (6) such other matters as justice may require.

The maximum amount per act or omission is set out in Section 21B(b) of the Exchange Act and Section 203(i)(2) During the relevant period, the maximum penalty for each act or omission at the first tier was $5,500 by a natural person and $55,000 by any other person; $55,000 for each act or omission by a natural person and $275,000 by any other person at the second tier; and $110,000 for each act or omission by a natural person and $550,000 by any other person at the third tier.[78] 17 C.F.R. § 201.1001. A second-tier penalty is permissible if the act or omission involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement. A third-tier penalty is permissible for an act or omission that not only must have involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement, but also must have "directly or indirectly resulted in substantial losses or created a significant risk of substantial losses to other persons or resulted in substantial pecuniary gain to the person who committed the act or omission."

The Division recommends imposition on Raymond James of a civil penalty at the third-tier level for each of "at least [twenty-seven] misleading letters" and [one] e–mail that Mr. Herula sent on Raymond James letterhead, or, alternatively, for each of "at least [sixteen] categories of red flags" that Raymond James ignored and "for each of the [six] general bases" the Division cited as Raymond James's failure to supervise. (Div. Post-Hearing Br. 110.)

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[77] Willfully under Section 15(b) of the Exchange Act means no more than intentionally committing the act that constitutes the violation. Tager v. SEC, 344 F.2d 5, 8 (2d Cir. 1965); C. James Padgett, 64 SEC Docket 319, 331 n.34 (Mar. 20, 1997).

[78] As required by the Debt Collection Improvement Act of 1996, the Commission increased the maximum penalty amounts for violations occurring after December 9, 1996, and, again for violations occurring after February 2, 2001. 17 C.F.R. §§ 201.1001, .1002.

The Division recommends imposition on Mr. Putnam of a reasonable civil penalty at the third-tier level. The Division suggests a penalty for each of "at least [fifteen] categories of red flags" that Mr. Putnam allegedly ignored. At a minimum, the Division would impose a civil penalty for each of the three unauthorized pieces of correspondence that Mr. Putnam knew about. (Div. Post-Hearing Br. 111.)

Raymond James argues that the Division has not shown that it committed a willful violation, a requisite for the assessment of a civil penalty. It maintains that it is not in the public interest to impose a civil penalty at any level, but certainly not at the third-tier level where: (1) Raymond James was not involved in any fraud, deceit, or manipulation and did not deliberately or recklessly disregard any regulatory requirement; (2) no individual was harmed by its actions; and (3) it was not enriched. Raymond James argues that the Commission should not impose a penalty on Raymond James because the district court and the Commission have assessed penalties against Mr. Herula and Mr. Ullom, the individuals who participated in and perpetuated the fraud.

Mr. Putnam argues that no civil penalty is justified in that his actions were reasonable at the time. Mr. Putnam contends that even if he failed to supervise Mr. Herula, his conduct did not meet the criteria for a penalty at the second or third tier. Mr. Putnam argues that failure to supervise involves a course of conduct, not a discrete violation, and that distinction makes the Division's proposed method of calculating a penalty inapplicable.

This Initial Decision finds Raymond James liable for willful violations of the Securities Act and Exchange Act and rules thereunder, and that Raymond James and Mr. Putnam failed reasonably to supervise, within the meaning of Section 15(b)(4)(E) with a view to preventing violations of the antifraud provisions by a person who was subject to their supervision. Addressing the six factors used to analyze whether a civil penalty is in the public interest, I conclude the following: Mr. Herula's violations, for which Raymond James is liable, involved fraud, deceit, or deliberate or reckless disregard of regulatory requirements. The significant financial losses suffered by investors were a result of Mr. Herula's actions for which Raymond James is liable. It is probable that Raymond James's and Mr. Putnam's failures to supervise Mr. Herula contributed to investor losses. Raymond James evidenced a low regard for supervision and compliance during the relevant period because it had from 1,100 to 4,000 registered representatives operating in small offices throughout the country without uniform policies and a restructured compliance program that was inadequately staffed for a new merged entity. Raymond James's and Mr. Putnam's failure to supervise Mr. Herula was such that he was able to participate in a large-scale fraud using his position at Raymond James for over a year. This fact, which occurred despite some red flags, indicates that Raymond James had serious problems with supervision during the relevant period. This finding is confirmed by the fact that Mr. Putnam only learned that Mr. Ullom knew about Mr. Herula's correspondence and received funds from Mr. Herula as a result of the Commission investigation.[79] (Tr. 1595.) An important purpose of sanctions is to serve as a deterrent against further violations by the individuals involved and for

[79] Raymond James put Mr. Ullom under heightened supervision in August 2002 as the result of a customer complaint. (Tr. 2033.)

others in the securities industry. See Meyer Blinder, 53 S.E.C. 250, 253 (1997); Kenneth Sonken, 48 S.E.C. 832, 836 (1987). For all the reasons cited, in these circumstances, I find a strong penalty is warranted.

