

NEW YORK STOCK EXCHANGE LLC

NYSE HEARING BOARD DECISION 07-148

September 18, 2007

X
FLOOR BROKER

* * *

Violated NYSE Rule 476(a)(6) by effecting transactions for customer which he should have known would improperly influence the price of a security – Censure and \$5,000 fine.

Appearances

For the Division of Enforcement
Linda Reifberg, Esq.
Penny Rosenberg, Esq.
Richard Best, Esq.
Pamela Huff, Esq.

For Respondent
George Brunelle, Esq.
Timothy P. Kebbe, Esq.

* * *

An Amended Charge Memorandum was issued by NYSE Regulation, Inc.'s ("NYSE") Division of Enforcement ("Enforcement"), charging X ("X" or "Respondent"), or Floor broker, with having:

- I. Violated NYSE Rule 435(3) in that he caused the sale of a security to be executed on the NYSE at successively lower prices for the purpose of unduly or improperly influencing the market price of such security and/or for the purpose of making a price which did not reflect the true state of the market in such security.
- II. Violated NYSE Rule 476(a)(6) in that he engaged in conduct inconsistent with just and equitable principles of trade by effecting transactions for another person which he knew or should have known would improperly influence the price of an NYSE listed security.

Respondent submitted an Amended Answer denying the charges, and raising, largely in the form of conclusory assertions, a number of affirmative defenses.

On June 6, 2007, Enforcement filed a Motion for Summary Judgment (the “Motion”) requesting that the Hearing Board find Respondent guilty of having violated both NYSE Rule 435(3) (Charge I) and NYSE Rule 476(a)(6) (Charge II) on the basis that there were no genuine issues of material fact and that Enforcement was entitled to judgment as a matter of law.

On June 29, 2007, Respondent filed a Memorandum of Law in opposition to the Motion, contending that there were issues of material fact, particularly as to whether he acted with wrongful intent, that precluded summary judgment. He further argued that the charges should be dismissed, which the Hearing Officer handling this matter on behalf of the New York Stock Exchange LLC, considered to be a motion to dismiss for failure to state a cause of action.

On July 19, 2007, the Hearing Officer issued an Order (“Summary Judgment Order”) which granted Enforcement’s Motion with respect to Charge II (violation of NYSE Rule 476(a)(6)), denied Enforcement’s Motion with respect to Charge I (violation of NYSE Rule 435(3)), and granted Respondent’s motion to dismiss Charge I on the ground that Enforcement had failed to state a cause of action. A copy of the Summary Judgment Order is attached to this Decision as Appendix A.

As set forth in the Summary Judgment Order, the Hearing Officer took note of the following undisputed facts in resolving the Motion:

1. Respondent’s employment in the securities industry began in May 1992, when he was hired as a part-time clerk while still in college. He became a full-time employee in 1994.
2. Respondent left his then-member firm in April 1996 and became employed on the Floor of the NYSE with a different member firm as a booth clerk.
3. In May 1996, Respondent became employed as a booth clerk by a sole proprietor.
4. In October 1996, Respondent became employed by Princeton Securities Group, Inc. (“Princeton”) as a booth clerk.
5. In the summer of 2000, Respondent became employed as a Floor broker by Princeton. He continued to be employed in this capacity with Princeton until September 2003, when Princeton terminated his employment.
6. While employed by Princeton, Respondent held the Series 7, 12, 14, and 63 securities licenses.
7. On the trading date in question, August 21, 2003, Respondent was executing orders entered by a hedge fund (“HF”) to purchase shares of XYZ stock. HF had been directing orders to Princeton to purchase shares of XYZ throughout August 2003.

