

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C.

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In the Matter of :  
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STEVEN E. MUTH, : INITIAL DECISION  
RICHARD J. ROUSE, : October 8, 2004  
and BRUCE J. BATES :  
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APPEARANCES: Steven E. Muth, pro se

Richard J. Rouse, pro se

Robert M. Fusfeld and Julie K. Lutz for the Division of Enforcement,  
Securities and Exchange Commission

BEFORE: Brenda P. Murray, Chief Administrative Law Judge

### INTRODUCTION

The Securities and Exchange Commission (Commission) initiated these proceedings on November 26, 2003, pursuant to Section 8A of the Securities Act of 1933 (Securities Act), and Sections 15(b) and 21C of the Securities Exchange Act of 1934 (Exchange Act).<sup>1</sup> The Order Instituting Proceedings (OIP) alleges that Respondent Steven E. Muth (Muth), while a registered representative with Schneider Securities, Inc. (Schneider), engaged in fraudulent sales practices and misrepresented material facts to Schneider customers from December 2000 through April 2001. As a result, the OIP alleges that Muth willfully violated Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

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<sup>1</sup> In connection with this matter, Bruce J. Bates consented to the entry of sanctions barring him from association in any supervisory capacity with any broker or dealer, barring him from association with any broker or dealer with the right to reapply for association other than in a supervisory capacity after two years, and ordering him to pay a civil penalty of \$15,000. See Steven E. Muth, 82 SEC Docket 3773, 3776-77 (June 2, 2004).

The OIP alleges that Respondent Richard J. Rouse (Rouse), the former Executive Vice President and a Director of Schneider, failed reasonably to supervise Muth with a view to preventing Muth's violations of the antifraud provisions of the federal securities laws by failing to develop a system to monitor whether Muth's supervisors, including himself, were adequately carrying out their responsibilities. The OIP further alleges that Rouse failed reasonably to supervise Muth by failing to follow the firm's procedures regarding heightened supervision and failed to respond to red flags relating to Muth's misconduct. As a result, the OIP alleges that Rouse failed reasonably to supervise Muth with a view to preventing Muth's violations, within the meaning of Section 15(b)(4)(E) of the Exchange Act.

I held a four-day public hearing from June 1-4, 2004, in Denver, Colorado, during which fourteen witnesses testified, including Muth, Rouse, and seven of Muth's customers. I admitted exhibits from the Division of Enforcement (Division), Muth, and Rouse into evidence. On July 27, 2004, I admitted an additional exhibit from Rouse into evidence. On August 24, 2004, I admitted two additional exhibits from the Division into evidence.<sup>2</sup>

### **PROCEDURAL ISSUES**

On September 10, 2004, the Division filed a Motion to Strike (Motion) exhibits that Muth included with his Post-Hearing Brief. Muth filed his opposition to the Division's Motion on September 27, 2004. The Commission favors a liberal standard of admissibility. See City of Anaheim, 71 SEC Docket 191, 193-94 & nn.4-8 (Nov. 16, 1999). This standard, however, is not limitless. See 17 C.F.R. § 201.320.

Most of the exhibits accompanying Muth's Post-Hearing Brief are not relevant to the allegations stated in the OIP. The remainder were already admitted during the hearing. Moreover, none of this material is new and Muth had the opportunity to offer exhibits at the hearing. Accordingly, I GRANT the Division's Motion and ORDER the exhibits included with Muth's Post-Hearing Brief stricken from the record.

### **FINDINGS OF FACT AND CONCLUSIONS OF LAW**

The findings and conclusions herein are based on the entire record and my observation of the witnesses' demeanor. I applied preponderance of the evidence as the standard of proof for the Division's case. See Steadman v. SEC, 450 U.S. 91, 102 (1981). I have considered and rejected all arguments and proposed findings and conclusions that are inconsistent with this Initial Decision.

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<sup>2</sup> Citations to the OIP will be noted as "(OIP \_\_\_\_)." Citations to Muth's and Rouse's Answers will be noted as "(Muth Answer \_\_\_\_)," and "(Rouse Answer \_\_\_\_)," respectively. 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 Muth's and Rouse's exhibits will be noted as "(Muth Ex. \_\_\_\_)," and "(Rouse Ex. \_\_\_\_)," respectively. Citations to the Division's Post-Hearing Brief will be noted as "(Div. Post-Hearing Br. \_\_\_\_)." Citations to Muth's and Rouse's Post-Hearing Briefs will be noted as "(Muth Post-Hearing Br. \_\_\_\_)," and "(Rouse Post-Hearing Br. \_\_\_\_)," respectively. Citations to the Division's Reply Brief will be noted as "(Div. Reply \_\_\_\_)."

## Background

### Steven E. Muth

Muth is a 44-year-old resident of Aurora, Colorado.<sup>3</sup> (Tr. 17.) He attended college but did not graduate. (Tr. 18.) He was employed continuously as a registered representative from 1983 until 2001, and has received Series 7, 24, 63, and 65 securities licenses. (Tr. 18-27.)

In 1991, the National Association of Securities Dealers (NASD) censured Muth, fined him \$2,500, suspended him from association with any NASD member for ten business days, and suspended him from association with any NASD member in any principal or ownership capacity for one year. (Tr. 31-33; Div. Ex. 48.) The conduct underlying the NASD action occurred while Muth was associated with an office of supervisory jurisdiction at a broker or dealer in which he had an ownership interest. (Tr. 33.) He maintains that he did nothing wrong in connection with the NASD matter and consented to the order only because he did not have enough money to fight it. (Tr. 33, 205-06.) Muth filed for bankruptcy in 1991. (Tr. 20-21.)

Muth was named as a defendant in a case filed by the Commission in the United States District Court for the Southern District of California, in which he was charged with manipulating the market price of Creative Host Services, Inc. (Creative Host), stock from November 1999 until June 2000. (Tr. 28-31.) On August 9, 2004, the district court entered a final judgment by consent against Muth, permanently enjoining him from future violations of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. 17 C.F.R. § 201.323 (official notice).<sup>4</sup> Subsequently, Muth consented to the entry of a sanction barring him from association with any broker or dealer. See Exchange Act Release No. 50223 (Aug. 20, 2004) (official notice).

### Richard J. Rouse

Rouse is a 46-year-old college graduate who is currently employed as a branch office manager at a broker or dealer. (Tr. 250.) He has worked in the securities industry since 1981, primarily as a compliance officer, and holds Series 4, 7, 24, 27, and 63 securities licenses. (Tr. 250-52.) Rouse has known Muth since 1990, when they both worked at Cobra Securities. (Tr. 260.) Rouse has previously testified as an expert on investment suitability. (Tr. 254-55.)

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<sup>3</sup> Muth represented that, at the time of his testimony, he was currently taking various medications, none of which he believed affected his ability to answer truthfully. (Tr. 23-24.) He did, however, believe that the medications affected his concentration and memory. (Tr. 24.)

<sup>4</sup> On August 30, 2004, the Division filed a Motion to Supplement the Record, in which it sought to add a copy of the district court's final judgment in the injunctive action. Because I have taken official notice of this action and final judgment, the Division's motion is moot.

Rouse joined Schneider in April 1995 as the director of compliance and subsequently became a regional sales manager.<sup>5</sup> (Tr. 253-55.) He also was a member of Schneider's board of directors. (Tr. 848-49.) In his capacity as regional sales manager, Rouse was responsible for supervising half of Schneider's branch offices and branch office managers. (Tr. 255-56, 848-49.) Rouse's annual salary during 2000 and 2001 was between \$80,000 and \$100,000. (Tr. 872-74.)

In 1993, the Commission censured Rouse in a disciplinary proceeding. (Tr. 256-57; Div. Ex. 49.) Also in 1993, the State of Florida sanctioned Rouse and fined him \$1,000 in connection with alleged violations of that state's penny stock rules. (Tr. 258; Div. Ex. 42.) In 2000, the NASD fined Rouse \$1,500 based on the deficiency of Schneider's written policies in the areas of excessive trading and use of discretion. (Tr. 258-59; Div. Ex. 42.)

### **Muth's Association with Schneider**

#### **Muth Joins Schneider and is Subjected to Heightened Supervisory Procedures**

Until September 2000, Muth was a registered representative associated with Kirkpatrick, Pettis, Smith, and Polian, Inc. (Kirkpatrick Pettis), where he was the top salesperson. (Tr. 22, 38.) While at Kirkpatrick Pettis, Muth recommended margin purchases of Bonso Electronics International, Inc. (Bonso), and Creative Host stock to a large portion of his customers and Kelli Bates worked as his personal assistant. (Tr. 41, 58, 225-29.)

Muth's conduct while he was associated with Kirkpatrick Pettis was the subject of at least four customer complaints. (Tr. 34; Div. Exs. 26; 2050.) These complaints included unauthorized trading and failure to execute a sell order, and one referred to suitability for margin trading. (Div. Exs. 7 at 207-11; 8 at 370-74; 26; 2050.) In May 2000, Kirkpatrick Pettis initiated an internal review of Muth's sales activities, which was terminated prior to completion when Muth resigned.<sup>6</sup> (Tr. 62-63; Div. Ex. 26 at 4-5.)

Schneider recruited Muth because he was a big producer. (Tr. 47, 263-64.) Rouse, Driver, and Thomas O'Rourke (O'Rourke),<sup>7</sup> participated in the decision to hire Muth. (Tr. 228-

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<sup>5</sup> James P. Driver (Driver) replaced Rouse as Schneider's director of compliance. (Tr. 255, 343-48.) In connection with this matter, Driver consented to the entry of a sanction barring him from association in a supervisory capacity with any broker or dealer with the right to reapply for association after two years. See James Patrick Driver, 81 SEC Docket 2778, 2781-82 (Nov. 26, 2003).

<sup>6</sup> Muth is currently involved in an arbitration proceeding with Kirkpatrick Pettis, in which the firm is seeking contribution from Muth for funds it paid to his former customers. (Tr. 38-40.)

<sup>7</sup> O'Rourke worked at Schneider from May 1987 until September 30, 2002, in various capacities, including director of marketing, director of corporate finance, president, and member of the board of directors. (Tr. 847.)

29, 259-60, 788.) Rouse was aware of the customer complaints made against Muth and that Muth believed the complaints were unjustified.<sup>8</sup> (Tr. 260-61, 788.)

Rouse knew that Muth was very active in, and passionate about, Bonso and Creative Host stocks. (Tr. 264, 307.) Rouse knew that many of Muth's customers at Kirkpatrick Pettis, whose accounts Muth ultimately transferred to Schneider, had positions in Bonso and Creative Host on margin. (Tr. 264.) Rouse also knew that Muth had left Kirkpatrick Pettis because it had prohibited margin purchases of Bonso and Creative Host. (Tr. 59, 265.) Muth joined Schneider because the firm agreed to give him more freedom than he had at Kirkpatrick Pettis with respect to margin transactions in Bonso and Creative Host stocks. (Tr. 59, 635-36, 684, 734-35; Div. Ex. 2094.)

Bonso and Creative Host were high-risk stocks, suitable only for investors that had a high risk tolerance and preferred aggressive or speculative investments. (Tr. 53-57, 307; Div. Exs. 50; 51.) Creative Host was a NASDAQ Consolidated Small-Cap market stock. (Div. Ex. 50.) Its closing stock price declined steadily, from a high of \$8.75 per share on October 9, 2000, to a low of \$0.75 per share on April 12, 2001. (Div. Ex. 50.) Its daily trading volume ranged from a high of 381,400 shares on November 29, 2000, to a low of 200 shares on January 26, 2001. (Div. Ex. 50.)

Bonso's stock was listed on the NASDAQ National Market System. (Div. Ex. 51.) From October 2, 2000, until late March 2001, its closing stock price was unstable, ranging from \$6.00 to \$12.87 per share. (Div. Ex. 51.) After March 2001, it generally closed between \$4.00 and \$6.00 per share. (Div. Ex. 51.) Bonso's daily trading volume ranged from a low of 1,100 shares on November 17, 2000, to a high of 295,000 shares on April 5, 2001. (Div. Ex. 51.)

Rouse believed that Muth's concentration solely on these speculative stocks was very unusual and cause for concern as a supervisor. (Tr. 306-07.) Muth discussed with Rouse a fifty percent or less margin requirement on purchases of Bonso and Creative Host.<sup>9</sup> (Tr. 60.) Schneider made a market for Bonso and Creative Host, at Muth's request. (Tr. 59-61, 264-65, 868.)

Before Muth could associate with Schneider, the State of Colorado Division of Securities required that he be subject to heightened supervisory procedures. (Tr. 64-65; Div. Ex. 2050.) In addition to Colorado, several other states in which Muth sought to be registered imposed special supervisory procedures, granted conditional registration status, requested additional information,

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<sup>8</sup> At the time Muth was hired, none of the complaints had been adjudicated and one was later rescinded. (Tr. 789; Muth Ex. I.) One of the complaining customers was convicted of making a materially false statement to a public servant while under oath in 1997. (Muth Ex. J.)

<sup>9</sup> On December 12, 2000, a Schneider representative notified Muth and Rouse that, effective the following day, Schneider's clearing firm increased margin maintenance for Creative Host to 100 percent. (Tr. 117-20; Div. Ex. 28.) On December 27, 2000, Schneider notified Muth and Rouse that margin maintenance for Bonso would be increased to fifty percent and that future margin purchases of Bonso would not be allowed. (Tr. 123-24; Div. Ex. 29.)

or requested Muth's application be withdrawn. (Tr. 71-74; Div. Exs. 2114-2116; 2118-2120; 2122; 2124.) By letter dated October 2, 2000, and sent to the Colorado Division of Securities, Schneider agreed to adopt the following procedures to provide heightened supervision over Muth:

- (1) Muth will act only as a Series 7 registered agent conducting the majority of his business in equity securities in states in which he is registered;
- (2) Muth's direct supervisor is Rouse. Muth and his supervisor will hold quarterly reviews, which will consist of daily and monthly reviews of Muth's accounts with Colorado residents and a review for excessive activity. All new accounts with Colorado residents will be reviewed and approved by Muth's supervisor to determine the suitability of the transaction prior to the execution of the initial transaction;
- (3) All of Muth's transactions will be reviewed on a daily basis by Rouse or his designee in his absence;
- (4) Muth and Rouse will meet monthly to discuss the transactions during the period. Muth will maintain a journal of all conversations that result in a transaction with Colorado residents, and this journal will be reviewed and initialed by Rouse on a monthly basis; and
- (5) Schneider will provide the Colorado Division of Securities any written customer complaints on Muth within fifteen days of receipt.

(Div. Ex. 2050.) These supervisory procedures were the only additional ones Schneider imposed. According to Rouse, the call log requirement were the only supervisory procedure the state required that was not already required pursuant to Schneider's compliance manual. (Tr. 274-76.)

Muth joined Schneider in September 2000, and initially worked at Schneider's main office in downtown Denver. (Tr. 22, 40, 216, 788, 852.) Muth brought with him to Schneider a group of people he had worked with at Kirkpatrick Pettis, including Kelli Bates and Dan Murphy (Murphy). (Tr. 35-42, 261-62, 310-11.) In early November 2000, Schneider opened a branch office and Muth and his group relocated to that office. (Tr. 40, 53-54, 216, 266, 454, 852.) Muth was a part-owner of this branch office.<sup>10</sup> (Tr. 45, 261-62, 310-11.)

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<sup>10</sup> The branch office was physically separate from Schneider's main office and owned by Dragon Productions, LLC (Dragon Productions), an entity that Muth and others formed one month prior to joining Schneider. (Tr. 40, 45, 53-54, 216.) Muth owned the largest portion of Dragon Productions during the period of time he was associated with Schneider. (Tr. 46-47.) There was no formal, written agreement between Dragon Productions and Schneider setting forth the arrangement between the two entities. (Tr. 48-50; Div. Ex. 1 at 85-86.) The branch office received eighty percent of gross commissions it generated and a percentage of any trading profits. Schneider received the remaining twenty percent of gross commissions. (Tr. 196.)