Civil penalties should be assessed at the third-tier level because the violations involved fraud, deceit, or deliberate or reckless disregard of the regulatory requirements and resulted in substantial losses to investors. I will not apply the maximum amounts allowed at the third-tier level because, except for the events at issue, the record does not show that Raymond James and Mr. Putnam have a poor record of compliance. In making this judgment, I have considered the twelve arbitration awards over the past three years cited by the Division and the fact that Raymond James requires that its customers agree to binding arbitration. The number of arbitration awards seems low given that Raymond James had over 500,000 accounts during this period. (Tr. 2788.) I have also considered that Mr. Putnam's prior violations occurred more than twenty-five years ago.

I find that Raymond James should pay a civil penalty of $300,000 for each of twenty-three unauthorized pieces of correspondence that Mr. Herula sent on Raymond James letterhead in connection with his fraudulent activities that are in evidence, and which were part of Raymond James's failure to reasonably supervise Mr. Herula with a view to preventing Mr. Herula's antifraud violations.[80] I find that Mr. Putnam should pay a civil penalty of $50,000 for each of four occurrences where he failed to reasonably supervise Mr. Herula with a view to preventing Mr. Herula's antifraud violations. The four occurrences are the Provident letter, the Lanciano letter, the Four Star correspondence, and the oral information from Mr. Ness that persons were using Raymond James's name when raising funds for Brite Business.

Proposed amendments to the Commission's Rules of Practice state that one purpose is to make clear that an administrative law judge has authority under Rule 1100, 17 C.F.R. § 201.1100, to create a Fair Fund under Section 308 of the Sarbanes-Oxley Act of 2002, 15 U.S.C. § 7246(a). See Commission Release No. 34-51595 (April 21, 2005). I will use Rule 1100 to create a Fair Fund to benefit Mr. Fitzhenry and Mr. Monlezun, the investors harmed by the violations.

Cease-and-Desist Order

The Division argues that Raymond James should be ordered to cease and desist from committing any future violations of Sections 17(a) of the Securities Act and Sections 10(b) and Rule 10b-5.[81] The Division contends that Mr. Herula's antifraud violations, which are attributable to Raymond James, were egregious, recurrent and demonstrated a high degree of

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[80] Div. Exs. 12, 14, 16, 18-20, 24, 44, 45, 52, 53, 55, 56, 57, 149 (four letters included), 272, 282, 362, 498, and R.J. Ex. 2035. One exhibit cited by the Division is not in evidence and the other four exhibits are not examples of unauthorized correspondence. (Div. Post-Hearing Br. 110.)

[81] I have found that Raymond James did not violate Section 17(a) of the Exchange Act and Rule 17a-4 and, therefore, will not consider the Division's request for a cease-and-desist order as to these provisions.

scienter. The Division contends that in the last three years Raymond James has been found liable in twelve arbitrations indicating that there is a risk of future violations by Raymond James's agents. (Div. Post-Hearing Br. 113.) The Division argues that Raymond James has failed to acknowledge its wrongdoings and has not offered any persuasive assurances against future violations. (Div. Post-Hearing Br. 114.)

Raymond James contends that a cease-and-desist order is unjustified because there is no risk of any future violation. (R.J. Post Hearing Br. 90.) None of the managers involved in these matters continue to hold supervisory positions. Since December 2000, Raymond James has made large-scale changes to its management structure and added compliance personnel. Raymond James's CEO is committed to making compliance and supervision one of Raymond James's highest operational priorities. (R.J. Post Hearing Br. 91-92.)

Sections 8A of the Securities Act and 21C of the Exchange Act provide that the Commission may issue a cease-and-desist order when it finds that a person is violating, has violated, or is about to violate any provision of the statutes or rules thereunder. The Commission's standard for ordering someone to cease and desist is as follows:

> Along with the risk of future violations, we will continue to consider our traditional factors in determining whether a cease-and-desist order is an appropriate sanction based on the entire record. Many of these factors are akin to those used by courts in determining whether injunctions are appropriate, including the seriousness of the violation, the isolated or recurrent nature of the violation, the respondent's state of mind, the sincerity of the respondent's assurances against future violations, the respondent's recognition of the wrongful nature of his or her conduct, and the respondent's opportunity to commit future violations. In addition, we consider whether the violation is recent, the degree of harm to investors or the marketplace resulting from the violation, and the remedial function to be served by the cease-and-desist order in the context of any other sanctions being sought in the same proceedings.