8. JB was a booth clerk employed by Princeton on this date. JB received orders from HF's head trader, and transmitted them to Princeton brokers, including Respondent, for execution.
9. At approximately 9:47 a.m. on August 21, 2003, HF's head trader began to place orders with JB for the purchase of XYZ. JB routed these orders to Respondent's hand-held terminal for execution. During the trading sequences at issue, Respondent was never in direct communication with anyone on HF's trading desk.
10. Between 11:06 a.m. and 11:19 a.m., sell stop orders totaling 520,400 shares were entered in XYZ at a price of \$4.25. These orders were entered onto the specialist's book for representation by the specialist. At this time, XYZ was trading above the \$4.25 stop price.
11. At approximately 11:20 a.m., the specialist in XYZ informed Floor brokers in the trading crowd, including Respondent, of the large sell stop order interest with a stop price of \$4.25. At that time, Respondent was representing HF's order to purchase 50,000 shares of XYZ, market not held.
12. Respondent called JB to ask him to inquire whether HF had additional interest in buying XYZ. By this time, Respondent had already purchased approximately 1,000,000 shares of XYZ for HF. Overall, the market in XYZ on this day was more heavily traded than usual.
13. JB discussed the matter with HF's head trader, who gave JB an order, time-stamped at 11:27:15 a.m., to purchase 300,000 shares of XYZ at \$4.20, not held. The order was transmitted to Respondent, who promptly told the specialist of HF's buying interest.
14. The specialist then told Respondent that there was a sizable pre-existing bid at \$4.20, and that Respondent should inquire whether his customer could pay more for the stock.
15. Respondent then discussed this with JB, who relayed the information to HF's head trader.
16. HF's head trader then canceled the limit order at \$4.20 and entered two new limit orders, totaling 500,000 shares, at a limit price of \$4.21, not held. These orders were entered between 11:30:33 and 11:30:46 a.m. At this time, the quotation in XYZ was \$4.26 bid, offered at \$4.28.
17. Between 11:31:16 and 11:31:27 a.m., HF's head trader canceled the two limit orders at \$4.21, and entered new limit orders, totaling 500,000 shares, to purchase XYZ at a price of \$4.25 not held. During this time, 25,900 shares of XYZ traded at prices between \$4.26 and \$4.28. Respondent was not involved in these trades.

18. At 11:32:33 a.m., 600 shares of XYZ traded at \$4.28. At 11:34:07, 100 shares of XYZ traded at \$4.28. Respondent was not involved in either trade.
19. At 11:34:08 a.m., with the market in XYZ quoted \$4.27 bid, offered at \$4.29, JB time-stamped an order from HF to sell 100,000 shares of XYZ at \$4.25, not held.
20. JB understood HF's head trader as saying that the order should be executed in such fashion as to elect the sell stop orders at \$4.25 on the specialist's book, and that Respondent should then purchase as much of the stop orders as possible.
21. Before relaying HF's head trader's instructions and the sell order to Respondent, JB discussed HF's orders with MF, a Senior Floor Official of the NYSE and a senior Floor broker with Princeton. JB understood MF to say that it was proper to execute the orders.
22. After receiving what he understood to be MF's approval, JB forwarded the orders to Respondent's hand-held terminal. Upon receipt of the order, Respondent called JB to ask about the identity of the seller.
23. JB told respondent that the order had been entered by HF, and JB expressed his understanding that MF had approved the execution of the orders.
24. At 11:34:50 a.m., with the market in XYZ quoted \$4.27 bid, offered at \$4.29, Respondent sold 15,000 shares of XYZ at \$4.27, the prevailing bid. This transaction was down \$.01 from the prior sale.
25. At 11:35:02, Respondent sold 35,000 shares at \$4.25, the prevailing bid in the market. This trade, down \$.02 from the immediately prior trade, which Respondent had also executed, elected the sell stop orders at \$4.25.
26. At 11:35:15 a.m., Respondent executed HF's order to buy 500,000 shares of XYZ at \$4.25.
27. At 11:36:45 a.m., JB canceled the remaining 50,000 shares of the HF sell order.
28. On October 23, 2003, in a deposition conducted by the NYSE's Market Surveillance Division, Respondent acknowledged that he understood his execution of HF's sell order would elect the stop orders.

DECISION

For the reasons set forth in the Summary Judgment Order, which is incorporated hereto and made a part hereof, the Hearing Officer found Respondent guilty of Charge II in that Respondent violated NYSE Rule 476(a)(6) by engaging in a violation of just and equitable principles of trade in that he effected transactions which he should have known would improperly influence the

price of a security. The Hearing Officer dismissed Charge I on the ground that Enforcement had failed to state a cause of action for intentional misconduct. See Appendix A.

