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BEFORE THE COMMISSIONER OF SECURITIES AND INSURANCE
MONTANA STATE AUDITOR

IN THE MATTER OF: JOSEPH STONE CAPITAL, LLC, a Montana licensed broker-dealer; LAWRENCE SULLIVAN, individually and in his capacity as a Joseph Stone Capital employee; JAMES PARDY, individually and in his capacity as the chief compliance officer for Joseph Stone Capital; ADAM MAGGIO, individually and in his capacity as a Joseph Stone Capital employee; DAVID MENASHE, individually and in his capacity as a Joseph Stone Capital employee; ROSS BARISH, individually and in his capacity as a Joseph Stone Capital employee; and FRANK SPADARO, individually and in his capacity as a Joseph Stone Capital employee. Respondents.	CASE NO. SEC-2016-124 **NOTICE OF PROPOSED AGENCY ACTION AND OPPORTUNITY FOR HEARING**

Staff of the Office of the Commissioner of Securities and Insurance, Montana State Auditor (CSI), pursuant to the authority of the Securities Act of Montana, Mont. Code Ann. § 30-10-101 et seq. (the Act), is proposing to the Commissioner of Securities and Insurance, Montana State Auditor (Commissioner), that she take specific action against Joseph Stone Capital, LLC; Lawrence Sullivan; James Pardy; Adam Maggio; David Menashe; Ross Barish;

and Frank Spadaro (collectively Respondents) for violations of the Act. The Commissioner has authority to take such action under the provisions of §§ 30-10-102, 30-10-107, 30-10-201, 30-10-301, 30-10-304, 30-10-305, and 30-10-309. Service of process is pursuant to § 30-10-107(8).

In particular, the CSI recommends specific action against Respondents including, but not limited to, the imposition of appropriate fines, restitution, and licensure suspension or revocation pursuant to the provisions of the Act.

REASONS FOR ACTION

The following facts, if true, justify and support such specific action.

ALLEGATIONS OF FACT

1. Respondent Joseph Stone Capital, LLC (Joseph Stone), is a CSI registered broker-dealer, Central Registration Depository (CRD) #159744.

2. Respondent Lawrence Sullivan (Sullivan) is not now nor has he ever been registered with the CSI as a broker/dealer representative. He was employed as a Joseph Stone salesperson during the relevant time period.

3. Respondent David Menashe (Menashe) is a CSI registered broker/dealer representative, CRD # 5727269. He was employed as a Joseph Stone salesperson during the relevant time period.

4. Respondent Ross Barish (Barish) is a CSI registered broker/dealer representative, CRD # 3094364. He was employed as a Joseph Stone salesperson during the relevant time period.

5. Respondent Frank Spadaro (Spadaro) is a CSI registered broker/dealer representative, CRD # 4617772. He was employed as a Joseph Stone salesperson during the relevant time period.

6. Respondent James Pardy (Pardy) was the chief compliance officer and the registered options principal (ROSFP) at all times relevant to this action. He is not registered with the CSI in any capacity. His CRD number is 2900751,

7. Respondent Adam Maggio (Maggio) is a CSI registered broker/dealer representative, CRD # 4177365. He was employed at Joseph Stone and worked on M.B's account during the relevant period.

8. On or about January 15, 2016, the CSI received a cold call from Sullivan. The call was transferred from the CSI switchboard to CSI Assistant Analyst Patrick Navarro. Navarro had no prior knowledge of Sullivan. Sullivan pitched an investment about PayPal to Navarro. Navarro informed him that he was speaking to the CSI and that the CSI regulates the offer and sale of securities in Montana. At that point Sullivan denied he was attempting to solicit investment in a security by Navarro; said, "Happy new year," to Navarro; and hung up.

9. As a result of this cold call, the CSI requested information from Joseph Stone on the same day, January 15, 2016. Included in that request were:

a) a complete list of all Joseph Stone's Montana clients;

b) copies of all new client form statements and amendments for the clients identified in item (a) above;

c) copies of all monthly statements for the clients identified in item (a) above for the period January 1, 2013, to the present;

d) a copy of Joseph Stone's supervisory and policy procedures manual;

e) copies of all recordings in Joseph Stone's possession involving conversations with the clients for the accounts identified in item (a) above;

f) the name and CRD number of Sullivan's direct supervisor;

g) copies of all compliance memorandums, e-mail or other internal correspondence generated regarding Sullivan; and

h) a summary of compensation received by Joseph Stone for the business transacted with the clients identified in item (a) above for the period January 1, 2013, to the present.

10. As a result of this request, Joseph Stone noted there were seven Montana clients holding ten separate accounts, none of which were assigned to Sullivan. Moreover, six of the accounts had less than five trades. The CSI analyzed the four remaining accounts.