KPMG Peat Marwick, LLP, 74 SEC Docket 384, 436 (Jan. 19, 2001).

I conclude that this record will not support imposition of a cease-and-desist order. The evidence is that traditional factors like egregious conduct, recurrent violations over an extended period, serious harm to investors, and opportunity for future violations are all present. However, there are other significant factors that show that the risk of future violations is slight. See WHX Corp. v. SEC, 362 F.3d 854 (D.C. Cir. 2004). Raymond James has fired Mr. Herula and Mr. Ullom. In deference to what it believed are the Commission's wishes, Raymond James took action so that Mr. Putnam is no longer at Raymond James nor a supervisor. (Tr. 3441-42.) I found the several witnesses associated with Raymond James and affiliated companies to be knowledgeable and committed to complying with the applicable statutes and regulations. I conclude, therefore, that the violations shown in this record do not reflect the corporate culture at Raymond James. I accept the sworn testimony of Mr. Helck that Raymond James is embarrassed that these events occurred and that it will give more scrutiny to the day-to-day activities of persons associated with the firm. (Tr. 3439, 3443.) Most important, I give

significant weight to Mr. Helck's testimony that Raymond James is in the process of carrying out the request of the audit committee of the holding company that it retain an outside consultant to evaluate its compliance and supervision systems and report its conclusions to the audit committee. (Tr. 3438-39.)

For all these reasons, I conclude that a cease-and-desist order is not necessary for the future protection of public investors and the capital markets.

Bar from Association on Mr. Putnam

The Division recommends that the Commission bar Mr. Putnam from associating with a broker-dealer or investment adviser in a supervisory capacity, or otherwise. The Division alleges that Mr. Putnam's failure to reasonably supervise Mr. Herula was egregious, continued over an extended period, and that Mr. Putnam's failure to act appropriately "was responsible, in part, for the success, magnitude and duration of Herula's fraudulent scheme." (Div. Post-Hearing Br. 116.) The Division notes that Mr. Putnam remains convinced that neither he nor Raymond James failed to supervise Mr. Herula.

Mr. Putnam argues that a bar is unjustified based on his conduct. Moreover, Mr. Putnam does not supervise sales personnel any longer and he has no plans to do so in the future. (Putnam Post-Hearing Br. 67-70.)

Sections 15(b)(6) of the Exchange Act and 203(f) of the Advisers Act provide that the Commission may censure, place limitations on the activities or functions, or suspend for a period of up to twelve months or bar a person who was associated with a broker-dealer or investment adviser at the time she committed wrongdoing. The factors for assessing whether a sanction is appropriate pursuant to Section 15(b)(6) of the Exchange Act and Section 203(f) of the Advisers Act are very similar to those detailed in the discussion of a cease-and-desist order. Steadman v. SEC, 603 F.2d 1126, 1140 (5th Cir. 1979), aff'd on other grounds, 450 U.S. 91 (1981). Mr. Putnam's conduct was serious. He was president of Raymond James and was Mr. Herula's supervisor. Mr. Putnam acknowledges being aware of unauthorized correspondence by Mr. Herula in March 2000, and he did not terminate Mr. Herula until nine months later. The evidence is that Mr. Putnam, a man of great accomplishment and integrity, failed reasonably to supervise Mr. Herula, a fact he fails to recognize. In these circumstances, I find it necessary to suspend Mr. Putnam from associating with a broker or dealer or investment adviser in a supervisory capacity for ninety days.

Requiring an Independent Assessment

The Division contends that Raymond James is unable to establish, implement, and then objectively assess whether its compliance policies and procedures are appropriate. The Division argues, therefore, that it is necessary that an independent consultant be mandated to ensure that appropriate changes are made. The Division would prohibit Raymond James from hiring new registered representatives and opening new branch offices until it follows the recommendations of the independent consultant. (Div. Post-Hearing Br. 118-19.)

Raymond James characterizes this proposal as draconian and unwarranted. It maintains that Raymond James, on its own initiative, is in the process of retaining an outside consultant to evaluate its systems and report on their effectiveness. (R.J. Post-Hearing Br. 98.)