PENALTY

On July 23, 24, and 31, 2007, a Hearing Panel on behalf of the New York Stock Exchange LLC was convened to hear evidence and argument concerning the penalty to be imposed (the “Penalty Hearing”). In reaching its decision on this matter, the Hearing Panel considered the evidence and argument presented at the Penalty Hearing, as well as the factors for determining sanctions as discussed in McCarthy v. SEC, 406 F.3d 179 (2d Cir. 2005) and Factors Considered by the New York Stock Exchange Division of Enforcement in Determining Sanctions, Info. Memo. 05-77 (Oct. 7, 2005) (“Information Memo 05-77”). In addition, the Hearing Panel considered various authorities presented by the parties, including, in particular, Jonathan F. Gutman, Decision 95-148 (NYSE Hearing Board Nov. 1, 1995) and Timothy Anderson, Decision 06-129 (NYSE Hearing Board July 10, 2006). These two cases bear directly on the improper influencing of market prices to elect stop orders, the precise issue in the instant case. However, the Hearing Panel considered the precedent cases only for guidance and based its decision on the particular facts and circumstances of the case before it. See Information Memo 05-77.

Enforcement sought a penalty of a censure, a one-month suspension, and a \$50,000 fine. For the reasons discussed below, the Hearing Panel determined to impose a lesser penalty. In the Hearing Panel’s view, mitigating considerations in this case, while clearly not excusing the violation of just and equitable principles of trade, warranted imposition of such lesser sanction, particularly in light of the factors put forth in McCarthy and Information Memo 05-77. Moreover, precedent cases such as Gutman and Anderson, while supporting the finding of liability, both involved more egregious conduct with greater adverse market impact than the instant case, but both resulted in lesser sanctions than those sought by Enforcement herein.

Both the Gutman and Anderson cases were settled by a Stipulation of Facts and Consent to Penalty, executed between each respondent and Enforcement, with no formal finding of scienter. But a fair reading of the stipulated facts in both cases clearly points to knowing and intentional participation in a scheme to improperly elect stop orders (Gutman) or actual initiation and implementation of such a scheme (Anderson), behavior that Enforcement has not demonstrated exists in the instant case. In Gutman, the penalty was a censure, a one-month bar, and a \$25,000 fine. In Anderson, which also involved short sale and order ticket violations, the penalty was a censure and a \$50,000 fine, with no suspension.

In the instant case, notwithstanding its inability to state a cause of action for scienter, Enforcement has sought penalties greater than those imposed in Gutman and Anderson. The Hearing Panel does not accept Enforcement’s position in this regard.

The first factor listed in McCarthy is the seriousness of the offense. McCarthy, 406 F.3d at 190. Information Memo 05-77 also lists this as its first factor, noting the nature of the wrongdoing and the degree of scienter involved. Enforcement’s position is clearly stated: “Cases where the misconduct derives from action that is intentional or knowing, or where there is reckless or deliberate indifference to misconduct, will generally be treated with greater severity than cases

where the misconduct derives from lower levels of awareness such as negligence.” NYSE Info. Memo. 05-77 at 2.

In the instant case, as resolved in the Summary Judgment Order, it was determined that Enforcement had failed to state a cause of action for scienter. Thus, the sanction to be imposed in this case, in accord with Enforcement’s own position (Hearing Transcript (“Tr.”) at 13), ought to be less than would be imposed had there been a finding that Respondent was guilty of intentional misconduct. See NYSE Info. Memo. 05-77 at 2.

Both McCarthy and Information Memo 05-77 list the harm caused by misconduct as a significant consideration in imposing sanctions. In order to indicate the extent to which Respondent’s misconduct harmed the investing public, Enforcement presented evidence that Respondent’s then-employer, Princeton, reached a negotiated settlement for the reimbursement of approximately \$280,000 to the broker-dealer firm that had entered the sell stop orders on behalf of its customers. See Enforcement’s Exhibit (“Enf. Ex.”) 1. This “price adjustment” was based on the closing price in XYZ of \$4.80, eight trading days after Respondent’s election of the stop orders. See Tr. at 55-57; Respondent’s Exhibit (“Resp. Ex.”) 73.

Enforcement did not present evidence as to how this settlement figure was reached, or how it could be correlated to any specific trading loss that may have been suffered by the sell stop order customers.

Respondent presented credible evidence that errors in trading are usually resolved, at the latest, by the opening on the next trading day, and, therefore, the settlement figure could not accurately reflect harm caused to the trading public. See Tr. at 143-44. The Hearing Panel concluded that Enforcement had failed to present any assessment of actual economic loss that could be fairly correlated to Respondent’s actions. It should also be noted that Respondent presented credible evidence that, while the trades at issue should not have occurred, when they did occur Respondent executed the orders in such fashion as to give maximum benefit to other market participants to the possible detriment of his own customer. See Tr. at 182-88, 302-04.