11. A CSI analysis of C.G.'s account revealed that Spadaro was the salesperson listed on the account, and that the following occurred over a 16-month period:

a) C. G. invested $533,348.48 with Joseph Stone;

b) Spadaro initiated 155 transactions in 30 securities in C.G.'s account. All were marked solicited even though C.G. was not contacted about the majority of the trades;

c) Several stocks were bought and sold several times over short periods including, but not limited to:

i. OPKO Health Inc. (purchased and sold 22 times over 12 months).

ii. Corporate Resources Services Inc. (transferred in and sold 7 times in the same month).

iii. Tower SemiConductor LTD (purchased and sold 17 times over 4 months).

iv. GLU Mobile Inc. (purchased and sold 12 times over 36 months).

d) The total of all trades resulted in $4,052,938.36 in purchases and $3,747,491.70 sales, with corresponding Looper[1] turnover rates of 30.52 and 28.22 respectively;

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[1] The Looper turnover rate generally calculates the total dollar amount of purchases during a time period divided by the average account equity and then annualized. See generally 38 S.E.C. 294 (1958). The rule of thumb concerning turnover is often referred to as the "2-4-6 Rule." The guideline views annual turnover rates as follows:

- Twice a year turnover is "suggestive" of excessive trading;
- Four times a year turnover is "indicative" of excessive trading; and
- Six times a year turnover is "conclusive" of excessive trading.

e) Spadaro made 6 option calls trades and 4 option puts trades in C.G.'s account;

f) Spadaro encouraged C.G. to trade on margin by representing that Joseph Stone would cover any margin calls that resulted from the trading.

g) The average hold period for a securities position in C.G.'s account was 51 days;

h) Joseph Stone and Spadaro received commissions totaling $114,858.44;

i) C.G.'s account lost $94,726.00

12. A CSI analysis of R.S.'s account revealed Menashe was the salesperson of record and that the following occurred over a 30-month period:

a) R.S. invested $86,684.56 with Joseph Stone;

b) Menashe initiated 52 transactions in 20 securities in R.S.'s account;

c) The total of all trades resulted in $2,650,549.30 in purchases and $2,646,295.46 sales, with corresponding Looper turnover rates of 11.48 and 11.46 respectively.

d) The average hold period for a securities position in R.S.'s account was 33.76 days;

e) Joseph Stone Capital and Menashe received commissions totaling $82,270.32.

f) Analysis of these facts revealed that, despite these commissions and turnover rates, R.S.'s account showed a positive return of $2,755.77 over the 30-month time period. This amounts to a 1.2% annual return in the account's total worth, while the market was performing at a rate of 10.3% annually during the same time period. Meanwhile, Respondents Joseph Stone and Menashe made a 94% profit on R.S.'s initial investment.

13. A CSI analysis of M.B.'s account revealed the following occurred over a 14-month period. Spadaro was the salesperson listed on the account at all times; Maggio was listed as a joint salesperson on the account beginning in July 2015:

a) M.B. invested $245,300.00 with Joseph Stone;

b) Spadaro and/or Maggio initiated 70 transactions in 14 securities in M.B.'s account;

c) The total of all trades resulted in $1,227,704.00 in purchases and $1,109,132.80 sales, with corresponding Looper turnover rates of 7.3 and 6.6 respectively;

d) Spadaro made 7 option calls trades, 5 of which expired, and 4 option puts trades in M.B.'s account;

e) The average hold period for a securities position in M.B.'s account was 77.5 days;

f) Respondent Joseph Stone received commissions totaling $40,330.21 on trading in the account;

g) M.B.'s account lost $74,092.52;

14. A CSI analysis of M.M.'s account revealed that Barish was the salesperson of record and that the following occurred over the 5-month period:

a) M.M. invested $12,159.95 with Joseph Stone;

b) Barish initiated 16 transactions in 8 securities in M.M.'s account, all of which were marked solicited even though M.M. was not contacted about the trades;

c) The total of all trades resulted in $95,600.40 in purchases and $93,434.41 sales, with corresponding Looper turnover rates of 38.06 and 37.20 respectively;

d) The average hold period for a securities position in M.M.'s account was 17.37 days;

e) Joseph Stone and Barish received commissions totaling $1,801.05;

f) M.M.'s account lost $4,073.32;

15. Joseph Stone's response to the CSI did not include any discussion or assertion related to churning or account turnover. Industry standards indicate churning as entering transactions for a client primarily to generate commission income and without regard for the financial objectives of the client. Churning may be evidenced by frequent in-and-out trading or

by repeated, rapid turnover of the portfolio and high commissions in relation to the equity in the account. Churning is likely to be found where there is excessive activity and a registered representative controlled the account.