### Bruce J. Bates is Hired as Branch Office Manager

Bruce J. Bates (Bates)<sup>11</sup> is the husband of Kelli Bates, Muth's personal assistant. (Tr. 41, 451-55.) Bates learned about the branch office manager position at the new branch office from his wife and Muth. (Div. Ex. 1 at 83-84.) On October 19, 2000, Bates was hired as branch office manager.<sup>12</sup> (Tr. 449.) Bates had virtually no prior experience supervising registered representatives, having supervised only himself and one other broker for a period of one month. (Tr. 300-01, 450.) Rouse knew about Bates's limited supervisory experience. (Tr. 300-01.) Bates received no formal training before becoming branch office manager. (Tr. 455.)

Bates received a salary of approximately \$3,500 per month and an override on commissions of the branch. (Tr. 454; Div. Ex. 2176.) The owners of the branch office, including Muth, paid Bates's salary. (Tr. 53.) The payment of Bates's salary is best illustrated as follows. For every one dollar of revenue that was earned, Schneider took twenty cents and the branch office retained the remaining eighty cents. (Tr. 267-69.) Bates's salary was paid from the eighty cents the branch retained. (Tr. 267-69.) Rouse was not concerned by this arrangement. (Tr. 303-04.)

Bates's wife worked as Muth's personal assistant for several years, including while Muth was at both Kirkpatrick Pettis and Schneider. (Tr. 41, 451-55.) According to her compensation agreement, Muth and Todd Dirks agreed to pay Kelli Bates an unspecified amount in salary, plus \$3,000 or 1.50% of their gross pay per month, whichever was greater. (Tr. 50-52; Div. Ex. 2180.) Rouse was not concerned that the wife of the branch manager was Muth's personal assistant whose salary was paid by Muth. (Tr. 304.)

Bates was an employee of the branch office, whose continued employment was subject to the branch directors' review of his performance every six months. (Tr. 198-99; Div. Ex. 2176.) Muth was a director of the branch. (Tr. 201.) The owners of the branch could replace Bates if they wanted to do so. (Tr. 383.) Rouse and Bates never discussed any conflicts that may arise as a result of Muth owning the branch and Bates being the branch office manager. (Tr. 456.)

At the time he became branch manager, Bates knew that Muth primarily recommended margin purchases of Creative Host and Bonso. (Tr. 456-58.) According to Bates, Muth was very enthusiastic about Bonso and Creative Host; he had his customers buy all day. (Tr. 466-67.) Bates became aware of the aforementioned customer complaints after he joined Schneider. (Tr. 457.) He does not recall discussing with Rouse Muth's concentration on Bonso and Creative Host or the customer complaints and the supervisory vigilance required. (Tr. 456-58, 467.)

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<sup>11</sup> Bates is 45 years old and has worked in the brokerage business since 1983, mostly as a retail registered representative. (Tr. 449-50.)

<sup>12</sup> In addition to his supervisory duties, Bates had approximately ten to fifteen personal clients. (Tr. 454.)

### **Muth's Conduct While Associated With Schneider**

In the period December 2000 through April 2001, Muth recommended Bonso and Creative Host stock to many of his customers, including the seven customers who testified. Muth's conduct surrounding the transactions of Bonso and Creative Host in these customers' accounts is summarized below.

#### **Gert DeHerrera**

Gert DeHerrera (DeHerrera) is a 47-year-old resident of Denver, Colorado. (Tr. 386; Div. Ex. 2136.) He attended college for two years, worked for the Kmart Corporation for ten years, and has been involved in real estate for the past twenty years. (Tr. 386.) DeHerrera opened his first brokerage account in 1999 at Piper Jaffray. (Tr. 387.) He traded mostly blue-chip stocks in this account and conducted twenty to thirty trades during a one-year period. (Tr. 387, 428.)

DeHerrera first met Muth approximately eight to ten years ago. (Tr. 387-89.) He loaned Muth \$5,000, which Muth never repaid. (Tr. 388-89, 424-26.) DeHerrera did not have any further contact with Muth until 1999 or 2000, at which time DeHerrera mentioned the outstanding loan to Muth. (Tr. 389-90.) Muth responded by taking DeHerrera on an all-expenses-paid business trip to China. (Tr. 390-91.)

In early November 2000, DeHerrera transferred his account to Muth at Schneider. (Tr. 392; Div. Ex. 2136.) He did not open a discretionary account. (Tr. 399.) At the time, DeHerrera's account had a \$67,000 margin balance and approximately \$85,000 in stock. (Tr. 433; Div. Ex. 2139.) Kelli Bates filled out DeHerrera's new account form, which accurately set forth his net worth as \$1.5 million, his annual income as \$100,000, and his liquid net worth as \$250,000. (Tr. 393-94; Div. Ex. 2136.) She also filled out his investment objectives and risk tolerance, which were described as eighty percent speculation and twenty percent aggressive growth, and eighty percent high risk and twenty percent maximum risk, respectively. (Tr. 394-97; Div. Ex. 2136.) DeHerrera was told that he was required to have these investment objectives and risk tolerance to have Muth as his broker. (Tr. 394-97.) His true investment objectives were twenty percent speculation, twenty percent capital appreciation, and sixty percent aggressive growth. (Tr. 396.) Contrary to the representation Schneider made to the Colorado Division of Securities, no one at Schneider contacted DeHerrera to verify his investment objectives or risk tolerance, and neither Rouse nor Bates contacted DeHerrera when he opened his account or at any time thereafter. (Tr. 398-99.)

In addition to opening a new account, DeHerrera signed a margin agreement. (Tr. 397-98; Div. Ex. 2137.) No one, including Muth, discussed with DeHerrera the risks of margin trading. (Tr. 398-99.)

The same day DeHerrera opened his account, Muth asked him if he was interested in purchasing a \$50,000 block of Creative Host stock. (Tr. 399-400.) Muth represented that its price would soon increase. (Tr. 400-01.) DeHerrera informed him that he had a large margin



balance and insufficient funds to cover the purchase. (Tr. 399-403, 421, 433-35.) Muth told him that they would check his margin balance and he was sure he could obtain the stock for DeHerrera. (Tr. 400-03, 421.) DeHerrera believed that Muth would take care of him by purchasing the stock and holding it for him because Muth had told him that he felt badly about the unpaid loan. (Tr. 422, 433-36.) Based on Muth's recent generosity, I find that DeHerrera reasonably believed that Muth was going to acquire and hold the stock for him.

Thereafter, DeHerrera embarked on a six-week vacation. (Tr. 403.) While DeHerrera was away, there was a purchase of Creative Host stock in his account, which was subsequently rescinded due to insufficient cash and margin. (Tr. 407-08.) DeHerrera did not authorize this purchase of Creative Host.<sup>13</sup> (Tr. 420-22, 433-36.)

During his trip, DeHerrera spoke with Kelli Bates, who informed him that there had been a margin call on his account and that they would have to liquidate his stocks to pay for it. (Tr. 404.) DeHerrera informed her that he should have cash in his account. (Tr. 404-06.) He requested that she notify him as to what stocks they sold, and that they use his cash first, followed by his stock holdings. (Tr. 418.)

A few days later, DeHerrera spoke to Kelli Bates again and she informed him that his stocks were liquidated to pay for the margin call. (Tr. 404-05, 439.) DeHerrera told her that there was supposed to be cash in his account and asked why they had not used it first, before they started selling his stock. (Tr. 405.) She informed him that there was no cash in his account, only stock. (Tr. 405.) In fact, the cash in DeHerrera's account at Piper Jaffray had not been properly transferred into his account at Schneider. (Tr. 401-10.) As a result, stocks were sold from DeHerrera's account. (Tr. 402-10.)

On December 19, 2000, the day after his account was liquidated and while he was still on vacation, there was a margin purchase of 10,000 shares of Creative Host stock into DeHerrera's account. (Tr. 406-08; Div. Ex. 2140.) DeHerrera, again, did not authorize this purchase. (Tr. 407-08, 420-22, 438.)

In January 2001, DeHerrera met with Muth to complain about these transactions, and Muth assured him that he would look into it. (Tr. 410.) Neither Bates nor Rouse attended this meeting. (Tr. 411.) In February 2001, DeHerrera faxed Schneider a letter complaining about the unauthorized trades and the failure to transfer his cash properly. (Tr. 410-11; Div. Exs. 32; 2138.) Bates responded within minutes and told DeHerrera that he had received the letter and would have to send it to the main office. (Tr. 411-12.) He also told DeHerrera to send a second letter requesting his complaint be tabled, because it would cause less trouble and be handled more expeditiously. (Tr. 413.) DeHerrera complied with Bates's request. (Tr. 413; Div. Ex. 32.) DeHerrera understood Bates to be Muth's subordinate, based on his past dealings with both. (Tr. 413-15.)

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<sup>13</sup> In making this finding, I am cognizant that Muth's handwritten call log indicates that DeHerrera authorized this purchase. (Div. Ex. 2051.) However, given my assessment of Muth's and DeHerrera's credibility, set forth below, I find the contrary to be true.

Subsequently, DeHerrera met with Muth, Bates, and others at the Schneider branch office. (Tr. 415.) After discussing the Creative Host trades in his account, he was informed that Schneider had misplaced his cash during the transfer and it had ended up in a separate account. (Tr. 415-16.) DeHerrera provided Muth and Bates with documents relating to his accounts at Schneider, which were never returned to him.<sup>14</sup> (Tr. 419-20.) The meeting ended with Bates and Muth agreeing to handle the matter within ten days. (Tr. 416-17.)

Approximately two weeks later, DeHerrera unsuccessfully attempted to contact Muth. Another two weeks later, Todd Dirks called him, stating that he was his new account manager and Muth had left. (Tr. 417.) DeHerrera's complaint was never resolved. (Tr. 418.) When he closed his account, all that remained in DeHerrera's account was \$20,000 he invested following the transfer to Schneider. (Tr. 420-21.) DeHerrera does not know what a "market not held order" is, but understands how margin trading works and the basics of options.<sup>15</sup> (Tr. 421, 427.)

### Gloria Poljanec

Gloria Poljanec (Poljanec) is a 75-year-old widow, and a resident of Littleton, Colorado. (Tr. 525-27.) Her sole sources of income since 2000 have been Social Security and her husband's pension. (Tr. 526.) Poljanec trusted and relied on Muth. (Tr. 561, 578; Muth Ex. K.)

On October 25, 2000, Poljanec transferred her account from Kirkpatrick Pettis and opened an account with Muth at Schneider.<sup>16</sup> (Tr. 527, 536-37; Div. Exs. 2067; 2068.) Poljanec did not fill out the investment objectives, financial information, and risk tolerance portions on her new account form. (Tr. 531; Div. Ex. 2067.) Her net worth is accurately described as \$300,000, but her annual income was actually \$36,000, not \$70,000, as stated on the form. (Tr. 531-32; Div. Ex. 2067.) Poljanec's previous investment experience was accurately described as more than ten years. (Tr. 532.) Poljanec's investment objectives were set forth as including fifty percent speculation and thirty percent aggressive growth. (Tr. 533-34; Div. Ex. 2067.) Her risk tolerance was described as fifty percent maximum risk, thirty percent high risk, and twenty percent businessman's risk. (Div. Ex. 2067.) Poljanec had never discussed these figures with anyone at Schneider before they were entered on her form. (Tr. 533.) No one at Schneider contacted Poljanec to verify her risk tolerance or investment objectives, and she was not contacted by Rouse or Bates upon opening her account. (Tr. 533-36.)

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<sup>14</sup> Schneider was unable to produce, pursuant to a subpoena, certain documents relating to DeHerrera's accounts. (Tr. 491-95.) The branch office manager believed that Muth may have taken the documents when he left Schneider. (Tr. 496.)

<sup>15</sup> A "market not held order" to buy or sell securities indicates that the customer has given the floor broker time and price discretion in executing the best possible trade, but will not hold the broker responsible if the best deal is not obtained. John R. D'Allessio, 79 SEC Docket 3627, 3633 n.17 (Apr. 3, 2003).

<sup>16</sup> Poljanec's account statement at Kirkpatrick Pettis for the period ending August 31, 2000, showed that she had more than \$36,000 in stock, including Bonso, a margin balance of almost \$4,000, and a total portfolio value of approximately \$33,000. (Div. Ex. 2068.)

Since before opening her account, Poljanec took care of her husband and sister, both of whom had been suffering from Alzheimer's disease. (Tr. 528.) In addition, Poljanec's daughter had undergone brain surgery. (Tr. 528.) Poljanec's husband entered a nursing home in 1999 and she knew the bills would accumulate, so she did not want to take any unnecessary investment risks. (Tr. 528-29.) Her husband's nursing home, for example, cost at least \$3,000 per month. (Tr. 536.) Poljanec wanted to be very conservative with her investments because she knew that she would need the money. (Tr. 534-35; Muth Ex. K.) She did not want to invest in risky or speculative stocks. (Tr. 534, 543-44, 561.) When she opened her account, Poljanec informed Muth of her personal circumstances and that she did not want to take risks. (Tr. 172, 528-29, 536; Muth Ex. K.) She also told Muth that she was an elderly woman with little investment experience, and needed the money in her account to pay for medical bills. (Tr. 534-36; Muth Ex. K.)

On January 23, 2001, Poljanec signed a margin trading agreement. (Tr. 560; Div. Ex. 2069.) Although Poljanec previously told Muth repeatedly that she did not want to trade on margin and could not afford margin calls, Muth pressured her until she could not say no to opening a margin account and trading on margin. (Muth Ex. K.) In particular, Muth told her that margin trading would not cost her any money, she would become a millionaire, and he could double her money quickly. (Tr. 539; Muth Ex. K.) No one at Schneider, including Muth, explained margin trading or its risks to Poljanec. (Tr. 539.)

No trades were made in Poljanec's account from November 2000 through January 2001. (Div. Exs. 2070-72.) In February 2001, Poljanec made two margin purchases of Bonso, one for 1,200 shares and the other for 500 shares, based on Muth's representations that a research report would be published that week that would drive its price up and enable her to get 100 percent of her investment back. (Tr. 540-43; Div. Ex. 2073; Muth Ex. K.) He also told her that he had mortgaged his home and put all of his money towards buying Bonso. (Muth Ex. K.) She remembers that Muth was "really pushing hard" to have her buy Bonso stock. (Tr. 541-42.) Contrary to Schneider's representation to the Colorado Division of Securities, no one at Schneider, including Rouse and Bates, contacted Poljanec about these transactions, her first since transferring her account to Schneider. (Tr. 542.)

On March 7, 2001, one day before the death of her husband, a margin purchase of 1,000 shares of Creative Host was made in Poljanec's account. (Tr. 543-45; Div. Ex. 2074.) Poljanec does not recall having any conversations with Muth about Creative Host. (Tr. 543-44.) She seriously doubts that she authorized Muth to make this purchase due to the stress that she was under at that time. (Tr. 544-45.) Given the proximity in time to her husband's death, her condition around this same time, and the fact that she does not remember discussing Creative Host with Muth, I find that Poljanec did not authorize this transaction.