Another way of considering the harm in this case is to look at the degree of price dislocation/distortion of the market’s natural supply-demand pricing mechanism caused by Respondent’s actions. The actual market impact can be considered as either three cents (the difference between the last independent sale and the electing sale) or two cents (the exhaustion of independent buying interest). Tr. at 256, 273-74. In contrast, the Gutman case involved a price dislocation of 37.5 cents, and Anderson involved initiation and implementation of a scheme that resulted in price dislocation of 44 cents.

Respondent acknowledged that the NYSE may suffer a reputational harm if floor brokers improperly influence the price of securities (Tr. at 291-92), and Enforcement presented evidence that such misconduct would reduce credibility and investor confidence in the NYSE. Tr. at 78-80. However, Respondent also presented evidence that an isolated event, such as in the instant case, would not cause any significant harm to the NYSE’s reputation. Tr. at 215-16. Both Gutman and Anderson thus involved scienter-based activity with potentially a much greater negative impact on public perception of the fairness and orderliness of the NYSE market, yet

both resulted in lesser sanctions than those sought by Enforcement in the instant case. The Hearing Panel concluded that Enforcement's position is untenable in this regard.

The factors listed in Information Memo 05-77 include considerations of the extent of misconduct and a respondent's prior disciplinary record. Enforcement did not present any evidence to indicate that Respondent's actions in the instant case were anything other than an isolated, single incident, which took place over a time period of about 75 seconds. There was no evidence introduced of any other regulatory or disciplinary problem involving Respondent, either prior to the activity in question, or in the four years that have followed.

Both McCarthy and Information Memo 05-77 list potential gain to a respondent as a factor to consider in imposing sanctions. The Respondent's testimony, uncontroverted by Enforcement, was that he did not profit in any way from the trading at issue. Tr. at 245.

Furthermore, both McCarthy and Information Memo 05-77 contemplate as a factor the potential for repetition or the implementation of corrective measures. The Hearing Panel received uncontroverted testimony from Enforcement's own witness, an NYSE Executive Floor Official, that Respondent is knowledgeable about NYSE rules, is perceived by his peers as honest and ethical, and has been recommended for appointment as a Floor Official, an honor reserved for only the most highly thought-of NYSE Floor members. Tr. at 91-101. There was no evidence introduced at the Penalty Hearing to suggest any likelihood of future violative conduct by the Respondent. Furthermore, Respondent testified that, as a result of this proceeding, he is "conscientious of understanding every rule [he] possibly can get [his] hands on." Tr. at 263.

Information Memo 05-77 lists acceptance of responsibility as a factor in determining sanctions. At the Penalty Hearing, the Respondent effectively acknowledged liability by forthrightly admitting that he understood that he had made a mistake in executing the orders as he did. Id.

Information Memo 05-77 also lists reliance on professional advice as a factor to consider in imposing sanctions. In the instant case, the Respondent testified at the Penalty Hearing that it gave him "pause" when he received the orders that resulted in the violative trades, but that he relied on a booth clerk's representation that a senior trader at his firm, who happened to be an NYSE Senior Floor Official, had indicated that it was permissible to execute the orders. Tr. at 242, 256. With what he then believed to be reasonable reassurance, and under what he felt to be urgent time pressure, Respondent then proceeded to execute the orders. At the Penalty Hearing, Respondent effectively admitted that, in hindsight, what he did was inadequate, and that he should have sought independent advice. Tr. at 241. As noted in the Summary Judgment Order, Respondent did not discuss the matter with a Floor Official, and could not have been certain that the senior trader at his firm had understood all the facts and had made an informed decision. Nonetheless, Respondent's actions demonstrated some degree of effort to obtain professional advice to ensure that he was complying with the rules, indeed, Respondent did not simply rush to execute the orders as soon as he received them.

With respect to the imposition of a suspension from membership as a sanction, the McCarthy decision states that the purpose of a suspension or expulsion "is to protect investors, not to penalize brokers." McCarthy, 406 F.3d at 188. In the Hearing Panel's view, due to the existence

of numerous mitigating factors, no such remedial purpose would be served in the instant case by imposing such a sanction on Respondent. Furthermore, following the implementation of the Hybrid Market system, specialists on the Floor no longer see accumulating stop order volume and, thus, cannot communicate that information to the trading crowd. See Hybrid Market Implementation – Phase III, Info. Memo. 06-73 (Oct. 6, 2006); NYSE Rule 1004. Therefore, any general deterrent value of a harsh penalty is reduced in that the specific conduct here is much less likely to occur because brokers are no longer aware of the accrual of stop orders. See Tr. 257-62.