16. C.G., M.B., and M.M all complained to Respondent Joseph Stone. A diligent response to those complaints was not maintained by the firms, nor reported on the CRD.

17. Respondent Pardy was the options principal and chief compliance officer for Joseph Stone at all relevant time periods. It was his responsibility to review transactions for appropriateness.

CONCLUSIONS OF LAW

1. The Montana State Auditor is the Commissioner of Securities and Insurance (Commissioner) pursuant to §§ 30-10-107, 2-15-1901, and 2-15-1903.

2. The Commissioner has jurisdiction over this matter pursuant to §§ 30-10-102, 30-10-107, 30-10-201, 30-10-301, 30-10-304, 30-10-305, and 30-10-307.

3. The Commissioner administers the Act, pursuant to §§ 2-15-1901 and 30-10-107.

4. The Commissioner shall administer the Act to protect the investor, persons engaged in securities transactions, and the public interest, pursuant to § 30-10-102(1).

5. At all times relevant to this action, Respondents Menashe, Barish, Maggio, and Spadaro were registered salespersons pursuant to § 30-10-201.

6. At all times relevant to this action, Respondent Joseph Stone was a registered broker-dealer pursuant to § 30-10-201.

7. Section 30-10-301 states a salesperson may not participate in fraudulent and other prohibited practices.

8. Fraudulent and other prohibited practices include any act, practice, or course of business that operates or would operate as a fraud or deceit upon any person. § 30-10-301(1)(c). Admin. R. Mont. 6.10.401 defines such practices. Each unethical practice is a separate violation of § 30-10-301(1)(c).

9. Admin. R. Mont. 6.10.401(1)(b) states that it is fraudulent and unethical for a broker-dealer or salesperson to induce trading in a customer's account which is excessive in size or frequency in view of the financial resources and character of the account.

10. Respondent Spadaro violated Rule 6.10.401(1)(b) when two accounts under his control were traded with effective Looper turnover rates in excess of 30 and 7, respectively, without authorization to do so.

11. Rule 6.10.401(1)(d) states that it is fraudulent and unethical to execute a transaction on behalf of a customer without authorization to do so.

12. Respondent Spadaro violated Rule 6.10.401(1)(d) when he engaged in excessive trading and traded on margin without explicit permission to do so. Spadaro also violated this rule when he made options calls, puts purchases, and sales without permission.

13. Admin. R. Mont. 6.10.401(1)(d) states that it is fraudulent and unethical for a broker-dealer or salesperson to execute a transaction on behalf of a customer without authorization to do so.

14. Respondent Spadaro violated 6.10.401(1)(d) when he executed trades without consulting clients and failed to document such trading.

15. Admin. R. Mont. 6.10.401(1)(e) states that it is a fraudulent and unethical for a person to exercise discretionary power in effecting a transaction for a customer's account without first obtaining written discretionary authority from the customer.

16. Respondents violated 6.10.401(1)(e) when they made discretionary trades without authorization to do so.

17. Admin. R. Mont. 6.10.401(1)(k) states that it is fraudulent and unethical for a broker-dealer or salesperson to charge unreasonable and inequitable fees for services performed.

18. Respondents Joseph Stone, Spadaro, Menashe, Maggio, and Barish violated 6.10.401(1)(k) when they charged total commissions of $239,260.02 out of the $877,492.99 principal originally invested by Montana clients, or 28% of their total investment.

19. Cumulatively, these violations also constitute a business practice that operated as a fraud or deceit upon a person or persons under § 30-10-301(1)(c).

20. Section 30-10-301(1)(c) states that it is unlawful for any person, in connection with the offer, sale, or purchase of any security, to engage in any act, practice, or course of business that operates or would operate as a fraud or deceit upon a person.

21. Respondent Spadaro violated § 30-10-301(c) when he traded on margin without permission, which caused margin calls in the account while Respondent Spadaro collected commissions.

22. Section 30-10-201(13)(g) states a salesperson may not participate in dishonest and unethical practices. Admin. R. Mont. 6.10.401(2) defines unethical practices under this section. Each unethical practice is a separate violation of § 30-10-201(13)(g).

a) Admin. R. Mont. 6.10.401(2)(g) states a salesperson may not engage in conduct such as manipulative or deceptive practices.

b) Respondents Joseph Stone and Spadaro violated 6.10.401(2)(g) when they informed C.G. they would cover any margin losses.

23. Section 30-10-201(13)(k) states a person who fails to reasonably supervise the person's salespersons or employees has violated the Act.