Thereafter, Poljanec instructed Muth to sell Bonso to pay for expenses, but he repeatedly talked her out of selling the shares by representing to her that she would throw off the market and the price would drop if she sold. (Tr. 545-51, 564, 573; Muth Ex. K.) On March 29, 2001, Poljanec received a margin call. (Tr. 548; Div. Ex. 2075.) She instructed Muth to get her out of the investment. (Tr. 548-49; Muth Ex. K.) He told her that he would sell her stock only if she

paid the margin calls. (Muth Ex. K.) Poljanec received another margin call on April 4, 2001, after which she called Muth to obtain an explanation. (Tr. 550-51; Div. Ex. 2076.) She spoke with Murphy and told him that she needed to get out of the investment, and he told her that he would have Muth call her back. (Tr. 551.) Muth never returned her phone call. (Tr. 551.) Poljanec also paid \$2,040 to satisfy a margin call because Muth told her that she needed to make payment immediately or she would lose everything. (Tr. 552-54, 564, 577; Div. Ex. 2081.)

In April 2001, Poljanec's account was essentially liquidated to cover the margin calls. (Tr. 551-52; Div. Ex. 2079.) In July 2001, Poljanec filed a complaint with the Commission. (Tr. 555; Div. Ex. 2077.) Schneider was notified about the complaint on July 12, 2001. (Div. Ex. 2077.) Poljanec reached a settlement with Schneider relating to Muth's handling of her account, pursuant to which Schneider reinstated 3,800 shares of Bonso and 500 shares of New China Homes, Ltd., and credited her account \$2,040. (Tr. 555-58; Div. Ex. 2078.)

Muth never told Poljanec that she was investing in risky and speculative stocks. (Tr. 562.) She does not know what a market not held order is, and Muth never informed her that he was entering such an order. (Tr. 556.)

### Tina Saltzman

Tina Saltzman (Saltzman), Poljanec's daughter, is a 55-year-old resident of Sadalia, Colorado. (Tr. 173, 583.) She has a master's degree in organizational management. (Tr. 625.) She does not consider herself to have been an experienced investor in 2000. (Tr. 583.) Saltzman had brain surgery in 1998, and during 2000 and 2001, her father was in a nursing home, prior to which she had helped her mother care for him. (Tr. 603-04.) Muth was the registered representative on Saltzman's account since before he worked at Kirkpatrick Pettis.<sup>17</sup> (Tr. 583-84.) Saltzman trusted and relied on Muth. (Tr. 603-05.)

When Saltzman transferred her account to Schneider, it had positions in Bonso and Creative Host, a margin balance of more than \$4,400, and total value of more than \$19,000.<sup>18</sup> (Tr. 584, 601-02; Div. Ex. 2163.) Saltzman's risk tolerance was moderate, a fact which she had previously communicated to Muth. Her investment objectives were income and growth for her son. (Tr. 584-85, 607.) She never informed Muth that she wanted to pursue a high-risk investment strategy. (Tr. 585-86, 607.) No one at Schneider inquired about her risk tolerance and investment objectives when she opened her account or at any point thereafter. (Tr. 586.)

On December 29, 2000, Saltzman purchased 1,000 shares of Creative Host on margin, based on Muth's representations that Creative Host was a phenomenal company, it would be one of the hottest stocks around, and she had to have it. (Tr. 588-90; Div. Ex. 2164.) He also represented that its stock price would soon reach \$20, \$40, and even \$80 per share. (Tr. 589-90.)

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<sup>17</sup> Saltzman's account was not for her benefit; rather, it was for the benefit of her son, a former student at the United States Air Force Academy. (Tr. 585.) He asked her to handle the account for him and gave her power of attorney. (Tr. 585.)

<sup>18</sup> The Division did not have a complete set of Saltzman's account documents. (Tr. 585.)

Muth never told her that he was making the purchase on margin, and she never authorized him to do so. (Tr. 589.) Contrary to Schneider's representation to the Colorado Division of Securities, neither Rouse nor Bates contacted Saltzman following this transaction, her first transaction at Schneider. (Tr. 594; Div. Ex. 2164.)

Saltzman purchased additional Bonso stock based on Muth's representations that its price would soon reach \$20, \$40, and even \$100 per share. (Tr. 590.) Muth also represented that a research report on Bonso would be released soon that would affect its price favorably. (Tr. 591.)

Saltzman instructed Muth to sell her Bonso stock on several occasions because it had risen in value and the proceeds would enable her son to pay off some debts and buy a house. (Tr. 591-93.) Muth refused and convinced her to not sell, saying that its price would go up, he was unable to sell it, and selling the stock would "upset the balance." (Tr. 591-93.) Saltzman complained only to Muth about his failure to sell because she believed he was the person in charge. (Tr. 594-95, 619-20.)

After Muth refused to execute Saltzman's sell orders, Bonso's stock price dropped. (Tr. 597.) As the balance in her account declined, she started owing money due to margin calls. (Tr. 597-98.) Saltzman estimates that she paid almost \$30,000 in margin calls. (Tr. 598.) She had also received margin calls when her account was with Kirkpatrick Pettis. (Tr. 616.)

Saltzman signed a margin agreement on April 16, 2001, after there had been margin trading in her account. (Tr. 593, 608; Div. Ex. 2162.) She signed it only after Muth called her and told her that she had to sign it, otherwise she would lose everything. (Tr. 593-94, 608.) No one at Schneider explained the risks of margin trading to Saltzman, and she has never heard of a market not held order. (Tr. 594-95.)

#### Robert J. Cassidy

Robert J. Cassidy (Cassidy) is a 76-year-old retired plumber, and a resident of Denver. (Tr. 634-35.) He retired in 1993. (Tr. 635.) Muth has been Cassidy's representative since before Muth worked at Kirkpatrick Pettis. (Tr. 635-36.) Cassidy transferred his account to Schneider because he had invested in Bonso and Creative Host and Muth was the only broker who knew anything about these stocks. (Tr. 636-37.) Cassidy had never traded on margin prior to meeting Muth. (Tr. 640-41.) Muth was aware that Cassidy had a heart condition. (Tr. 655, 673.)

Murphy filled out Cassidy's new account form, dated January 31, 2001, which Cassidy signed without reading over in detail. (Tr. 637-39; Div. Ex. 38.) The form identified Cassidy's risk tolerance as fifty percent businessman's risk, thirty percent high risk, and twenty percent maximum risk. (Div. Ex. 38.) Cassidy is unaware how this was determined and believes these risk tolerance levels were inappropriate due to his age. (Tr. 639.) His net worth was described accurately as \$535,000, and his annual income and liquid net worth were described as \$40-45,000 and \$25,000, respectively. (Tr. 637; Div. Ex. 38.) While his investment objectives included twenty percent speculation and thirty percent aggressive growth, Cassidy believes that he should not have been invested in speculative or risky stocks, due to his health problems. (Tr.

654-55; Div. Ex. 38.) Muth did not inquire as to Cassidy's investment objectives or risk tolerance, and neither Rouse nor Bates contacted him when he opened his account. (Tr. 640-41.)

Cassidy signed a margin agreement, dated January 18, 2001, without reading it. (Tr. 640, 654; Div. Ex. 38.) No one at Schneider explained margin trading and its risks to Cassidy. (Tr. 640-48, 654.) The words "Doesn't Qualify" are written across the top of the margin agreement, which indicates that someone at Schneider determined that Cassidy did not qualify to trade on margin. (Div. Ex. 38.)

When Cassidy transferred his account to Schneider, it had positions in Bonso and Creative Host, a margin balance of approximately \$100, and a total value of almost \$102,000. (Div. Ex. 38.) Thereafter, Cassidy "got talked into [buying stock]" by Muth on several occasions. (Tr. 655.) In December 2000, Cassidy purchased 4,700 shares of Bonso on margin in three separate transactions based on Muth's representations that it would go "sky high" and its price would reach at least \$40 per share. (Tr. 642-44; Div. Ex. 38.) Muth never informed him that Bonso was a risky investment. (Tr. 642-44.) Cassidy also purchased 3,500 shares of Creative Host on margin in December 2000 based on Muth's representations that Creative Host was a good stock with no risk and its price would go sky high. (Tr. 645; Div. Ex. 38.) These transactions occurred before Cassidy had signed the margin agreement or new account form. (Tr. 136-38; Div. Ex. 38.) At least one of Cassidy's purchases of Bonso was entered as a market not held order. (Div. Ex. 2060.)

In February 2001, Cassidy purchased 3,000 more shares of Bonso on margin at Muth's recommendation. (Tr. 647; Div. Ex. 38.) More specifically, Muth called Cassidy and told him to buy Bonso, whereupon Cassidy told Muth that he did not have enough money. (Tr. 647.) Muth told Cassidy that it "would not cost him a dime" if he bought it on margin. (Tr. 647.) In March 2001, Cassidy purchased 3,000 more shares of Creative Host on margin based on Muth's representation that it was a sure thing. (Tr. 647; Div. Ex. 38.)

Cassidy soon received margin calls. (Tr. 640-41, 648-49, 670.) In April 2001, shares of Creative Host and Bonso were sold from Cassidy's account to pay margin calls after Cassidy refused to pay them. (Tr. 649; Div. Ex. 38.) As a result, Cassidy's account balance at the end of April 2001 was a little more than \$1,000. (Div. Ex. 38.)

At one point, Cassidy told Murphy that he wanted to sell some of his Creative Host stock, but Murphy initially refused, telling Cassidy it would hurt the stock price. (Tr. 646-52.) According to Cassidy, Muth knew that he wanted to sell because Murphy worked for Muth and Murphy would not sell without Muth's prior approval. (Tr. 646, 662-63.) Cassidy also asked Muth directly to sell his Bonso stock on three or four occasions, but Muth talked him out of it by representing that the price would go up. (Tr. 646-52, 662.) In May 2001, Cassidy transferred his account from Schneider. (Tr. 650.) He has never heard of Bates or Rouse. (Tr. 649-50.)

### Bernald Acker

Bernald Acker (Acker) is a 68-year-old resident of Castle Rock, Colorado, who has been retired since 1998. (Tr. 683-84.) Muth was Acker's account executive at Kirkpatrick Pettis.

(Tr. 684.) Acker transferred his account to Schneider for convenience. (Tr. 685.) At the time of the transfer, Acker's account held shares of Bonso, had a margin balance of more than \$4,000, and a total value of approximately \$55,000. (Div. Ex. 2097.)

No transactions took place in Acker's account during November 2000. (Div. Ex. 2098.) In late December 2000, Acker called Muth because he wanted to sell his Bonso stock, but Muth talked him out of it by representing that its price would go up. (Tr. 687.) Muth then told Acker that he should buy Creative Host because its stock price would go up significantly due to the disposition of pending litigation against the company. (Tr. 687-88, 699.) Muth predicted the price would explode and it was "a steal" at its current price. (Tr. 689, 699.)

Acker informed Muth that he did not have sufficient funds to make the purchase, and Muth responded by telling him that he could buy it on margin. (Tr. 688.) Acker told Muth that he did not like margin accounts, but Muth kept reiterating that the price would increase significantly in a matter of days. (Tr. 688.) Acker relented and told Muth that he would buy 5,000 shares; however, Muth insisted that Acker buy 10,000 shares. (Tr. 688.) Acker relented again and purchased 10,000 shares of Creative Host on margin based on Muth's representations. (Tr. 687-88; Div. Ex. 2099.) Acker had not signed a margin agreement or new account form at the time of this purchase. (Tr. 692; Div. Exs. 2095; 2096.)

Muth never told Acker that Creative Host was a speculative, risky stock, and Acker never told Muth that he was interested in purchasing such stocks. (Tr. 689.) Muth did not disclose to Acker any risks associated with purchasing Creative Host. (Tr. 689.) At the time of the purchase, and contrary to Schneider's representation to the Colorado Division of Securities, no one at Schneider inquired as to Acker's risk tolerance or investment objectives. (Tr. 692-93.) At the time margin trading began in his account in December 2000, no one at Schneider had explained to Acker the risks of margin trading. (Tr. 699.)

On January 9, 2001, Acker received a margin call and told Muth that he did not have the funds to cover it. (Tr. 690-91; Div. Ex. 2101.) Muth informed Acker that he would have to sell stock in Acker's account to pay for it. (Tr. 691.) After receiving this margin call, Acker repeatedly tried to sell all of the Bonso and Creative Host stock he held to recoup his losses, but Muth refused, telling him that the prices would increase. (Tr. 691, 700-06, 713.) Muth also predicted that Bonso's price would increase dramatically, due to the imminent release of a glowing research report. (Tr. 700-01.)

Subsequently, Schneider sent Acker a new account form, that Acker signed on January 31, 2001, and Acker was told that he needed to return it quickly. (Tr. 692-94; Div. Ex. 2095.) When Acker received the new account form, the investment objectives and risk tolerance portions were already filled out for him. (Tr. 693-95.) The form set forth Acker's investment objectives as fifty percent speculation, thirty percent aggressive growth, and twenty percent capital appreciation. (Tr. 693-94; Div. Ex. 2095.) It set forth his risk tolerance as fifty percent maximum risk, thirty percent high risk, and twenty percent businessman's risk. (Tr. 694-95; Div. Ex. 2095.) Acker is unaware as to how these determinations were made because no discussions had taken place. (Tr. 694-95.) His true investment objectives and risk tolerance are speculative growth and moderate, respectively. (Tr. 696.)

The form accurately described Acker's net worth as \$1.2 million. (Tr. 697; Div. Ex. 2095.) Acker's annual income in 2000 was less than \$60,000 and was derived from his pension and Social Security. (Tr. 684, 697.) His liquid assets were approximately \$100,000, not \$800,000, as described on the form. (Tr. 709; Div. Ex. 2095.)

Acker received a margin agreement after he had already purchased Creative Host on margin and received a margin call. (Tr. 695; Div. Exs. 2096; 2101.) Acker understood what a margin agreement was but did not understand how margin trading worked. (Tr. 731.) Acker signed the agreement on January 19, 2001, without reading it because he believed it was simply a standard form. (Tr. 731.)

Thereafter, Acker received additional margin calls and had to sell Bonso and Creative Host.<sup>19</sup> (Tr. 702-04; Div. Exs. 2104; 2105.) In or about May 2001, Acker closed his account at Schneider with a zero balance. (Tr. 707; Div. Ex. 2107.) Acker does not know what a market not held order is, and Muth never told him that he was entering transactions in Acker's account as market not held orders. (Tr. 708.)

#### Paul V. Lundy, Jr.

Paul V. Lundy, Jr. (Lundy), is a 75-year-old resident of Boulder, Colorado, who is a college graduate and retired employee of the federal government. (Tr. 734, 767.) He worked part-time as a securities broker from 1958 through 1960 and has traded commodities and stocks in the past. (Tr. 734, 767-68.) Lundy transferred his account to Schneider from Kirkpatrick Pettis in October 2000, at which time he owned positions in Bonso and Creative Host, and his account had a total value of more than \$49,000, with minimal margin debt. (Div. Exs. 2009; 2010.)

Lundy did not fill out most of his new account form at Schneider, including his financial information, investment objectives, and risk tolerance. (Tr. 735-40, 757; Div. Ex. 2007.) He was not consulted before these portions were filled out. (Tr. 740.) Rather, per Muth's instructions, Lundy signed and returned to Muth a blank form quickly because he trusted Muth. (Tr. 741, 757-60.) Lundy's net worth is described accurately therein as \$250,000. (Tr. 736-37; Div. Ex. 2007.) His annual income for 2000 was \$45,000, not \$50,000 as set forth on the form, and his liquid net worth was described as twice its actual amount. (Tr. 735-37; Div. Ex. 2007.)