The Hearing Panel concluded that Respondent's actions constituted a one-time error in professional judgment by an otherwise conscientious, well-regarded Floor broker with a spotless regulatory and disciplinary record. Under the facts and circumstances of the instant case, the Hearing Panel determined to impose a penalty of a censure and a \$5,000 fine.

For the Hearing Panel

Brian McNamara
Hearing Officer

Panelists
Maryellen Crawford
Robert Schnell

435(3) charge and again raised, largely in the form of conclusory assertions, affirmative defenses. He also sought to inspect documents in the possession or within the control of the NYSE and Enforcement.

On June 6, 2007, Enforcement filed a Motion for Summary Judgment (the “Motion”), requesting that the Hearing Board find Respondent guilty of having violated both NYSE Rule 435(3) (Charge I) and NYSE Rule 476(a)(6) (Charge II) on the basis that there were no genuine issues of material fact and that Enforcement was entitled to judgment as a matter of law. On June 29, 2007, Respondent filed his Memorandum of Law in Opposition to Enforcement’s Motion for Summary Judgment (the “Opposition”). He contended that there were issues of material fact, particularly as to whether he had acted with wrongful intent, that precluded summary judgment. He also reiterated a prior request for an order permitting additional discovery. He further argued that the Charges should be dismissed, which the Hearing Officer considered to be a motion to dismiss for failure to state a cause of action. See Opp’n at 17, 28, 35.

During a conference call held on July 10, 2007, I informed the parties that Enforcement’s motion was granted with respect to Charge II (a violation of NYSE Rule 476(a)(6)) and denied with respect to Charge I, and that Respondent’s motion to dismiss was granted with respect to Charge I (a violation of NYSE Rule 435(3)). The reasons for my holdings are set forth below.

Authority To Consider Summary Judgment Motion and Applicable Legal Standard

NYSE Rule 476(c), as amended effective April 1, 2006, grants a Hearing Officer the authority to “resolve any and all procedural and evidentiary matters and substantive legal motions.” This authority is expansive and encompasses the resolution of a request by either party for dispositive legal relief—either by granting or denying such a request. The Rule does not restrict the Hearing Officer’s authority to dispose of a case by making a determination of guilt or innocence when the moving party is entitled to such a determination as a matter of law. The broad language of NYSE Rule 476(c) is in contrast to NASD Rule 9264(e), which explicitly limits the Hearing Officer’s power to decide a summary judgment motion, providing that:

The Hearing Officer may promptly deny or defer decisions on any motion for summary disposition, however, only the Hearing Panel or, if applicable, the Extended Hearing Panel, may grant a motion for summary disposition, except the Hearing Officer may grant motions for summary disposition with respect to questions of jurisdiction. The Hearing Panel or, if applicable, the Extended Hearing Panel, may grant the motion for summary disposition if there is no genuine issue with regard to any material fact and the Party that files the motion is entitled to summary disposition as a matter of law.

NASD R. 9264(e) (emphasis added). Therefore, I hold that the jurisdiction conferred on a Hearing Officer by NYSE Rule 476(c) includes the authority to consider and, if warranted, grant a motion for summary judgment.

While the Federal Rules of Civil Procedure are not applicable to NYSE proceedings per se, those rules and the case law applying them can provide helpful guidance. Moreover, the procedural rules of other regulators, such as the U.S. Securities and Exchange Commission (the “SEC” or “Commission”) and the NASD, may be taken into account, particularly since the legal standard for summary judgment that applies in both SEC and NASD proceedings is similar to the standard applied under Rule 56 of the Federal Rules of Civil Procedure. See, e.g., Edward Becker, Release No. ID-252, 82 S.E.C. Docket 3427, 2004 WL 1238256, at *2 (June 3, 2004) (analogizing to Rule 56 in applying Rule 250(a) of SEC’s Rules of Practice, which governs summary judgment); Lorsin, Inc., Release No. ID-250, 82 S.E.C. Docket 3044, 2004 WL 1064141, at *2 (May 11, 2004) (same); Dep’t of Enforcement v. U.S. Rica Fin., Inc., Compl. No. C01000003, 2003 WL 22149390, at *4 (N.A.S.D. N.A.C. Sept. 9, 2003) (in deciding motion for summary disposition under NASD Rule 9264, noting that “federal law also provides significant guidance”).