24. Respondents Joseph Stone and Pardy violated § 30-10-201(13)(k) by failing to supervise its salespersons when it failed to review trading frequency and amounts;

25. Section 30-10-321 states that for purposes of any action brought by the commissioner under § 30-10-301, any person that knowingly provides substantial assistance to another person in violation of a provision of this part or of any rule or regulation issued under this part must be considered to be in violation of that provision to the same extent as the person to whom the assistance is provided.

26. Respondents Joseph Stone and Pardy violated § 30-10-321 when they ignored the excessive transactions in, and the excessive commissions charged in, the Montana based accounts, neglected to report actions to the CSI and CRD, and allowed trades to go through

without contacting Montana clients, thereby providing substantial assistance to fraudulent actions as defined in the administrative rules, which work in conjunction with § 30-10-301.

27. It is unlawful for a person to transact business as a broker-dealer salesperson in Montana without proper registration § 30-10-201(1). To transact a security also means to offer a security. § 30-10-103(24). To offer a security includes each attempt or offer to dispose of or solicitation of an offer to buy a security or interest in a security for value.

28. Respondent Sullivan violated § 30-10-201(1) when he solicited a Montana resident to purchase shares in PayPal and eBay without proper registration. Joseph Stone's insufficient policies and procedures allowed for Respondent Sullivan to sell securities while not being registered.

RELIEF REQUESTED

WHEREFORE, the CSI seeks the following relief:

1. Order Respondents severally to pay fines not to exceed $5,000 for each identifiable violation of the Act, pursuant to § 30-10-305(3).

2. Order Respondents to pay restitution pursuant to § 30-10-309(1).

3. Order Respondent Joseph Stone's registration as a broker-dealer in Montana be revoked for violating provisions of the Act, pursuant to § 30-10-201(13).

4. Order Respondent Spadaro's, Respondent Barish's, Respondent Menashe's, and Respondent Maggio's salesperson licenses be revoked.

5. Order Respondent Lawrence Sullivan and Respondent James Pardy be permanently barred from conducting business in Montana.

6. Any other remedy the Commissioner deems appropriate.

PUBLIC INTEREST

For any and all of the reasons set forth above, it is in the public interest and will protect Montana investors to take the actions listed in the relief requested, and to take any other action necessary to ensure Montana investors are protected.

STATEMENT OF RIGHTS

You are entitled to a hearing to respond to this notice, and to present evidence and arguments on all issues involved in this case. You have a right to be represented by an attorney at any and all stages of this proceeding. You may demand a formal hearing before a hearing examiner appointed by the Commissioner pursuant to the Montana Administrative Procedure Act, § 2-4-601 et seq. including § 2-4-631. If you demand a hearing, you will be given notice of the time, place, and the nature of the hearing.

If you wish to contest the proposed action under the jurisdiction of the Commissioner, you must advise the Commissioner within 15 days of the date you receive this notice. You must advise the Commissioner of your intent to contest the proposed action by writing to Brett O'Neil, State Auditor's Office, 840 Helena Avenue, Helena, Montana 59601. Your letter must clearly indicate whether you demand a hearing, or whether you waive formal proceedings and, if so, what informal proceedings you prefer for disposition of this case. Pursuant to § 2-4-603(2), you may not request to proceed informally if the action could result in suspension, revocation or any other adverse action against a professional license. Should you request a hearing on the matters raised in this Notice, a hearing must be held within a reasonable period of time unless postponed by mutual consent of the parties, pursuant to § 30-10-305.

Should you request a hearing, you have the right to be accompanied, represented, and advised by counsel. If the counsel you choose has not been admitted to practice law in the state of Montana, he or she must comply with the requirements of *Application of American Smelting and Refining Co.* (1973), 164 Mont. 139, 520 P.2d 103, and *Montana Supreme Court*

Commission on the Unauthorized Practice of Law v. O'Neil, 2006 MT 284, 334 Mont. 311, 147 P.3d 200.

CONTACT WITH COMMISSIONER'S OFFICE

If you have questions or wish to discuss this matter, please contact Brett O'Neil, legal counsel for the CSI, at 840 Helena Avenue, Helena, MT, 59601, 406-444-2040. If an attorney represents you, please make any contacts with the CSI through your attorney.

POSSIBILITY OF DEFAULT

Failure to give notice or to advise of your demand for a hearing or informal procedure within 15 days will result in the entry of a default order imposing the disciplinary sanctions against you without further notice to you, pursuant to Mont. Admin. R. 6.2.101, and the Attorney General's Model Rule 10, Mont. Admin. R. 1.3.214.

DATED this 7th day of June, 2016.

BRETT O'NEIL
Attorney for CSI

CERTIFICATE OF SERVICE

I hereby certify that a true and accurate copy of the foregoing was served on the 8th day of June, 2016, by US mail, certified first-class postage paid, to the following:

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