The new account form described his investment objectives incorrectly as thirty percent speculation, fifty percent aggressive growth, and twenty percent capital appreciation. (Tr. 738, 756; Div. Ex. 2007.) His true investment objectives were thirty percent aggressive growth, fifty percent capital appreciation, and twenty percent conservative income. (Tr. 739.) This is consistent with his investment objectives while at Kirkpatrick Pettis. (Div. Ex. 2009.) The form also overstated Lundy's risk tolerance, describing him as more risk-oriented than he actually was. (Tr. 739-40, 756; Div. Ex. 2007.) Lundy never told Muth that he was interested in high-

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<sup>19</sup> On one occasion, Acker paid \$3,000 because he wanted to save the remaining stock he owned. (Tr. 706; Div. Ex. 2106.)



risk trading. (Tr. 739.) Lundy did not sign a margin agreement when he opened his account. (Tr. 741, 752.)

No transactions were effected in Lundy's account during October or November 2000. (Div. Exs. 2010; 2011.) In December 2000, however, Lundy purchased 5,000 shares of Bonso on margin after receiving a telephone call from Muth. (Tr. 743-44; Div. Exs. 2012-14.) Lundy recorded the conversation, which is summarized as follows:

Muth: We're the biggest franchiser of Schneider . . . We make money through research, we control the research of Schneider . . . And the beauty of this, we have two big research reports and guess who they're on? Creative and Bonso.

Lundy: Creative sure as hell needs it.

Muth: Right. You just wanna hold tight on Creative, you don't wanna be buying it right now even though it's cheap, I think it's gonna be the buy of the century in my opinion soon. The problem is I—we've been buying up blocks of stock from Kirkpatrick Pettis and we're finishing up all the resistance. Once we get those guys out . . . then I think the Creative is gonna start running like crazy.

Muth: The Bonso, we—we've got a major report on them and I talked to the company. In my opinion the biggest announcement in the company's history is going to come out as early as next week. We're getting ready to come—and I told you like I told you in the beginning I was gonna call ya and take care of you before things start happening. But anyway, in my opinion, this Bonso is gonna start taking off hard.

Muth: [L]et me explain our company. . . As of Friday, we're hoping to have all of our paperwork complete. We can—see, we can buy and sell, but once our company is complete, we have sort of a mutual fund with our company. So our mutual fund, it's like a hedge fund, can go in—it—it's our inventories, we can go and buy up \$4 million worth of these stocks or Bonso and stuff.

Lundy: Yeah.

Muth: That we believe in through our company, because we have our inventories up which could show a significant difference in the stock. And that's what we expect to be up Friday. So we—once our inventories are up, we plan on comin' in and utilizing all of our money to buy up the Bonso like crazy where then I think the Bonso's gonna come out with some huge numbers as well as announcements here soon.

Lundy: When you say soon, what do you mean, next week or so?

Muth: I think next week.

Muth: And not only that, I think our research report which is an eight page research report—and by the way I—I’ve been reading it, you won’t get it for about another two, three weeks, in fact, this is how I feel pretty confident there’s a huge announcement coming. . . [A]nd [the president of Bonso] says, Just wait one more-two more weeks. This was last week when I talked to him. Two more weeks, two more weeks. And I says, if we can come out with something, we can incorporate that in our research report. And he goes, biggest announcement in history, two weeks, just wait two weeks. . . But I do know this, the numbers that are coming out in January, I expect to be, in my opinion, at least a 400 percent increase in earnings and at least a 200 percent increase in sales. . . [T]heir sales alone could triple without any new contracts just because they’re purchasing raw materials. . . [T]heir earnings would probably increase by about ten percent or so, fifteen percent. But their sales would increase by literally probably 300 times.

Muth: I’m gonna take care of you before they start comin’ in big time in this thing. And—and what I was gonna recommend is buying and—and looking, if you know, the margins made you a lot and remember why I told you we came over to—to this company? Because PaineWebber is our clearing agent and PaineWebber give—gave us when we first negotiated our deal—remember Kirkpatrick Pettis kept giving us margin calls?

Lundy: Yeah.

Muth: No more.

Lundy: I got—it’s a death, you know, up to eighty percent.

Muth: Oh, I know. They—they were cockroaches. Here we negotiated a fifty percent rate and that’s our deal. Fifty percent.

Lundy: Yeah, but is it gonna stay that way?

Muth: That’s what we negotiated on. No messing around. And remember, I told ya, we own the company now. So the—we negotiated a fifty percent rate; we own the company. And I’ll give you an example—

Lundy: Can you guarantee no increase in the margin?

Muth: No, I can’t. But I can tell you this much, if they go in to increase it, which I can tell you according to our contracts with ‘em, they said that they’re—they told us it would be fifty percent. And we didn’t say the words, guaranteed, but they said, fifty percent ratio. That’s the deal. They—I can tell you this much, that we’ve negotiated—if there are any problems, we have the ability to put up what’s called subordinated loans against our margin.

Muth: Dragon Productions is what owns our company, Dragon Productions will own the—the hedge fund which could put up the subordinated loans. Now, at this point in time, 100 percent PaineWebber has honored, 100 percent everyone that came over—that came over is sitting, you know, loaded with money, because the deal we structured.

Muth: But I think you're gonna start seeing a very big move starting right—today. In fact, in minutes. That's why I promised you I'm taking care of you as much as I can, and that's why I started this company so we could have research come out.

Muth: We also have our own trading here and then once our fund is set up Friday I think you're gonna see huge, huge, huge money comin' into—into the Bonsos and Creatives. That's why I wanna get my customers up before the fund is set up. . . [T]hat's why we're getting ready to go berserko on this thing. So what I would recommend is we can do 5,000 no problem whatsoever. No mar—no money, you know, your margin should be no problem whatsoever. You could probably go about 8 or 9 but I'm goin' just conservative, so I don't even have to worry about anything. . . And then next week cross your fingers this is humongous, I mean who knows, maybe this thing finally runs like crazy.

Lundy: Well, I sure can't take any more margin calls.

Muth: I know.

Lundy: [T]his—you nickeled and dimed me to death—

Muth: I know.

Lundy: --on this—

Muth: I know.

Lundy: --last go 'round.

Muth: I know.

Lundy: [H]ell, I'm retired.

Muth: I know.

Lundy: I'm 72 years old and I'm just telling you this is where I'm at.

Muth: I know.

Lundy: I had to go into hock.

Muth: Well, I'll put it this way, I really believe the Bonso's about ready to run on us. And I do believe this, if Bonso runs, you might as well hang onto your pants and start up buying up Creative, because hang on—because we're gonna come in with so many millions of dollars it ain't even gonna be funny in Creative.

Lundy: You got research on Creative, too?

Muth: Yes, An eight-pager.

Muth: [I]f Bonso was to trade equivalent to that company's valuation on a book-to-price earnings per share—and you'll see this in our research report, we show broken down all the contract manufacturers, we show the scale companies, Bonso would be trading literally at like \$150. . . It's pretty unbelievable what's happening over there. I—I mean I'm so excited, I can't stand it.

Muth: [W]e're excited. I am so excited, and I think finally this darn stock is gonna take off and go to an appropriate level like one of these measurement companies or one of these—

Lundy: What do you see it—

Muth: --luxury—

Lundy: --going to reasonably?

Muth: Well, if you read the—

Lundy: Conservatively, okay.

Muth: --research report, I think we're gonna, I mean I don't—I don't know what projection price the analyst is gonna put on it, but after reading some of the compatibles, I think it's an \$80 stock this year.

Lundy: This year?

Muth: Yeah.

Lundy: Now, wait before—before the first of the year?

Muth: No, no. [I mean the next twelve months.]

Muth: I promised I'd take care of you and just hang tight is all I can say. We're gonna start jammin' on this thing. And just watch it next week and cross your fingers, you know, and—and give it about two weeks maybe three weeks on our research report.

Lundy: Okay.

Muth: But the research we—I—if you wanna come in the office, I'll let you read it, but I can't sen[d] it out to ya.

Lundy: Until when?

Muth: In fact, I promise, we're gonna have dinner, I'm gonna—we're gonna celebrate. Let's celebrate right now.

Lundy: I'm conservative.

Muth: I—I honestly believe we finally have—okay, let's see if next week we have something.

Lundy: So you're talking about 5,000 shares on margin now?

Muth: Yes, Yes. And I think—I think you're gonna be—

Lundy: With no margin calls?

Muth: No margin calls, no money due, no none of that.

Lundy: Okay. That seems pretty—pretty great if it works out that way, but it hasn't in the past and that's why I'm a little—

Muth: Well—

Lundy: --leery.

Muth: --that's why we started our own company.

Lundy: Okay. . . . But I've . . . got your word on this now there's not gonna be any margin call 'cause I'm getting—this is the Christmas season, I'm pretty—

Muth: I know.

Lundy: --damn short.

Muth: You—no, you'll be fine. And I'll call you if there's any problems, but I've already double-checked, triple-checked and we've already structured our deal, so I'm not concerned in the least bit.

Lundy: Okay.

(Tr. 743-46; Div. Exs. 2013; 2014.)

Muth filled out portions of the order ticket for Lundy's margin purchase of 5,000 shares of Bonso and entered it as a market not held order, although they did not discuss such an order during their conversation. (Tr. 192; Div. Exs. 2013; 2014; 2060.) Subsequently, Lundy received margin calls and immediately tried to contact Muth, because Muth had assured him repeatedly that there would be no margin calls. (Tr. 162-63, 746, 748, 762, 777; Div. Ex. 2015.) Muth, however, evaded Lundy for the most part, and Lundy felt that he had been had. (Tr. 748.) Eventually, Muth and his associates, including Driver, spoke with Lundy and told him that the margin call was binding and he had to cover it immediately. (Tr. 749.) Lundy expressed disbelief at this, because he had not signed a margin agreement. (Tr. 749.) On December 28, 2000, shares of Bonso in Lundy's account were sold to cover the margin call without any prior notice to Lundy. (Tr. 752-53; Div. Ex. 2012.)

In early January 2001, Lundy received a margin call for approximately \$4,700. (Tr. 750.) Lundy, again, expressed disbelief, due to the lack of a margin agreement. (Tr. 750.) Lundy eventually paid the second margin call by wire transfer because he felt that he had no alternative. (Tr. 750.) Thereafter, Lundy participated in a teleconference with Muth and Bates, during which Lundy complained about the margin trading. (Tr. 751-52.)

On January 18, 2001, Lundy sent a complaint letter to the Commission. (Tr. 753; Div. Ex. 2059.) By the end of that month, Schneider received a letter from the Commission, which indicated that Lundy had taped his conversation with Muth. (Tr. 353-54; Div. Ex. 9 at 429.) Muth subsequently drafted a response in which he attempted to explain his representations. (Div. Ex. 2019.) Ultimately, Schneider received a copy of the tape and played it at a meeting held on May 10, 2001, which was attended by Muth and members of Schneider's board of directors, including Rouse. (Tr. 344-45, 353; Div. Ex. 2132.) After listening to the tape, the attendees discussed its contents and Muth agreed that Lundy was not suitable for the transaction. (Tr. 345-50; Div. Ex. 2132.) Driver agreed with this assessment. (Tr. 345-46.) Following the meeting, Muth was suspended for two weeks and then permitted to resign. (Tr. 243, 293.)

In May 2001, Driver sent Lundy a letter outlining proposed settlement terms between Lundy and Schneider, based on Muth's conduct. (Div. Ex. 2021.) In July 2001, Lundy entered into a settlement with Schneider, which restored his account to where it was when he transferred it to Schneider. (Tr. 755; Div. Ex. 2022.)

### John Nabozniak

John Nabozniak (Nabozniak) is a 67-year-old resident of Edmonton, Alberta, Canada. (Tr. 804.) He attended college in Montreal, and is an engineer. (Tr. 805.) Nabozniak began investing shortly after college and, since that time, has typically made medium-risk investments while avoiding high-risk investments. (Tr. 805.) Nabozniak's policy was to invest primarily in blue-chip stocks, with small amounts in speculative investments. (Tr. 805-07.) He considers himself to be of "average" sophistication in terms of investing experience. (Tr. 824.)

Muth took over Nabozniak's account while at another firm. (Tr. 806-07.) Nabozniak told Muth that he had a medium risk tolerance and was not willing to purchase on margin

because he had previously lost money purchasing blue-chip stocks on margin. (Tr. 806-07.) Based on his positive experience with another representative at the firm, Nabozniak gained trust in the firm's employees, including Muth. (Tr. 807, 829.) As a result, Muth convinced Nabozniak to purchase on margin, telling him there was no other way to make money. (Tr. 806-07; Div. Ex. 39.)

Nabozniak transferred his account to Schneider around the time when its value had declined, causing him to panic. (Tr. 818; Div. Ex. 39.) He was under a great deal of work-related stress and did not inspect his account statements and forms in detail. (Tr. 817.) He owned positions in Bonso and Creative Host, had a margin balance of more than \$5,500, and his account had a total value of more than \$28,000. (Div. Ex. 39.)

Nabozniak did not fill out his new account form; rather, he was sent a blank form, which he signed and returned for Muth to complete afterwards. (Tr. 817-18, 825.) This was consistent with his relationship with Muth at other firms. (Tr. 825-26.) In his new account form, his risk tolerance was described as including fifty percent maximum risk, which was too high. (Tr. 809; Div. Ex. 39.) He never noticed that the risk tolerance was inaccurate because he did not inspect his account statements in detail. (Tr. 817-19.) His net worth, annual income, and liquid net worth were described as more than \$500,000, \$80,000, and \$50,000, respectively. (Div. Ex. 39.)

In December 2000, Nabozniak purchased 2,700 shares of Bonso on margin at \$11.80 per share based on Muth's representations. (Tr. 809-11, 840-42; Div. Ex. 39.) More specifically, Muth represented that Bonso was a good stock with the potential of going up to at least \$20 per share. (Tr. 810, 841-42.) Muth also represented that a favorable research report on Bonso would be forthcoming. (Tr. 810.) Nabozniak was aware that margin trading was risky, because he had purchased on margin in the past. (Tr. 820.) Muth never informed him that Bonso was a speculative stock. (Tr. 833.)

Shortly thereafter, Nabozniak decided to sell Bonso. (Tr. 812, 820, 823.) He attempted to contact Muth by telephone approximately four to six times in order to sell, but would inevitably end up talking to Murphy because Muth was purportedly unavailable. (Tr. 812-16, 820-21.) Upon informing Murphy of his desire to sell, Murphy resisted and told him that Muth would not let him sell Bonso because it would affect Bonso's stock price. (Tr. 812-13, 823.) Nabozniak told Murphy that he believed he was being subjected to "boiler-room tactics." (Tr. 838-39.) Nabozniak always believed that Muth was his broker, not Murphy. (Tr. 818-21.) He believed that Murphy acted as Muth's administrative person to convey bad news. (Tr. 835.) The only occasions Nabozniak communicated with Muth occurred when Muth wanted him to purchase stock. (Tr. 827.)

Subsequently, Nabozniak received margin calls resulting from his purchase of Bonso, and Murphy sold off some stock from his account to cover it. (Tr. 813; Div. Ex. 39.) The margin calls resulted in Nabozniak's account having a closing balance of \$39.70 on May 31, 2001. (Div. Ex. 39.) Nabozniak has not yet retired due, in part, to the losses he sustained while his account was with Muth at Schneider. (Tr. 814.)

## Muth

Muth knew his customers trusted him. (Tr. 128.) He “zealously believed” in Creative Host and Bonso, which he admitted were high-risk stocks, suitable only for investors that had a high risk tolerance and preferred aggressive or speculative investments. (Tr. 53-57, 155.) Muth further admitted that buying a stock on margin is more risky than buying that same security not on margin and that there is no guarantee whether the price goes up or down or whether there will be a margin call. (Tr. 56, 146.)