A Hearing Officer’s power under NYSE Rule 476(c) to resolve a summary judgment motion is analogous to that of a district judge under Rule 56 of the Federal Rules of Civil Procedure, which provides that summary judgment is appropriate “if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law.” Fed. R. Civ. P. 56(c). A fact is material if it would “affect the outcome of a suit under the governing law.” Anderson v. Liberty Lobby, 477 U.S. 242 (1986).

In assessing the record for purposes of deciding a summary judgment motion, the facts, as well as the reasonable inferences that may be drawn from them, must be viewed in the light most favorable to the non-moving party. See Eastman Kodak Co. v. Image Tech. Servs., Inc., 504 U.S. 451, 456 (1992); O’Shea v. Yellow Tech. Servs., Inc., 185 F.3d 1093, 1096 (10th Cir. 1999); R.A. Mackie & Co. v. PetroCorp., Inc., 244 F. Supp. 2d 279, 281-282 (S.D.N.Y. 2003) (citations omitted). More particularly, in deciding the motion, the Hearing Officer must take the pleadings of the non-moving party as true, except as modified by stipulations or admissions made by that party, by uncontested affidavits, or by facts officially noted by the Hearing Officer. See 17 C.F.R. § 201.250(a); NASD Rule 9264(e).

Respondent does not object to the Hearing Officer’s addressing the Motion, and he proposes that I use essentially the same legal standard as set forth above.

Therefore, I hold that, under NYSE Rule 476(c), a moving party is entitled to summary judgment if it can demonstrate that there are no genuine issues of material fact and that the moving party is entitled to judgment as a matter of law.

Legal Standard for Motion to Dismiss

Similarly, there can be no question that a Hearing Officer has the authority to decide a motion to dismiss for failure to state a cause of action under NYSE Rule 476(c), and federal law may provide guidance on the standard to be applied to such a motion, including Federal Rule of Civil Procedure 12(b)(6).

I find that a respondent's motion to dismiss will be granted, pursuant to NYSE Rule 476(c), where Enforcement has failed to state a cause of action, even accepting all factual allegations in the Charge Memorandum as true, and considering the Charge Memorandum in its entirety, as well as other sources, such as documents incorporated into the Charge Memorandum by reference, and matters of which a Hearing Officer may take administrative notice. See Tellabs, Inc. v. Makor Issues & Rights, Ltd., 127 S. Ct. 2499, 2509 (U.S. 2007) (setting forth federal standard for motion to dismiss under Fed. R. Civ. P. 12(b)(6)).

Undisputed Facts

Respondent's employment in the securities industry began in May 1992, when he was hired as a part-time clerk while still in college. He became a full-time employee in 1994. He left his then-member firm in April 1996 and became employed on the Floor of the NYSE with a different member firm as a booth clerk. In May 1996, he became employed as a booth clerk by a sole proprietor.

In October 1996, Respondent became employed by Princeton Securities Group, Inc. ("Princeton") as a booth clerk. In the summer of 2000, he became an NYSE member, and was employed as a Floor broker by Princeton. He continued to be employed in this capacity with Princeton until September 2003, when Princeton terminated his employment. While employed by Princeton, Respondent held the Series 7, 12, 14, and 63 securities licenses.

On the trading date in question, August 21, 2003, Respondent was executing orders entered by a hedge fund ("HF") to purchase shares of XYZ stock. HF had been directing orders to Princeton to purchase shares of XYZ throughout August 2003.

JB was a booth clerk employed by Princeton on this date. JB received orders from HF's head trader, and transmitted them to Princeton brokers, including Respondent, for execution. At approximately 9:47 a.m. on August 21, 2003, HF's head trader began to place orders with JB for the purchase of XYZ. JB routed these orders to Respondent's hand-held terminal for execution. During the trading sequences at issue, Respondent was never in direct communication with anyone on HF's trading desk.

Between 11:06 a.m. and 11:19 a.m., sell stop orders totaling 520,400 shares were entered in XYZ at a price of \$4.25. See MARS Report for XYZ, dated August 21, 2003, Enforcement ("Enf. Ex.") 8. These orders were entered onto the specialist's book for representation by the specialist. At this time, XYZ was trading above the \$4.25 stop

price. At approximately 11:20 a.m., the specialist in XYZ informed Floor brokers in the Trading Crowd, including Respondent, of the large sell stop order interest with a stop price of \$4.25. At that time, Respondent was representing HF's order to purchase 50,000 shares of XYZ, market not held.

