

NEW YORK STOCK EXCHANGE, INC.

EXCHANGE HEARING PANEL DECISION 04-95
SUSQUEHANNA SPECIALISTS, INC.
MEMBER ORGANIZATION

September 8, 2004

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**Failed to appropriately supervise its specialist operations in violation of
Exchange Rule 342 – Censure and \$25,000 fine.**

Appearances:

For the Division of Enforcement
Linda S. Riefberg, Esq.
Penny Rosenberg, Esq.
Suzanne R. Elovic, Esq.
Michael C. Grey

For the Respondent
Andrew E. Tomback, Esq.
Richard T. Sharp, Esq.
David Sieradzki, Esq.
Sander Bak, Esq.
Michelle M. Campana, Esq.
Kendra Fershee, Esq.
Richard J. McDonald, Esq.

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An Exchange Hearing Panel conducted a hearing on charges brought by the Exchange's Division of Enforcement against Susquehanna Specialists, Inc., a member organization (the "Firm"). The Firm was charged with having:

- I. Through a member associated with it as a specialist, failed to maintain a fair and orderly market in an Exchange-listed security by failing to comply with the specialist's affirmative obligation to maintain a liquid and continuous two-way auction market in violation of Exchange Rule 104.10.
- II. Failed to appropriately supervise its specialist operations in violation of Exchange Rule 342.

The Firm, through its counsel, submitted an Answer which admitted certain of the facts in the Charge Memorandum and denied others. The Firm denied the specific charges. After receiving evidence, the Exchange Hearing Panel found as follows:

Background

1. The Firm has been a member organization of the Exchange since 1994.
2. The Firm is the specialist for approximately 150 listed securities on the Exchange, including XYZ. In 2002, the Firm employed approximately 15 specialists and 60 clerks.

3. At all relevant times, the Firm was the registered specialist member organization for the common stock of XYZ.
4. At all relevant times, X was the individual at the Firm assigned as the specialist for XYZ.
5. X became a specialist with Firm A in 1987. In March 2000, the Firm acquired Firm A and X continued as a specialist with the Firm.
6. The investigation was referred by the Division of Market Surveillance of the Exchange to the Division of Enforcement of the Exchange.
7. By letter dated November 14, 2002 to the Firm and X, which they received, the Division of Enforcement (“Enforcement”) notified them that it was investigating the trading in XYZ on June 25, 2002.

The Market in XYZ

8. On the morning of June 25, 2002 there was a 14 million-share offering in XYZ at a price of \$56.60. ABC acted as the offering’s lead underwriter.
9. Prior to the opening of trading in XYZ on the Exchange, an ABC junior Floor broker, JB, who was handling transactions for the underwriting syndicate, told X that ABC would bid at the opening at the offering price of \$56.60.
10. At approximately 9:35 a.m., trading in XYZ opened on the Exchange with a transaction of 1,085,500 shares at a price of \$56.60; ABC purchased approximately 650,000 of their shares.
11. Between the opening and 9:43:51 a.m., approximately 1,200,000 shares of XYZ were executed at a price of \$56.60 with the exception of one ITS (“Intermarket Trading System”) transaction of 100 shares at a price of \$56.61. During that period, ABC purchased approximately 800,000 shares and X purchased 51,000 shares for the Firm dealer account.
12. A senior broker, SB, from ABC was with JB for the opening and remained with him for approximately the next five minutes of trading. The opening and the initial trading was uneventful so SB left the crowd.
13. Shortly thereafter the sell volume began to snowball and JB found himself with more stock offered than he had orders to buy. He had an order to buy 200,000 shares at a price of \$56.60, the offering price. X informed him that he had orders to sell 300,000 shares.
14. JB asked X for time to see if he could get more stock to buy. He came back with a bid for 100,000 shares at a top of \$56.50 or a dime below the offering price. This was

at approximately 9:43:50 a.m. X understood that the order was 10,000 shares to buy at \$56.50.