Muth maintains that his customers were risk-oriented investors who were suitable to invest in Bonso and Creative Host. (Tr. 53-56, 223-25.) He described the customers who testified as sophisticated, savvy, and speculative investors. (Tr. 128-30, 135, 171, 174.) He also maintains that he rarely predicted a specific stock price and never failed to execute a sell order. (Tr. 129-31, 171-74, 212.) Muth denies making any misrepresentations to his customers and offers various explanations for his statements to Lundy. (Tr. 129-33, 143-57, 171-73.)

Muth testified that although his customers did not specifically request a market not held order, he entered such orders nonetheless because he believed that most of them wanted that type of order. (Tr. 101-06.) Muth believes that most trades are in the form of market not held orders and that such orders are in customers’ best interests. (Tr. 102-03.)

## Witness Credibility

I find that Muth was not credible for several reasons. First, much of the evidence directly contradicts his hearing testimony. For example, Muth maintains that Kirkpatrick Pettis’s internal review was completed and he was exonerated of all wrongdoing, whereas his Form U-5 explicitly states the review ended when he resigned. (Tr. 62-64; Div. Ex. 26 at 4-5.) Furthermore, he claimed that all his customers were suitable to invest in Bonso and Creative Host, but later admitted that Lundy was unsuitable to purchase Bonso.

Next, Muth’s professed zealous belief in Bonso and Creative Host is also contrary to the evidence. For instance, Muth gave his customers conflicting opinions about Creative Host. Specifically, Muth told a customer that he was “not too excited about [Creative Host].” Then, fifteen minutes later, he told a different customer that he liked Creative Host technically and fundamentally. (Tr. 114-16; Div. Ex. 22 at 4.) Moreover, in August 2003, Muth sued Bonso for securities fraud, alleging that he knew the company did not prepare its financial statements in accordance with generally accepted accounting principals around the time of the events at issue here. (Div. Ex. 2181.) In addition, much of Muth’s testimony is littered with references about being unable to remember certain events, yet he recalled specific facts and details when it served his interests to do so, especially insofar as his customers were concerned.

In contrast to Muth, I find his customers each to be truthful and credible. These customers were generally: unsophisticated and risk-averse investors; retired or near retirement; with modest financial profiles; who trusted and relied on Muth in selecting investments. As a result, I find the risky and speculative margin purchases of Bonso and Creative Host that Muth



recommended to Poljanec, Saltzman, Acker, Cassidy, Lundy, and Nabozniak were unsuited to their needs.

Furthermore, when the customers' testimony is considered collectively, patterns emerge that bolster the credibility of the individual witnesses. A few illustrations suffice to make this point. First, the customers testified that they did not fill out their new account forms, which usually set forth their financial situation, investment objectives, and risk tolerance at inflated levels. Second, the customers testified consistently as to Muth's representations and sales tactics. For example, when a customer wanted to sell, Muth refused to do so and frequently referred to the harm it would inflict on the stock price or that the price of the stock would soon increase. Muth also frequently referred to favorable research reports that would soon be issued and quoted specific prices that he believed the stock would reach, often within a short period of time. Next, none of the customers have even heard of a market not held order, let alone requested one. Finally, the customers uniformly testified that Muth failed to explain the risks of margin trading and the speculative nature of Bonso and Creative Host.

**Muth Misrepresented Material Facts, Gave Baseless Stock Price Predictions, and Engaged in Sales Practice Abuses While Associated with Schneider**

The Division alleges that Muth willfully violated Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act, and Rule 10b-5 thereunder by making misstatements of material facts to, and engaging in sales practice violations with, numerous Schneider customers. (OIP at 2-4.) Proving willful conduct requires a showing of intent to commit the act that constitutes the violation, not intent to violate. Wonsover v. SEC, 205 F.3d 408, 413-15 (D.C. Cir. 2000); Arthur Lipper Corp. v. SEC, 547 F.2d 171, 180 (2d Cir. 1976).

Section 17(a) of the Securities Act proscribes fraudulent conduct in the offer and sale of securities, and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder proscribe fraudulent conduct in connection with the 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 . . . present[ing] 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). Proof of scienter can

be demonstrated by circumstantial evidence. Herman & MacLean v. Huddleston, 459 U.S. 375, 390 n.30 (1983).

A fact is material if there is a substantial likelihood that a reasonable investor would consider it important in making an investment decision and would view disclosure of the omitted fact as having significantly altered the total mix of information made available. Basic Inc. v. Levinson, 485 U.S. 224, 231-32 (1988); TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976). Materiality is a mixed question of law and fact. TSC Indus., 426 U.S. at 450.

Courts have interpreted broadly the requirement of Exchange Act Section 10(b) and Rule 10b-5 that violations must occur “in connection with” the purchase or sale of a security. See SEC v. Zandford, 535 U.S. 813, 819-25 (2002); Superintendent of Ins. v. Bankers Life & Cas. Co., 404 U.S. 6, 12 (1971); In re Ames Dep’t Stores, Inc., Stock Litig., 991 F.2d 953, 964-65 (2d Cir. 1993). The jurisdictional requirements of the antifraud provisions are also interpreted broadly. SEC v. Softpoint, Inc., 958 F. Supp. 846, 865 (S.D.N.Y. 1997), aff’d, 159 F.3d 1348 (2d Cir. 1998).

### Misrepresentations of Material Fact

The Division alleges that Muth misrepresented, among other things, that: (1) analyst research reports for Creative Host and Bonso existed and would be published by Schneider in December 2000; (2) a hedge fund purportedly would be formed to invest millions of dollars in these two securities; (3) Schneider customers would not owe any funds for margin purchases; and (4) Schneider customers would not receive margin calls on securities purchased on margin. (OIP at 2.) Each of these alleged misrepresentations will be addressed in turn.

#### 1. *Research reports*

As set forth above, Muth represented to several of his customers that Schneider research reports wildly favorable to Bonso and Creative Host existed and would soon be published, often within a week or two, causing an increase in their respective stock prices. He also represented to Lundy that his office controlled the research at Schneider. His customers purchased or were dissuaded from selling these stocks based on these false representations by Muth.

Muth argues otherwise, and introduced various “research reports” in support. (Muth Exs. A, B, E, F.) He also maintains that, as he represented to Lundy, he and his group “controlled the research at Schneider.” (Tr. 157.) Muth’s arguments, however, are contrary to the evidence.

One of Muth’s exhibits is merely a draft copy of a research report on Bonso, dated December 7, 2000. (Div. Ex. 2152; Muth Ex. B.) On December 14, 2000, Muth asked for Driver’s approval to send it to Bonso’s president. (Tr. 193; Div. Ex. 2152.) On December 20, 2000, Driver notified Muth that no research or draft reports could be disseminated without the prior approval of the compliance department and Schneider’s main office. (Tr. 194; Div. Ex. 2153.) This report was not approved for issuance. (Div. Ex. 2152.)

Another Bonso report was dated April 12, 2001, well after Muth made the representations at issue, and it is unclear whether this report was ever published or whether it is a draft copy.

(Muth Ex. A.) The only published research report on Bonso, dated February 4, 2001, was not produced by Schneider. (Muth Ex. E.) Finally, as to Creative Host, the only report in evidence is an undated draft copy. (Muth Ex. F.)

Accordingly, I conclude that there were no existing and soon to be published Schneider research reports on Bonso and Creative Host, and that neither Muth nor his group controlled the research at Schneider.

## 2. *Hedge fund*

During his conversation with Lundy, Muth represented that he would have a hedge fund operational within days, which he would then use to purchase large amounts of Bonso stock, driving up its price. Muth's statements to Lundy clearly suggest that only ministerial tasks remained before the fund was officially formed, such as the filing of paperwork. The evidence establishes otherwise. More specifically, at the time of Muth's conversation with Lundy, no one had contributed any money to the fund and, as of February 28, 2001, Muth's hedge fund had not yet been put into operation. (Tr. 113, 148-53; Div. Ex. 22 at 3.) In fact, the hedge fund was never formed and Muth never obtained any investors' money for it. (Tr. 150.) As such, I conclude that Muth's statements to Lundy regarding the hedge fund were false and misleading.

## 3. *Statements regarding margin purchases and margin calls*

Muth pressured and ultimately convinced Poljanec to open a margin account and purchase on margin by representing that margin trading would not cost her any money and would make her a millionaire. He convinced Cassidy to purchase Bonso on margin by representing that it "would not cost him a dime." Finally, Muth assured Lundy that he would not receive any margin calls on his purchase of Bonso.

Muth testified that when he said "no margin call" to Lundy, he meant no margin call only on the initial trade and that Lundy shared this interpretation.<sup>20</sup> (Tr. 145-46, 156-57.) I find his explanation entirely unbelievable. The tape and transcript show that Muth made his representation only after Lundy informed him that he could not take any more margin calls. In addition, Lundy's prompt complaints following receipt of margin calls establish that he interpreted Muth's statements quite differently.

Muth's representations to these customers were plainly false. Muth himself admitted that margin trading is inherently risky and there can never be a guarantee that there will not be a margin call or whether a stock's price will increase. In addition, the Commission has noted that margin trading increases the risk of loss to customers. See Laurie Jones Canady, 69 SEC Docket 1468, 1482 n.27 (Apr. 5, 1999).

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<sup>20</sup> Muth has also accused Lundy of splicing the tape to omit certain portions. (Tr. 143; Muth Post-Hearing Br. at 10.) I do not credit these accusations.

4. *Muth's scienter*

Muth convinced his customers to purchase Bonso and Creative Host on margin by misrepresenting material facts with the requisite degree of scienter. The evidence is conclusive that Muth was either aware of, or recklessly indifferent to, the falsity of his statements, each of which was geared to promoting sales of Bonso and Creative Host. Further evidence of Muth's scienter can be inferred from his insistence that his customers purchase on margin, because using margin enables customers to purchase greater amounts of securities, thereby generating increased commissions for the salesperson. See Canady, 69 SEC Docket at 1482 n.27. As a result, Muth had a financial incentive for his customers to purchase on margin.

Baseless Stock Price Predictions

The Division alleges that Muth gave baseless stock price predictions to Schneider customers for Bonso and Creative Host. (OIP at 2; Div. Post-Hearing Br. at 10.) Predictions of specific and substantial price increases for any security violate the antifraud provisions of the federal securities laws if made without a reasonable basis. Joseph J. Barbato, 53 S.E.C. 1259, 1273 (1999); Donald A. Roche, 53 S.E.C. 16, 18-19 (1997); Lester Kuznetz, 48 S.E.C. 551, 553 (1986). An honest belief in an issuer's prospects does not in itself give one a reasonable basis for recommending the stock to others. Gilbert F. Tuffli, 46 S.E.C. 401, 405 (1976).

Muth committed fraud when he predicted substantial increases in the prices of Bonso and Creative Host stock in order to persuade his customers to purchase on margin. These stocks were risky and speculative investments, yet Muth made predictions of large and often rapid price increases. More specifically, he told: Saltzman that Creative Host would reach \$20, \$40, and even \$80 per share; Cassidy that Bonso would reach \$40 per share; Lundy that Bonso would reach \$80 per share; and Nabozniak that Bonso would reach \$20 per share. Each of these predictions occurred in December 2000, during which time the closing price of Creative Host ranged from \$1.87 to \$5.12 per share and the closing price of Bonso ranged from \$7.87 to \$11.56 per share. (Div. Exs. 50; 51.)

Muth had no reasonable basis for making these predictions because his claims were often based on his own misrepresentations, such as his nonexistent hedge fund's trading or the imminent release of a research report or other news item. Moreover, given the risky and speculative nature of these stocks, there could be no reasonable basis for his predictions. Finally, it is questionable whether Muth even had an honest belief in these companies, given his conflicting opinions as to Creative Host and subsequent securities fraud lawsuit that he initiated against Bonso. Muth acted recklessly, at a minimum, when he made such predictions.

While I have addressed Muth's misrepresentations and price predictions individually, the context in which Muth made these statements must also be considered. His misstatements and improper price predictions were frequently made in conjunction with one another. He also directed other high-pressure sales tactics at his customers. For example, Muth told Lundy that Bonso could take off within minutes, implying that Lundy should invest immediately. He also told Lundy that he had a conversation with Bonso's president regarding an imminent corporate announcement, which suggests that Muth had access to inside information and that Muth's misstatements and price predictions were, in fact, accurate. Muth's misrepresentations, baseless

predictions of substantial price increases, and other sales tactics, as illustrated best by the Lundy tape, effectively convinced Muth's customers that purchasing on margin was a risk-free proposition.

### Unsuitable Trading

The Division next alleges that Muth fraudulently recommended unsuitable margin purchases of Bonso and Creative Host to Acker, Cassidy, Poljanec, Saltzman, Nabozniak, and Lundy. (OIP at 2-4; Div. Post-Hearing Br. at 3.)

As part of their basic obligation to deal fairly with the investing public, a broker's recommendations must be suitable for the client in light of the client's tolerance for risk and investment objectives, as determined by their financial situation and needs. Edgar B. Alacan, 83 SEC Docket 842, 863 (July 6, 2004); Sandra K. Simpson, 77 SEC Docket 1983, 2003 (May 14, 2002); J. Stephen Stout, 73 SEC Docket 1441, 1460 (Oct. 4, 2000). Failure to adhere to this obligation may violate the antifraud provisions of the federal securities laws. See Kenneth Ward, 79 SEC Docket 3035, 3057 (Mar. 19, 2003) (finding violation of antifraud provisions based on unsuitable recommendation where broker failed to disclose associated risks), aff'd, 75 Fed. Appx. 320 (5th Cir. 2003); Canady, 69 SEC Docket at 1482-84 (finding fraud based on salesperson's unsuitable recommendations of securities purchases on margin); Barbato, 53 S.E.C. at 1275-76 (finding fraud based on broker's recommendation of unsuitable speculative securities).

Several factors generally are associated with a finding that a broker's unsuitable recommendations violate the antifraud provisions of the securities laws, including: (1) the recommended securities were unsuited to the customer's needs; (2) the broker knew that his recommendations were unsuitable or acted with recklessness regarding their suitability in making them; and (3) the broker made material misrepresentations or failed to disclose material information relating to the suitability of the securities, including the associated risks. Alacan, 83 SEC Docket at 864 (citing Brown v. E.F. Hutton Group, Inc., 991 F.2d 1020, 1031 (2d Cir. 1993)).

Muth committed fraud when he recommended that Acker, Cassidy, Poljanec, Saltzman, Nabozniak, and Lundy purchase Bonso and Creative Host on margin. Acker, Cassidy, Poljanec, Nabozniak, and Lundy were each more than sixty years old, and all but Nabozniak were retired or not working. Each had relatively modest financial profiles, including income, net worth, and liquid net worth. Each was an unsophisticated investor who wanted to pursue a more conservative investment strategy and had a more moderate risk tolerance than was set forth on their account forms. None were interested in purchasing extremely risky or highly speculative stocks, on margin or otherwise.

Nevertheless, Muth repeatedly recommended to these customers risky margin purchases of Bonso and Creative Host. Muth never disclosed to these customers that Bonso and Creative Host were risky and speculative stocks, nor did he disclose the risks of margin trading.<sup>21</sup> In addition, as

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<sup>21</sup> The Commission has noted several risks associated with margin trading:

Trading on margin increases the risk of loss to a customer for two reasons. First, the customer is at risk to lose more than the amount invested if the value of the security

noted, Muth misrepresented material facts, provided baseless price predictions, and engaged in other high-pressure sales tactics designed to convince his customers that purchasing on margin at Schneider was risk-free.

The evidence establishes that Muth knew that purchasing Bonso and Creative Host on margin was extremely risky, and he was, at a minimum, recklessly indifferent to his customers' true investment objectives and risk tolerance. No customer filled out the pertinent information on their new account forms, and no customer was consulted by Muth or Muth's associates before such information was entered on their forms. Nearly all of this information was inflated, apparently to give the illusion that these customers were qualified to purchase Bonso and Creative Host on margin. These actions indicate that Muth's recommendations were not simply the result of his zealous enthusiasm for these stocks, but were instead part of a planned course of conduct.