Intervention of the type the Division proposes is an extreme measure warranted when it appears that the broker-dealer will not, or cannot, take remedial action on its own initiative. The evidence does not show that to be true in this situation. I accept the representation of Mr. Helck that Raymond James has taken positive steps to remedy the regulatory deficiencies shown to have existed during the relevant period, and that it is in the process of carrying out the request of the holding company's audit committee for an outside consultant's evaluation of its compliance and supervision systems. Furthermore, almost all the persons associated with Raymond James and affiliated companies who testified were credible and displayed a positive attitude about conscientiously observing the regulatory requirements of a broker-dealer firm. For the reasons stated, I deny the request that Raymond James be required to hire an outside consultant and be prohibited from opening offices and from hiring additional registered representatives.

RECORD CERTIFICATION

Pursuant to Rule 351(b) of the Commission's Rules of Practice, 17 C.F.R. § 201.351(b), I hereby certify that the record includes the items set forth in the revised record index issued by the Secretary of the Commission on July 28, 2005.

ORDER

Based on the findings and conclusions set forth above:

I ORDER, pursuant to Section 8A(e) of the Securities Act of 1933, Section 21C(e) of the Securities Exchange Act of 1934, and Section 203(j) of the of the Investment Advisers Act of 1940, that Raymond James Financial Services, Inc., shall disgorge $5,866.25, plus prejudgment interest at the rate established under Section 6621(a)(2) of the Internal Revenue Code, 26 U.S.C. § 6621(a)(2), compounded quarterly, pursuant to 17 C.F.R. § 201.600. Prejudgment interest is due from January 1, 2001, through the last day of the month preceding the month in which payment is made.

I FURTHER ORDER, pursuant to Section 21B of the Securities Exchange Act of 1934 and Section 203(i) of the Investment Advisers Act of 1940, that Raymond James Financial Services, Inc., shall pay a civil penalty of $6,900,000.

I FURTHER ORDER, pursuant to Section 21B of the Securities Exchange Act of 1934 and Section 203(i) of the Investment Advisers Act of 1940, that J. Stephen Putnam shall pay a civil penalty of $200,000.

I FURTHER ORDER, pursuant to Section 15(b) of the Securities Exchange Act of 1934 and Section 203(f) of the Investment Advisers Act of 1940, that J. Stephen Putnam is suspended from association with any broker, dealer, or investment adviser in any supervisory capacity for a period of ninety days.

I FURTHER ORDER, that a Fair Fund pursuant to Rule 1100 of the Commission's Rules of Practice shall be established.

I FURTHER ORDER, that the allegation that Raymond James violated Section 17(a)(1) of the Securities Exchange Act of 1934 and Exchange Rule 17a-4 is dismissed.

I FURTHER ORDER, that the Division's request that Raymond James be ordered to cease and desist from violations of Sections 17(a) of the Securities Act of 1933 and Sections 10(b) and 17(a) of the Securities Exchange Act of 1934 and Exchange Act Rules 10b-5 and 17a-4 is denied.

Payment of disgorgement, prejudgment interest, and civil penalties shall be made on the first day following the day this initial decision becomes final. Payment shall be made by certified check, United States Postal money order, bank cashier's check, or bank money order, payable to the U.S. Securities and Exchange Commission. The disgorgement, prejudgment interest, and civil money penalties shall be distributed pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002 (Fair Fund distribution). The payment, and a cover letter identifying the Respondent and the proceeding designation, shall be delivered to the Comptroller, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, Virginia 22312. A copy of the cover letter and instrument of payment shall be sent to the Commission's Division of Enforcement, directed to the attention of counsel of record.

This Initial Decision shall become effective in accordance with and subject to the provisions of Rule 360 of the Commission's Rules of Practice, 17 C.F.R. § 201.360. Pursuant to that Rule, a party may file a petition for review of this Initial Decision within twenty-one days after service of the Initial Decision. A party may also file a motion to correct a manifest error of fact within ten days of the Initial Decision, pursuant to Rule 111 of the Commission's Rules of Practice, 17 C.F.R. § 201.111. If a motion to correct a manifest error of fact is filed by a party, then that party shall have twenty-one days to file a petition for review from the date of the undersigned's order resolving such motion to correct a manifest error of fact. The Initial Decision will not become final until the Commission enters an order of finality. The Commission will enter an order of finality unless a party files a petition for review or a motion to correct a manifest error of fact or the Commission determines on its own initiative to review the Initial Decision as to a party. If any of these events occur, the Initial Decision shall not become final as to that party.

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Brenda P. Murray
Chief Administrative Law Judge