15. Whatever the size of that order it was no longer at the offering price. It was reasonable to assume that ABC was no longer supporting the offering price but was walking the price down.
16. It was unusual for an underwriter to bust the offering price just nine minutes into trading. However, there was a growing volume of sell orders possibly caused in part by a financial news service republishing old but negative information about XYZ.
17. X correctly decided to ask for a Floor Governor. The nearest Floor Governor was spoken to and it was determined that he could not assist because he had an order in XYZ. Another Floor Governor was sought out and he, FG, arrived at the post.
18. He began to assess the situation while the sell imbalance continued to grow. After a discussion with the specialist, the quote was spread to a \$51 bid, offered at \$56.60. There was a discrepancy in testimony as to what price the specialist was willing to purchase the imbalance or the entire amount for sale. The amounts were \$51, \$53 or \$54 and \$54.60. The stock could not trade at any of these prices without FG's approval.
19. Quoting the stock at \$51, a price that FG would not approve for a trade, was intended to bring in additional buyers and stabilize the stock. The quote was spread or gapped at 9:46:34 a.m. almost three minutes after the last trade.
20. In the meantime, SB had returned to the crowd and spoke to JB and FG. He also assessed the selling interest in the crowd and added that to the sell interest that the specialist had. He determined that he needed to bring down to the Floor a major buy order to make a stand and stem the tide of sell orders.
21. SB passed his request through a booth clerk to the upstairs trader who was sending the buy orders to the Floor. SB wanted to have one million shares to buy on the Floor. He received an order for 500,000 shares to buy at \$55 at 9:53:38 a.m. Together with the orders already on the Floor, this gave him the one million shares to buy, which could trade at \$55.
22. For the first time since the order imbalance started, ABC now had a buy order larger than the sell interest. SB let everyone know of ABC's willingness to pay \$55 for up to a million shares.
23. Now the Firm commenced to collect paper from the crowd. These orders had to be matched against paper orders they were already holding to determine order cancellations and new orders. In addition, X told some brokers who had to leave the crowd that he would put them up (page them) before the stock traded. All of this was done to achieve an exact count for the print.

24. A transaction of 1,427,200 shares of XYZ at \$55 printed on the tape at 10:00:20 a.m. ABC purchased approximately 800,000 of those shares and X purchased 200,000. The remaining shares were purchased by orders on the book.
25. Charge I is based on the almost 17-minute gap in trading of XYZ from 9:43:51 a.m. to 10:00:20 a.m. That gap is attributed to X and through him to the Firm. Had this not been a secondary, it is likely that a trading halt would have occurred based on the sell imbalance and the stock would have been reopened. In effect, that is what happened but without an official trading halt. However, none of the participants were eager to have a trading halt in a secondary.
26. The length of the gap was unfortunate, but it is not fair to attribute it to X or his Firm. When the rising tide of sell orders swamped the buy orders on the Floor, X waited reasonably for JB to get additional buy orders. When the buy order came in, it was not an order to buy at \$56.60 but ABC broke the offering price support by a dime at \$56.50.
27. This break in the price support was a surprise to X and also to JB, the ABC broker. X prudently called for a Floor Governor given the rapidly growing sell order imbalance and the probable break in ABC's support of the offer price. The first Floor Governor addressed was unable to participate and another was sought and obtained.
28. The Governor assessed the situation, the quote was gapped or spread, and ABC was asked about getting more buying power onto the Floor. SB was about to get a large buy order to the Floor. Orders were then collected and corrected, absent brokers were paged to give them an opportunity to return and participate, and finally the trade printed. X acted reasonably in trying to get additional buy orders from the underwriter, especially given the growing sell imbalance. X was not reluctant to trade or commit Firm capital; in fact, he was a broker willing to take major positions. His participation in the print described in paragraph 24 above was approximately \$11 million.

Failure to Supervise

29. The Firm's conduct in regard to supervision can be broken down into two distinct parts. At the time of these events, the Firm did not have formal written organization charts or procedures. This included a table of supervision as to who was in charge in the absence of senior Firm personnel or a listing of the members of the Firm's SWAT team to deal with large crowds and other situations.
30. Even though there was an absence of written material, Firm personnel seemed aware of the necessary information. This may have been due to the relatively small size of the Firm or the Firm's regular weekly meetings.
31. The other aspect of the Firm's supervision relates specifically to the morning of June 25, 2002 when the 17-minute trading hiatus occurred. On that day, the Firm's senior partner was not present, and the Firm was supervised from the Floor by a second partner, SP.

32. SP traded a panel of about 10 less active stocks. In addition, he had a permanent back-up specialist which enabled him to leave his panel on a moment's notice.
33. SP's philosophy was to let the specialists do what they were trained to do on their own. His basic supervisory technique was to walk around the post between one and six times an hour depending on events.
34. SP was aware of the secondary and noted that at 9:15 or 9:20 a.m., the secondary seemed like a non-event. Later on he noticed X and FG in discussion and saw the gapped quote on the panel above them. He was not previously aware of the gapped quote.
35. SP continued to walk. He did not talk to X or FG and ask what was happening. His upstairs office made him aware of a negative news story about XYZ on a financial news wire, but he did not share it with X until after trading resumed.
36. SP was aware that something unusual was taking place, but he did not investigate or offer to help. This was not reasonable supervision; it was no supervision.

DECISION

The Hearing Panel, by unanimous vote, found the Firm not guilty of Charge I, finding that X reasonably complied with the obligations of a specialist in difficult circumstances. The Hearing Panel, also by unanimous vote, found the Firm guilty of Charge II, finding that a senior partner of the Firm failed to exercise supervision during a 17-minute period on June 25, 2002.

PENALTY

In view of the above findings, the Hearing Panel, by unanimous vote, determined that the Firm be censured and fined \$25,000.

For the Hearing Panel

Vincent F. Murphy
Hearing Officer