Muth defends the suitability of his recommendations by citing the forms his customers signed, which set forth their purported financial information, investment objectives, and risk tolerance.<sup>22</sup> (Muth Post-Hearing Br. at 6.) I find Muth's argument unpersuasive because, as discussed, the contents of these forms are inaccurate and the circumstances under which their signatures were obtained are dubious, at best. For example, Muth sent Lundy and Nabozniak blank forms to sign, which he would fill out afterwards, and instructed each to return the forms quickly. Even Rouse found this conduct unacceptable. (Tr. 862.) Finally, Muth's defense is contradicted by his later admission that Lundy was unsuitable to purchase Bonso on margin.

#### Failure to Execute Customer Sell Orders

The Division alleges that Muth failed to follow sell instructions from Acker, Cassidy, Poljanec, Saltzman, and Nabozniak in violation of the antifraud provisions of the federal securities laws. (OIP at 2-4; Div. Post-Hearing Brief at 3, 10-11.) A broker who willfully fails or refuses to follow a customer's instructions concerning the management of an account violates Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act, and Rule 10b-5 thereunder. See Steven D. Goodman, 74 SEC Docket 707, 712-13 (Jan. 26, 2001) (dissuading customers from selling and failing to execute sell orders).

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depreciates sufficiently, giving rise to a margin call in the account. Second, the client is required to pay interest on the margin loan, adding to the investor's cost of maintaining the account and increasing the amount by which his investment must appreciate before the customer realizes a net gain. At the same time, using margin permit[s] the customers to purchase greater amounts of securities, thereby generating increased commissions for [the salesperson].

Canady, 69 SEC Docket at 1482 n.27.

<sup>22</sup> Muth also asserts that his customers were "sophisticated, extremely seasoned investors." (Muth Post-Hearing Br. at 6.) I find his argument contrary to the evidence and my observation of the customers and, therefore, reject it.

Each of the aforementioned customers instructed Muth to sell their positions in Bonso or Creative Host, frequently on multiple occasions. On some occasions, Muth, or a person acting at his direction, refused to execute their sell orders. Other times, customers were dissuaded from selling through high-pressure tactics, which typically included representations that selling would hurt the market price or that the customer should hold the stock because its price was going to increase. Thereafter, the price of both stocks declined steadily, thereby increasing the losses to these customers. (Div. Exs. 50; 51.) Muth acted with scienter in refusing to execute these sell orders. He knew that his customers wanted to sell their positions in Bonso and Creative Host, as well as their reasons, yet he either refused or dissuaded them from doing so.

Muth argues that he was only recommending that his customers not sell. (Muth Post-Hearing Br. at 7.) Muth's argument incorrectly characterizes his tactics as simple recommendations. The consistency with which the customers testified concerning his conduct establishes that Muth actively prevented his customers from selling, rather than merely offering a recommendation. His argument also minimizes his customers' lack of investment sophistication and that they trusted and relied on him to act in their best interests.

### Unauthorized Trading

The Division alleges that Muth engaged in unauthorized trades in the accounts of Poljanec and DeHerrera and, therefore, violated the antifraud provisions of the federal securities laws. (Div. Post-Hearing Br. at 4, 11.)

A broker who trades in a customer's account without authorization commits fraud if there is accompanying deceptive conduct. Alacan, 83 SEC Docket at 854; Simpson, 77 SEC Docket at 2001; Canady, 69 SEC Docket at 1484. The deceptive conduct element of the offense is satisfied when the broker fails to inform the customer of the materially significant fact of the trade before it is made. Alacan, 83 SEC Docket at 854; Simpson, 77 SEC Docket at 2001-02. Mere after-the-fact acceptance of an unauthorized trade does not transform the transaction into an authorized trade. Simpson, 77 SEC Docket at 2002-03. Furthermore, evidence that the customer paid for the disputed trade, failed to complain promptly, or contributed additional funds to the account does not necessarily establish that they approved of the broker's actions. See Alacan, 83 SEC Docket at 855 n.27.

DeHerrera's credible testimony, along with his contemporaneous oral and written complaints about unauthorized trading, support the conclusion that Muth failed to inform him in advance about the two purchases of Creative Host in his account. Similarly, the persuasive evidence is that Muth also purchased Creative Host on margin in Poljanec's account without her prior authorization. Furthermore, the evidence establishes that neither DeHerrera nor Poljanec gave Muth discretionary authority over their accounts. In effecting these transactions, Muth acted with scienter in that he knew the trading at issue was conducted without authorization or, at a minimum, he was recklessly indifferent to whether DeHerrera and Poljanec had authorized the trades.

## Conclusion

Based on the foregoing, I conclude that Muth, on multiple occasions, willfully violated Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act, and Rule 10b-5 thereunder.

### **Rouse's Supervision of Muth**

#### Rouse's Contentions

Rouse admitted that he was responsible for implementing the heightened supervisory procedures that Schneider agreed to adopt while Muth was physically located in Schneider's main office. (Tr. 273-74, 289-91, 790.) He contends, however, that Bates became responsible for supervising Muth when he assumed the role of branch office manager and Muth relocated to the branch office. (Tr. 274-76, 284-91, 875.) According to Rouse, many of the state-required procedures were already part of Schneider's branch office manager's supervisory manual and, as a result, were the responsibility of the branch office manager. (Tr. 274-76, 857-58.)

Rouse testified that he had no supervisory responsibility over Muth as of November 2000, insofar as Muth's daily activity and customers were concerned, but he still reviewed Muth's call logs and activity on a monthly basis. (Tr. 273-90.) He further testified that after December 2000, he had no role with respect to the special supervisory procedures. (Tr. 284-91.)

Rouse further maintains that he had no responsibility to supervise Bates in his role as branch office manager. (Tr. 287-88.) He testified that he was merely Bates's supervisor in terms of Bates's personal production, meaning Bates's transactions with customers. (Tr. 273.) Rouse's contentions are not supported by the evidence in the record.

#### Rouse Supervised Muth and Bates

The heightened supervisory procedures that Schneider adopted explicitly stated that Rouse was Muth's direct supervisor and responsible for their implementation. (Div. Ex. 2050.) In accordance with these procedures, Rouse conducted the quarterly meeting with Muth and drafted the first quarter report to the Colorado Division of Securities, in which he detailed Muth's securities activities. (Tr. 276-77, 375; Div. Ex. 24.) Rouse's report, dated January 29, 2001, represented that it constitutes a report from Muth's supervisor. (Div. Ex. 24.) This is consistent with Schneider's prior letter to the state, which adopted the special supervisory procedures and represented that Rouse was Muth's direct supervisor. (Div. Ex. 2050.)

On February 16, 2001, Schneider drafted a letter to the Colorado Division of Securities, amending its prior letter. (Div. Exs. 2050; 2111.) This letter represented that Bates, not Rouse, would be Muth's direct supervisor, and further represented that Bates would be responsible for implementing the special supervisory procedures outlined in the prior letter, for which Rouse was previously responsible. (Div. Exs. 2050; 2111.) No written document prior to this letter relieved Rouse of his supervisory responsibilities over Muth or delegated these responsibilities to Bates.



Schneider's office supervision chart lists Rouse as Bates's direct supervisor from November 2000 through May 2001. (Div. Ex. 23.) The chart does not distinguish between Bates's retail and other activities, as it does with other members of the branch office. (Div. Ex. 23.) For example, supervision of David Lavigne was divided between O'Rourke and Bates, depending on whether Lavigne's research or retail activities were involved.<sup>23</sup> (Div. Ex. 23.)

The hearing and investigative testimony of Rouse, Muth, Bates, Driver, and O'Rourke also establishes that Rouse was responsible for supervising Muth and Bates consistent with the time frame established by the documentary evidence. Rouse admitted that there were some aspects of supervising Muth under the special supervisory procedures that he and Bates performed together in November and December 2000. (Tr. 273-76, 284-91, 302-03; Div. Ex. 5 at 134-35.) Rouse also stated that, around the time of his quarterly report, Bates was performing the daily supervision required by Colorado, but he was still overseeing Bates's work. (Div. Ex. 5 at 213.)

According to Bates, he and Rouse shared responsibility for the immediate supervision of Muth until late January or early February 2001. (Tr. 458-66; Div. Ex. 3 at 150-54.) Bates was uncertain as to who was responsible for what aspects of Muth's supervision, but believed that Rouse was responsible for the heightened supervisory procedures until February 16, 2001. (Tr. 461-66.) Bates characterized himself as a "manager in training," reporting directly to Rouse, who he believed was his immediate supervisor, as well as to the compliance department. (Tr. 459-60; Div. Ex. 3 at 121-23.)

Driver's testimony corroborates Bates's. According to Driver, there was a three-month transition period during which Rouse and Bates both supervised Muth, with Bates performing day-to-day supervisory activities.<sup>24</sup> (Tr. 373-80.) Driver's investigative testimony was consistent with his hearing testimony. There, he stated that Rouse was responsible for the special supervisory procedures until late January or early February 2001, but Bates was responsible for Muth's day-to-day supervision under Rouse's oversight. (Div. Exs. 7 at 237-39; 8 at 284-89.) Driver referred to the transition period as a mentoring process. (Div. Ex. 8 at 285.) This transition period corresponds with the time frame established by the documentary evidence. In addition, O'Rourke testified that Rouse was Muth's supervisor for purposes of the heightened procedures and that he was unaware of any formal division of responsibility between Rouse and Bates. (Div. Ex. 46 at 91-92.)

During the three-month transition period, Rouse and Bates spoke frequently about the special supervisory procedures and Bates's supervisory duties. (Tr. 462; Div. Ex. 5 at 167, 176.) Rouse spent a significant amount of time with Bates to assist him in his supervisory duties. (Tr. 301-02.) Rouse testified that he also visited the branch office frequently. (Div. Ex. 5 at 176.) Bates testified that Rouse visited the branch once a month. (Div. Ex. 3 at 152.)

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<sup>23</sup> This chart also lists Bates as Muth's direct supervisor from October 2000 through May 1, 2001. (Div. Ex. 23.) For the reasons set forth in this Initial Decision, I do not find this chart to be indicative of who had supervisory responsibility over Muth for purposes of the heightened procedures Schneider adopted.

<sup>24</sup> Rouse's investigative testimony also alludes to this transition period. (Div. Ex. 6 at 291-92.)

When Muth initially transferred to Schneider, Rouse was responsible for all aspects of Muth's supervision, including review of his new account cards and order tickets. (Tr. 178, 273-76, 289-91, 790.) According to Bates, he assumed responsibility for reviewing Muth's daily transactions when Muth transferred to the branch office. (Tr. 462; Div. Ex. 3 at 155, 244-46.) In his investigative testimony, Rouse admitted to overseeing Bates's review and reviewing Muth's daily trade blotters. (Div. Ex. 5 at 163-64, 176.) According to Muth and Rouse, they continued to discuss Muth's trades and spoke at least every other day following Muth's transfer to the branch office. (Tr. 76-78; Div. Ex. 5 at 134-35.) Muth testified that when Bates started, he was unable to answer many of Muth's questions; consequently, Muth would direct his questions to Rouse. (Tr. 88-89.)

Rouse stated in his investigative testimony that he and Bates reviewed with Muth transactions during the month, even after Muth had moved to the branch office. (Div. Ex. 5 at 163-64, 187.) Rouse and Bates testified that Rouse conducted these monthly reviews through at least December 2000. (Tr. 274-79; Div. Exs. 3 at 245-46; 5 at 163-64, 186-90.) Bates testified that he never participated in these monthly meetings. (Div. Ex. 3 at 245-46.) In conducting these reviews, Rouse testified that he examined customers' new account forms and monthly account statements but did not review every account. (Div. Ex. 5 at 189-90.)

Rouse testified that he oversaw Muth's and Bates's work insofar as the call logs were concerned through December 2000 because he wanted to ensure they were being kept accurately. (Tr. 273-76, 281, 289-91, 875-79; Div. Ex. 5 at 176, 187.) In his investigative testimony, however, Rouse stated that he was solely responsible for these logs. (Div. Ex. 5 at 134-35.) According to Bates, Rouse was responsible for the call logs until February 2001. (Tr. 465-66.)

I do not credit Rouse's contentions as to his lack of supervisory responsibility over Muth and Bates. Rouse's investigative and hearing testimony concerning his responsibilities was internally inconsistent. Rouse's contentions were also contrary to the documentary evidence and the testimony of the other witnesses.

The heightened supervisory procedures that Schneider adopted designated Rouse to be Muth's direct supervisor. No written document relieved him of this responsibility or delegated it to Bates until February 16, 2001. Moreover, Rouse's responsibilities and conduct between November 2000 and February 16, 2001, as established by his drafting of the quarterly report and his investigative and hearing testimony, in addition to that of the other witnesses, are also inconsistent with his contentions. Such evidence indicates that Rouse was responsible for supervising Muth's activities, consistent with the time frame and responsibilities identified in the documentary evidence.

Based on the weight of the evidence, I find that Rouse was responsible for: (1) supervising Muth pursuant to the heightened supervisory procedures Schneider adopted until February 16, 2001; and (2) supervising Bates's work as branch office manager. At a minimum, Rouse shared responsibility with Bates for supervising Muth pursuant to the heightened procedures until February 16, 2001, in that Bates was responsible for Muth's daily supervision under Rouse's oversight.

### Rouse's Supervision was Deficient

In his quarterly report to the state, Rouse represented that “all of [Muth's transactions] are reviewed” on a daily basis. (Div. Ex. 24.) Rouse did not inform the Colorado Division of Securities that he had delegated this responsibility to Bates. (Tr. 278-79.) Rouse never actually reviewed Muth's daily trades or order tickets to ensure that Bates had reviewed and signed them, nor did he review and sign Muth's order tickets on a daily basis. (Tr. 75-76, 292, 302, 462; Div. Ex. 2 at 241.) Muth does not specifically recall anyone reviewing, on a daily basis, transactions in his customers' accounts. (Div. Ex. 2 at 241-43.)

Muth entered market not held orders for his customers despite the fact that no customer requested it. (Tr. 101-06; Div. Exs. 2013; 2014; 2060.) Bates approved Muth's order tickets for Cassidy and Lundy as market not held orders, but could not recall what that type of order entailed. (Tr. 479; Div. Ex. 2060.) Rouse knew that Muth was putting in market not held orders for some of his customers. (Tr. 296.) He also knew that such orders are not executed immediately. (Tr. 296-98.) Rouse never contacted any of Muth's customers to determine whether they authorized Muth to enter such orders. (Tr. 296-98.)

In his quarterly report to the state, Rouse represented that he reviewed monthly activity statements for active customers, including Colorado residents. (Div. Ex. 24.) Rouse further represented that he personally reviewed with Muth on a monthly basis the securities Muth recommended to his customers to determine suitability. (Div. Ex. 24.)

As Muth's customers credibly testified, no one at Schneider, including Rouse and Bates, contacted them at the time they opened their accounts or following their initial transactions to verify their investment objectives and risk tolerance. Rouse admitted that he did not contact Muth's customers. (Tr. 295.) Rouse never questioned the suitability of any of Muth's customers during these monthly reviews. (Tr. 178-79; Div. Ex. 5 at 190-91.) Rouse never told Muth that any of his customers had purchased an unsuitable investment. (Tr. 78.) Rouse and Bates never reviewed the initial transactions of Muth's Colorado customers to determine suitability. (Div. Ex. 2 at 238-40.) Rouse approved Muth's customers' new account forms by signing them immediately with little or no review. (Div. Ex. 2 at 238-40.)

Rouse did not review Lundy's initial transaction because he was not one of Muth's most active customers. (Tr. 280.) In fact, no supervisor reviewed this transaction. (Tr. 161-62.) Rouse testified that he discussed with Muth the subject of customer suitability only as to his most active customers (five trades or more per month) and Lundy had made only one trade during the first quarter. (Tr. 280-81.) At the time of his initial transaction, Lundy did not have a margin agreement in place with Schneider. (Tr. 162.) Rouse also never discussed with Muth whether Cassidy's or Acker's initial transactions at Schneider were suitable. (Tr. 109, 132-34.) According to Rouse, the compliance department was responsible for ensuring that Bates was reviewing a customer's initial transaction for suitability. (Tr. 883.)

In the quarterly report to the state, Rouse represented that, as of the date of the report, there had been no problems reported. (Div. Ex. 24.) Before Rouse's report was sent to the

Colorado Division of Securities, however, Lundy had complained about Muth's conduct. (Tr. 162-63; Div. Ex. 2059.) By the end of January 2001, Schneider received a letter from the Commission about Lundy's complaints, which disclosed that Lundy taped a conversation he had with Muth. (Tr. 353-54.)

Muth discussed Lundy's verbal complaint with Driver, Rouse, and Bates. (Tr. 164-69; Div. Ex. 2 at 202-04.) They asked Muth what he told Lundy, and Muth informed them that he had said that they were working on a research report for Bonso that he felt would introduce value to the marketplace. (Tr. 170; Div. Ex. 2 at 202-04.) Muth also told them that he informed other customers of this as well. (Tr. 170; Div. Ex. 2 at 203-04.) They also discussed Lundy's "aptitude" for margin trading. (Div. Ex. 2 at 202-04.)

Rouse testified that he does not recall seeing Lundy's written complaint or having heard Lundy's tape before the May 2001 meeting. (Tr. 280-83, 294.) I do not find his testimony credible, given the fact he also testified that he first heard the tape in February or March 2001. (Tr. 293.) In addition, Muth testified that he and Rouse discussed Lundy's verbal complaint, and Driver testified that Rouse read the complaint letter after it was received. (Div. Ex. 9 at 453.) Bates was also aware of Lundy's complaint. (Div. Ex. 9 at 396-418.) Upon hearing the tape, Rouse found Muth's representations to Lundy to be "questionable," but did not consider whether the recommendation was suitable. (Tr. 294-95.) According to Rouse, Bates was responsible for this investigation. (Tr. 296.) Rouse does not know what steps, if any, were taken as a result of Lundy's complaint, because he believed that to be a compliance function. (Tr. 295.) Supervision over Muth was not increased as a result of Lundy's complaint. (Tr. 165.)

As set forth above, DeHerrera sent a written complaint in February 2001, and Muth and Bates discussed the matter with him. Bates does not recall discussing with Rouse the need for heightened supervision over Muth following DeHerrera's complaint. (Tr. 472.) Rouse testified that he was unaware that DeHerrera had sent a written complaint. (Tr. 292, 305.) Muth noticed no increase in supervision as a result of DeHerrera's complaint. (Tr. 183-84.) Although Schneider received Lundy's and DeHerrera's complaints in January and February 2001, respectively, Muth was not disciplined until May 2001 and no heightened supervision was implemented. There is no evidence that any of Muth's customers were contacted following receipt of Lundy's or DeHerrera's complaints. There also is no evidence that any of Muth's customers' accounts were reviewed.

In his quarterly report to the state, Rouse also represented that he had reviewed Muth's call logs, which he stated were maintained in full compliance with Colorado's requirement. (Div. Ex. 24.) Rouse did not initial Muth's call log to document his review, as required by the special supervisory procedures. (Tr. 80, 282-83; Div. Exs. 22; 2051.) Rouse asserts, however, that he kept a separate journal to document his review, which runs only until December 1, 2000, and purports to document Rouse's review on a monthly basis. (Tr. 282-83; Rouse Ex. D.) It consists of three pages and has scant information about what he discussed with Muth. (Rouse Ex. D.)

Muth initially maintained a handwritten call log, which runs from October 23, 2000, to January 2001. (Div. Ex. 2051.) This log contains sparse information concerning the substance

of Muth's conversations throughout its use. (Div. Ex. 2051.) For example, the December 12, 2000, entries refer to Muth's conversations with Cassidy and Lundy. (Div. Ex. 2051.) The entries for these respective customers are "recommend Bonso buy." (Div. Ex. 2051.) The entry for Lundy, in particular, must be compared with the actual conversation that took place, as previously summarized. Such a comparison reveals that Muth's log did not adequately reflect the substance of the conversations he had with a customer.

Rouse found that Muth's handwritten call log needed more detail and contained irrelevant information. (Tr. 291; Rouse Ex. D.) In spite of this observation, Rouse did not attempt to contact any of Muth's customers. (Tr. 296.) Rouse's testimony that the detail in Muth's call log improved between November 2000 and February 2001 is not credible. (Tr. 291-92.) A simple review of the log evidences that Muth continued to provide little information concerning the substance of his conversations, including those set forth above. Bates was not concerned about the contents of Muth's call logs. (Div. Ex. 3 at 164.)

Muth filled out some portions of the call log and had others, typically Kelli Bates, fill out the remaining portions. (Tr. 81-85; Div. Ex. 2151.) Rouse knew that Muth did not personally prepare all the entries in the call logs and he was aware that Kelli Bates had made some of the entries. (Tr. 282.) Rouse was not concerned that Muth did not personally make these entries, nor was he concerned that Bates, when reviewing the call logs, would be reviewing his wife's work. (Tr. 282.) Bates's initials appear sporadically throughout Muth's handwritten call log. (Div. Ex. 2051.) Rouse's initials do not appear anywhere in Muth's handwritten call log. (Div. Ex. 2051.)

Beginning on February 26, 2001, Muth began dictating notes of his conversations with customers, which Kelli Bates then transcribed into the log. (Tr. 83-86; Div. Ex. 22.) No explanation was given for the time gap between ending use of the handwritten log and beginning use of the typewritten log.<sup>25</sup> Bates's and Rouse's initials are not contained in this call log. (Div. Ex. 22.) Rouse was unconcerned that Bates's initials were absent from both sets of Muth's call logs. (Tr. 879; Div. Exs. 22; 2051.)

Neither Rouse nor Bates ever questioned Muth about any gaps in his written call log. (Tr. 93.) Muth does not recall discussing his call log with Rouse and does not remember Rouse ever reviewing it. (Tr. 80; Div. Ex. 1 at 105-07.) Bates does not recall discussing with Rouse that Muth was not making all of the required entries. (Tr. 469.)

Muth testified that Bates was very persistent and aggressive in examining the call logs and checking on customer suitability, even more so during the last few weeks of Muth's employment at Schneider. (Tr. 87-88.) I do not find Muth's testimony on this matter credible, based on his characterization of Bates as a lazy supervisor. (Tr. 88-91; Div. Ex. 1 at 104-07.) He also previously testified that he could not recall whether Bates or Rouse examined and initialed the call log and no one from Schneider ever questioned anything that he wrote in the log. (Tr. 88-91; Div. Ex. 1 at 104-07.)

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<sup>25</sup> The two call logs were the only documents or tapes produced pursuant to a Commission subpoena relating to Muth's call logs. (Tr. 491-501; Div. Exs. 22; 2051.)

Muth typically did not record in the call logs when he entered a market not held order and Rouse knew Muth was entering such orders for his customers. (Tr. 108, 296.) His call log reveals that he made inconsistent recommendations to customers about Creative Host within a short period of time. (Div. Ex. 22.)

### Subsequent Events

Schneider permitted Muth to resign in May 2001. (Muth Answer at 2; Tr. 186, 293.) Bates ceased being the branch office manager in May 2001, following receipt of a letter from David Lavigne, which represented that the branch office no longer had sufficient revenue to pay Bates, due to Muth's departure. (Tr. 472-73; Div. Ex. 2178.) Schneider ceased doing business as a broker or dealer in late 2002. (Tr. 847.)

After his employment with Schneider, Muth and others formed Dragon Capital, LLC (Dragon Capital), to engage in various activities, including public relations and corporate finance. (Tr. 25-28.) Since its inception, Dragon Capital has purchased stock in one private company and has been involved with several others. (Tr. 28.) Muth owns fifty-one percent of Dragon Capital. (Tr. 27.) He represented that he is not currently involved in the securities industry. (Tr. 25.)

### **Rouse Failed Reasonably to Supervise**

The Division alleges that, between December 2000 and February 2001, Rouse failed reasonably to supervise Muth within the meaning of Section 15(b)(4)(E) of the Exchange Act. (OIP at 3-4; Div. Post-Hearing Br. at 11-16.)

The Commission has long emphasized that it is critical for investor protection that a broker establish and enforce effective procedures to supervise its employees. See John H. Gutfreund, 51 S.E.C. 93, 108 (1992) (settled order); Donald T. Sheldon, 51 S.E.C. 59, 78-79 (1992), aff'd, 45 F.3d 1515 (11th Cir. 1995). Section 15(b)(6) of the Exchange Act, incorporating Section 15(b)(4)(E) by reference, provides that the Commission may sanction any person associated with a broker or dealer if it finds that such person "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)(4)(E) further provides that an associated person shall not 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). Because different supervisors may have different responsibilities under each firm's compliance

program, what may be a reasonable discharge of supervisory duties in one situation can be unreasonable in another. A factual analysis is required in each case. Huff, 50 S.E.C. at 528.

### Rouse Supervised Muth and Bates

Determining whether a particular person is a “supervisor” depends on whether, under the facts and circumstances of a particular case, that person has a requisite degree of responsibility, ability or authority to affect the conduct of the employee whose behavior is at issue. Gutfreund, 51 S.E.C. at 112-13. Rouse was a high-ranking member of Schneider. The documentary evidence establishes that Rouse was Muth’s supervisor until February 16, 2001, for purposes of the heightened procedures Schneider adopted for Muth’s supervision, and that Rouse also supervised Bates. The testimony of Muth, Bates, Driver, and O’Rourke establishes that Rouse was responsible for supervising Muth pursuant to the heightened procedures, and Bates was responsible for Muth’s day-to-day supervision, under Rouse’s oversight. In both his investigative and hearing testimony, Rouse essentially admitted that he was at least partially responsible for supervising Muth and that he supervised Bates. Accordingly, I conclude that, until February 16, 2001, Rouse was Muth’s supervisor for purposes of the supervisory procedures Schneider adopted for Muth, and that he was also responsible for supervising Bates’s work as branch office manager. At a minimum, Rouse shared responsibility with Bates for supervising Muth, in that Bates was responsible for Muth’s daily supervision under Rouse’s oversight.

As set forth above, Rouse argues that Bates was, in fact, responsible for many of the heightened procedures Schneider adopted, because they were already assigned to the branch office manager pursuant to Schneider’s supervisory manual.<sup>26</sup> His argument is unavailing. Whether or not many of these procedures were already contained in Schneider’s supervisory manual is irrelevant. At the State of Colorado’s insistence, Schneider agreed to adopt procedures directed specifically at supervising Muth’s securities activities, designating Rouse as Muth’s supervisor for purposes of implementing these procedures. There is no dispute that the procedures were to provide a heightened supervisory framework within which Muth would be monitored. In other words, the heightened supervisory procedures were intended to supplement Schneider’s already existing procedures, insofar as Muth was concerned. As a result, I conclude that it is improper to characterize the procedures Schneider adopted for Muth’s supervision as subsumed within Schneider’s existing supervisory scheme.

### Rouse Failed Reasonably to Supervise

Rouse failed reasonably to supervise Muth by failing to follow the firm’s procedures regarding heightened supervision. Furthermore, Rouse ignored, failed to detect, or did not adequately respond to red flags that arose during Muth’s association with Schneider. Rouse also failed reasonably to supervise Muth with a view to preventing Muth’s violations by failing to develop a system to monitor whether Muth’s supervisors, including himself, were adequately

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<sup>26</sup> The Commission has repeatedly warned that procedures that rely solely on supervision by branch managers are insufficient. See Rita H. Malm, 52 S.E.C. 64, 70 (1994); Sheldon, 51 S.E.C. at 79.

carrying out their responsibilities. Had Rouse carried out his supervisory responsibilities effectively, Muth's violations would have been detected and prevented.

The record provides numerous indicia of Muth's potential for wrongdoing. Muth had been previously sanctioned by the NASD. He left his prior firm amid an internal investigation of customer complaints, which included unauthorized trading and failure to execute customer sell orders. His conduct was suspect in that Muth was zealous about, and concentrated in, using margin to purchase two risky and speculative stocks. In addition to Colorado, several other states imposed special supervisory procedures, granted conditional registration status, requested additional information, or requested Muth's application be withdrawn. Having hired and retained a representative such as Muth, Schneider had an obligation to ensure that he was closely supervised. 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); Frank J. Custable, 51 S.E.C. 855, 856-59 (1993) (finding prior history of customer complaints against representative required increased supervision and monitoring).

Rouse refused to acknowledge that hiring Bates as branch office manager was similarly fraught with potential problems and did not provide reasonable supervision of Muth. Bates had virtually no prior experience supervising registered representatives and received no formal training beforehand. Muth was part-owner of the branch and paid the salaries of Bates and Bates's wife from the commissions the branch generated. Moreover, the owners of the branch could have replaced Bates if they wanted to do so. Knowing these facts, Rouse was reasonably required to pay careful attention to the supervision of Bates and Muth.

There was no written, formal division of responsibility between Rouse and Bates for supervising Muth. (Tr. 277, 459-61; Div. Ex. 6 at 329.) Furthermore, Rouse and Bates gave conflicting investigative and hearing testimony as to their respective responsibilities concerning Muth's supervision. These facts support a conclusion that no system was in place to monitor whether Muth's supervisors were executing their supervisory responsibilities. Such a system was necessary under the facts here, given the conflicts of interest inherent in Bates's position, Bates's supervisory inexperience, and Muth's history of customer complaints.

There is little, if any, evidence that Rouse fulfilled his duty to supervise Muth pursuant to the heightened procedures or that he monitored Bates's supervision of Muth. Rouse did not review Muth's transactions and order tickets on a daily basis. Although Rouse purportedly delegated this responsibility to Bates, given the facts, Rouse should have overseen Bates's review. Rouse did not, however, review Muth's order tickets to ascertain whether Bates had reviewed and initialed them. Many of Muth's transactions were entered as market not held orders, without the customers' knowledge. Rouse was aware that such orders were entered, yet did not attempt to contact any customer to determine whether they authorized it. There is no evidence that Rouse required Bates to conduct any inquiries into this issue.

Rouse and Bates never contacted any of Muth's customers who testified at the hearing when they opened their accounts or following their initial transactions to determine whether their risky margin trades were in accordance with their investment objectives and financial situation.



They also never questioned the suitability of any investment made by Muth's customers. Even taking the customers' account forms at face value, issues regarding their suitability to engage in margin trading are apparent. Many of these forms accurately depicted the customers' limited wealth, income, and/or advanced age, while identifying a preference for high-risk, speculative investments. In addition, the handwriting on the new account forms and the customers' signatures were markedly different. Furthermore, Cassidy's margin agreement was marked with "Doesn't Qualify." Yet no inquiries were made to explore these issues.

By limiting his review of transactions in the accounts of Muth's customer to those which he deemed to be "active," Rouse essentially allowed Muth to recommend unsuitable and fraudulent margin investments freely so long as he conducted a limited number of transactions in an account. A reasonable review and discussion of Muth's transactions would surely have disclosed that Muth recommended margin purchases of risky and speculative stocks to customers of limited means. It also would have disclosed that several of Muth's customers had not executed margin agreements or new account forms before margin trades occurred in their accounts.

Rouse did not initial Muth's call logs to document his review, as required by the special supervisory procedures. Given the absence of Rouse's initials, the meager information in his journal, and Muth's testimony, Rouse's review and discussion of Muth's call logs was cursory, at best. Muth's call logs contained limited and irrelevant information, thereby rendering it impossible to determine what Muth had represented to his customers. Rouse knew that Bates did not initial most of Muth's call logs and Muth did not personally complete the logs, yet he did not contact any of Muth's customers.

Lundy's and DeHerrera's complaints triggered no increased supervision of Muth, nor did they cause anyone to contact Muth's other customers. Lundy's complaint, in particular, demonstrated that Muth had made multiple misrepresentations to induce Lundy to purchase on margin. Rouse was aware of Lundy's complaint, yet did nothing in response, and was unaware of what steps, if any, were taken as a result. Similarly, Bates did nothing following DeHerrera's complaint. In fact, he persuaded DeHerrera to table his complaint. In short, there was no follow-up, much less an adequate follow-up, to these customers' complaints and other red flags indicating a need to supervise Muth closely. See Gutfreund, 51 S.E.C. at 108 (finding there must be adequate follow-up and review when firm's procedures detect irregularities); Sheldon, 51 S.E.C. at 79-80 (failing to adequately follow-up instructions given in response to customer complaints); Huff, 50 S.E.C. at 531 (finding supervisors have obligation to exercise particular vigilance when indications of irregularity reach their attention). Rouse's position that he was unaware of either complaint, if true, is further evidence that he failed to exercise any meaningful supervisory authority over Muth.

## SANCTIONS

The Division seeks a cease-and-desist order against Muth, an order barring Muth from association with any broker or dealer, and an order imposing a civil monetary penalty of \$2,090,000. The Division also seeks an order requiring Muth to disgorge \$14,204.75, plus prejudgment interest. As to Rouse, the Division requests that he be barred from association with any broker or dealer in any supervisory capacity with the right to reapply after one year, and that he

be suspended from association with any broker or dealer in any capacity for nine months. It also requests an order requiring Rouse to pay a civil penalty of \$110,000.

In its Post-Hearing Brief, the Division requested that I create a “fair funds” account for distribution to the seven customers who testified. See Section 308(a) of the Sarbanes-Oxley Act, 15 U.S.C. § 7246(a); 17 C.F.R. §§ 201.1100-1106. Because I conclude that authority to create a fair funds account lies solely with Commission, I cannot grant the Division’s request. However, I recommend that the Commission create such an account for the benefit of these seven customers.

#### Cease-and-Desist Order and Associational Bar

Section 8A(a) of the Securities Act and Section 21C(a) of the Exchange Act authorize the Commission to impose a cease-and-desist order upon any person who “is violating, has violated, or is about to violate” any provision of the Securities Act, the Exchange Act, or the rules and regulations thereunder.

In pertinent part, Section 15(b)(6) of the Exchange Act permits the Commission to sanction persons associated with a broker or dealer if it finds that the sanction is in the public interest and such persons have willfully committed or omitted any act enumerated in Section 15(b)(4)(D) or (E). Specifically, the Commission may censure associated persons, place limitations on the activities or functions of such persons, suspend such persons for a period not exceeding twelve months, or bar such persons from being associated with a broker or dealer.

I have already concluded that Muth willfully violated Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act, and Rule 10b-5 thereunder. I have also concluded that Rouse failed reasonably to supervise within the meaning of Section 15(b)(4)(E) of the Exchange Act. Therefore, I must now determine whether a cease-and-desist order as to Muth and sanctions under Section 15(b)(6) of the Exchange Act as to both Respondents are appropriate.<sup>27</sup>

In determining whether a cease-and-desist order and sanctions under Section 15(b) of the Exchange Act are appropriate, the Commission considers:

[T]he egregiousness of the respondent’s actions; the isolated or recurrent nature of the infraction; the degree of scienter involved; the sincerity of the respondent’s assurances against future violations; the respondent’s recognition of the wrongful nature of his conduct; and the likelihood that the respondent’s occupation will present opportunities to commit future violations.

Steadman v. SEC, 603 F.2d 1126, 1140 (5th Cir. 1979), aff’d on other grounds, 450 U.S. 91 (1981); Orlando Joseph Jett, 82 SEC Docket 1211, 1260-61 (Mar. 5, 2004); KPMG Peat Marwick LLP, 74 SEC Docket 384, 436 (Jan. 19, 2001), reh’g denied, 74 SEC Docket 1351 (Mar. 8, 2001), pet.

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<sup>27</sup> Because Muth has already been barred from association with any broker or dealer, I deny the Division’s request for that sanction here. See Exchange Act Release No. 50223 (Aug. 20, 2004) (official notice).

denied, 289 F.3d 109 (D.C. Cir. 2002). The severity of sanctions depends of the facts of each case and the value of the sanctions in preventing a recurrence of the violative conduct. See Berko v. SEC, 316 F.2d 137, 141-43 (2d Cir. 1963).

In addition to the Steadman factors discussed above, in determining whether to impose a cease-and-desist order, the Commission considers whether there is a risk of future violations, 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, 74 SEC Docket at 436.

Here, a cease-and-desist order as to Muth is plainly warranted in the public interest. Muth's misconduct demonstrated a high degree of scienter. His violations were also egregious and recurrent. He repeatedly defrauded multiple customers over an extended period of time, causing substantial losses to them while generating substantial income for himself. (Tr. 501-25; Div. Ex. 40.) The numerous instances of Muth's fraudulent conduct here raise a sufficient risk of future violations. See KPMG, 74 SEC Docket at 430-36. Muth has been previously sanctioned by the NASD. See Alacan, 83 SEC Docket at 870 (finding that conduct outside of limitations period is properly considered in determining whether to impose cease-and-desist order). Furthermore, since this proceeding was instituted, he was sanctioned by the Commission and permanently enjoined from violating the antifraud provisions of the securities laws.

Muth has not offered any persuasive assurances against future violations, nor has he acknowledged the wrongful nature of his conduct. For example, in an apparent attempt to shift responsibility, he questioned Bates repeatedly about whether Bates authorized the transactions that took place in his customers' accounts and whether Bates ever told him that any of the selected investments were unsuitable for his customers. (Tr. 474-77.) Although Muth represented that he is no longer active in the securities industry, his vague description as to his activities with Dragon Capital and his lack of credibility lead me to conclude otherwise. In order to protect the public from further abusive behavior, I conclude that Muth should be ordered to cease and desist from violating the antifraud provisions of the securities laws.

The Division requests that Rouse be barred from association with any broker or dealer in a supervisory capacity, with the right to reapply after one year, and that he be suspended from association with any broker or dealer in any capacity for nine months. I find the Division's request is necessary in the public interest.

Rouse's actions or, perhaps more appropriately inactions, were egregious and recurrent. He completely abdicated his supervisory responsibilities for months. His failure to act allowed and were responsible, in part, for the success, magnitude, and duration of Muth's fraudulent misconduct. Had Rouse fulfilled his obligations, Muth's activities could have been halted before Muth's customers incurred substantial losses. Rouse's conduct evidenced a high degree of scienter. His lack of supervisory vigilance was certainly more than mere negligence; it was reckless, given Rouse's knowledge of Muth's past activities, Bates's inexperience and conflicts of interest in supervising Muth, and the representations made to the State of Colorado. In spite of this, Rouse exercised little, if any, supervision over Muth's activities.

Consistent with a vigorous defense, Rouse has not acknowledged his wrongful conduct. However, his argument as to his lack of supervisory authority over Muth seems to blame Bates for allowing Muth's fraud. He also places blame on Muth's customers for providing inaccurate information on their account forms and failing to refuse Muth's recommendations. (Rouse Post-Hearing Br. at 2.) Rouse has offered no assurances against future violations. He is currently employed as a branch office manager for a broker or dealer and also acts as a registered representative. As a result, his occupation will afford him the opportunity to commit future violations.

### Disgorgement

Section 8A(e) of the Securities Act and Section 21C(e) of the Exchange Act provide that the Commission may enter an order requiring disgorgement, including reasonable interest, in any cease-and-desist proceeding. Disgorgement is designed to deprive a wrongdoer of his ill-gotten gains and deter others from violating the securities laws. SEC v. First City Financial Corp., 890 F.2d 1215, 1230-32 (D.C. Cir. 1989.) It returns the violator to where he would have been absent the misconduct. An order to disgorge a certain amount need only be a reasonable approximation of the profits causally connected to the violation. Id. at 1231-32.

Once the Division shows that its disgorgement figure reasonably approximates the amount of unjust enrichment, the burden shifts to the respondent to demonstrate clearly that the Division's disgorgement figure is not a reasonable approximation. SEC v. Lorin, 76 F.3d 458, 462 (2d Cir. 1996); SEC v. Patel, 61 F.3d 137, 140 (2d Cir. 1995.) Any risk of uncertainty as to the disgorgement amount falls on the wrongdoer whose misconduct created that uncertainty. First City, 890 F.2d at 1232.

Here, the Division requests that Muth be ordered to disgorge \$14,204.75. (Div. Post-Hearing Br. at 17.) In support thereof, the Division presented evidence that Muth earned \$14,204.75 in commissions resulting from purchases and sales in Bonso and Creative Host stock from November 2000 through May 2001 in the accounts of the seven customers who testified.<sup>28</sup> (Tr. 501-25; Div. Ex. 40.) Muth presented no evidence in opposition.

Based on the foregoing, I conclude that the Division's disgorgement figure reasonably approximates the amount of Muth's unjust enrichment. Therefore, Muth will be ordered to disgorge \$14,204.75, plus prejudgment interest. See Barbato, 53 S.E.C. at 1279-80 (ordering disgorgement with respect to commissions received only for violations pertaining to customers who testified at hearing).

### Civil Monetary Penalty

Under Section 21B(a) of the Exchange Act, the Commission may impose a civil monetary penalty if a respondent has: (1) willfully violated any provision of the Securities Act, the Exchange

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<sup>28</sup> The undisputed evidence is that Muth earned \$494,422.13 in commissions resulting from purchases and sales in Bonso and Creative Host stock from November 2000 through May 2001 in the accounts of all other customers. (Tr. 501-25; Div. Ex. 40.)

Act, or the rules and regulations thereunder; or (2) has failed reasonably to supervise, within the meaning of Section 15(b)(4)(E) of the Exchange Act. It must also find that such a penalty is in the public interest. In considering whether a penalty is in the public interest, the Commission may consider the following six factors: (1) fraud; (2) harm to others; (3) unjust enrichment; (4) prior violations; (5) need for deterrence; and (6) such other matters as justice may require. See Section 21B(c) of the Exchange Act.

Section 21B(b) of the Exchange Act specifies a three-tier system for determining the maximum amount of a penalty. For each “act or omission” by a natural person, the maximum amount of a penalty is \$5,000 in the first tier; \$50,000 in the second tier; and \$100,000 in the third tier.<sup>29</sup> 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 statutory maximum is not an overall limitation, but a limitation per violation. Thus, for example, each fraudulent misrepresentation to each investor constitutes a separate act or omission. See Mark David Anderson, 80 SEC Docket 3250, 3270 (Aug. 15, 2003) (imposing a civil penalty of \$1,000 for each of the respondent’s ninety-six violations). The Division seeks an order requiring Muth to pay a total civil monetary penalty in the amount of \$2,090,000, based on fourteen purchases of Bonso or Creative Host in the accounts of the customers who testified and his failure to timely execute sell orders for five of these customers. (Div. Post-Hearing Br. at 17.)

Here, Muth’s misconduct involved fraud and resulted in substantial losses to his customers and substantial gains to himself. He has been previously sanctioned and enjoined for other instances of misconduct. There was no mitigating evidence presented. In order to deter Muth and others from committing future violations, a third-tier penalty is warranted in the public interest.

Muth’s fraudulent conduct resulted in at least fourteen purchases of Bonso and Creative Host in the accounts of the customers who testified. He also failed to execute sell orders from five of these customers. On this record, I will require Muth to pay a civil penalty of \$2,090,000, as requested by the Division.

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<sup>29</sup> 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. For a natural person, the adjusted maximum penalty amounts for each violation occurring after December 9, 1996, and on or before February 2, 2001, were \$5,500 (tier one), \$55,000 (tier two), and \$110,000 (tier three), respectively. For violations occurring after February 2, 2001, the adjusted maximum penalty amounts for each violation were \$6,500 (tier one), \$60,000 (tier two), and \$120,000 (tier three), respectively.

As to Rouse, the Division requests that be ordered to pay a civil monetary penalty in the amount of \$110,000. (Div. Post-Hearing Br. at 18; Div. Reply at 9-10.) Rouse submitted financial information, which he claims evidences his inability to pay. (Rouse Ex. E.)

In any case in which the Commission may impose a civil penalty, a respondent may present evidence of his ability to pay the penalty. The Commission may, in its discretion, or the hearing officer may, in his or her discretion, consider such evidence in determining whether a civil penalty is in the public interest. See Section 21B(d) of the Exchange Act; 17 C.F.R. § 201.630. A respondent carries the burden of demonstrating an inability to pay. Brian A. Schmidt, 76 SEC Docket 2255, 2273 (Jan. 24, 2002). However, inability to pay is but one factor in determining whether a penalty is in the public interest. Schmidt, 76 SEC Docket at 2273-74.

The Division does not contest the financial statements that Rouse submitted, but contends that a civil penalty is in the public interest nonetheless. After examining the financial statements submitted by Rouse and the facts of this case, I agree with the Division.

There is no evidence that Rouse was unjustly enriched directly from Muth's conduct. As previously stated, however, Rouse's supervisory failures allowed and were partially responsible for the success and duration of Muth's fraud. Therefore, Rouse's activities involved fraud. See Consol. Inv. Servs., 52 S.E.C. at 590. For the same reasons, I also conclude that Rouse was at least an indirect cause of Muth's customers' losses. The Commission, NASD, and the State of Florida have each sanctioned Rouse previously. Given the importance of supervisors in protecting investors, there is a valid regulatory purpose in deterring supervisors from similar conduct. Accordingly, I will order Rouse to pay a civil penalty of \$110,000.

### **CERTIFICATION OF RECORD**

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 updated record index issued by the Secretary of the Commission on October 5, 2004.

### **ORDER**

Based on the findings and conclusions set forth above:

IT IS ORDERED THAT, pursuant to Section 8A of the Securities Act of 1933 and Section 21C of the Securities Exchange Act of 1934, Steven E. Muth shall cease and desist from committing or causing any violations or future violations of Section 17(a) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934, and Rule 10b-5 thereunder.

IT IS FURTHER ORDERED THAT, pursuant to Section 21B of the Securities Exchange Act of 1934, Steven E. Muth shall pay a civil penalty of \$2,090,000.

IT IS FURTHER ORDERED THAT, pursuant to Section 8A of the Securities Act of 1933 and Section 21C of the Securities Exchange Act of 1934, Steven E. Muth shall disgorge the sum of \$14,204.75, 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 May 1, 2001, through the last day of the month preceding the month which payment is made.

IT IS FURTHER ORDERED THAT, pursuant to Section 15(b) of the Securities Exchange Act of 1934, Richard J. Rouse is hereby barred from association with any broker or dealer in any supervisory capacity with the right to reapply for association after one year, and is hereby suspended from association with any broker or dealer in any capacity for nine months.

IT IS FURTHER ORDERED THAT, pursuant to Section 21B of the Securities Exchange Act of 1934, Richard J. Rouse shall pay a civil penalty of \$110,000.

Payment of the disgorgement, prejudgment interest, and civil penalty 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 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