Respondent called JB to ask him to inquire whether HF had additional interest in buying XYZ. By this time, Respondent had already purchased approximately 1,000,000 shares of XYZ for HF. Enf. Ex. 8 Overall, the market in XYZ on this day was more heavily traded than usual.

JB discussed the matter with HF's head trader, who gave JB an order, time-stamped at 11:27:15 a.m., to purchase 300,000 shares of XYZ at \$4.20, not held. The order was transmitted to Respondent, who promptly informed the specialist of HF's buying interest. The specialist then told Respondent that there was a sizable pre-existing bid at \$4.20, and that Respondent should inquire whether his customer could pay more for the stock. Respondent then discussed this with JB, who relayed the information to HF's head trader. The trader then canceled the limit order at \$4.20, and entered two new limit orders to purchase XYZ, totaling 500,000 shares, at a limit price of \$4.21, not held. These orders were entered between 11:30:33 and 11:30:46 a.m. At this time, the quotation in XYZ was \$4.26 bid, offered at \$4.28.

Between 11:31:16 and 11:31:27 a.m., HF's head trader canceled the two limit orders at \$4.21 and entered new limit orders, totaling 500,000 shares, to purchase XYZ at a price of \$4.25, not held. During this time, 25,900 shares of XYZ traded at prices between \$4.26 and \$4.28. Respondent was not involved in these trades.

At 11:32:33 a.m., 600 shares of XYZ traded at \$4.28. Respondent was not involved in this trade. At 11:34:07, 100 shares of XYZ traded at a price of 4.28. Respondent was not involved in this trade.

At 11:34:08 a.m., with the market in XYZ quoted \$4.27 bid, offered at 4.29, JB time-stamped an order from HF to sell 100,000 shares of XYZ at \$4.25, not held. JB understood HF's head trader as saying that the order should be executed in such fashion as to elect the sell stop orders at \$4.25 on the specialist book and that Respondent should then purchase as much of the stop order as possible.

Before relaying HF's head trader's instructions and the sell order to Respondent, JB discussed HF's orders with MF, a Senior Floor Official of the NYSE, and a senior Floor broker with Princeton. JB understood MF to say that it was proper to execute the orders.

After receiving what he understood to be MF's approval, JB forwarded the sell order to Respondent's hand-held terminal. Upon receipt of the order, Respondent called JB to ask about the identity of the seller. JB told Respondent that the order had been entered by HF, and JB expressed his understanding that MF had approved the execution of the orders.

At 11:34:50, with the market in XYZ quoted \$4.27 bid, offered at \$4.29, Respondent sold 15,000 shares of XYZ at \$4.27, the prevailing bid. This transaction was down \$.01 from the prior sale. At 11:35:02, Respondent sold 35,000 shares of XYZ at \$4.25, the prevailing bid in the market. This trade, down \$.02 from the immediately prior trade, which Respondent had also executed, elected the sell stop orders at \$4.25.

At 11:35:15 a.m., Respondent executed HF's order to buy 500,000 shares of XYZ at \$4.25.

At 11:36:45 a.m., JB canceled the remaining 50,000 shares of the HF sell order.

On October 10, 2003, in a deposition conducted by the NYSE's Market Surveillance Division, Respondent acknowledged that he understood that his execution of HF's sell order would elect the stop orders.

Discussion

NYSE Rule 476(a)(6) (Charge II)

1. The Parties' Arguments

In support of its charge that Respondent should be deemed liable for a violation of NYSE Rule 476(a)(6), Enforcement made four arguments.

First, Enforcement contended that precedent cases such as Jonathan F. Gutman, Decision 95-148 (NYSE Hearing Board Nov. 1, 1995) and Timothy Anderson, Decision 06-129 (NYSE Hearing Board July 10, 2006) make clear that transactions in which a customer's orders are used to reduce the price of a security in order to elect a stop order which that customer then purchases are violations of Rule 476(a)(6). Second, Enforcement argued that Respondent's successive sales on behalf of HF at lower prices to reduce the price of XYZ, such that the stop orders would be elected and then purchased by HF, improperly influenced the price of HF. Third, Enforcement contended that Respondent's acknowledgement that he had traded with existing bids in the market at successively lower prices to cause the election of the stop orders—which he was then able to purchase on behalf of the same customer whose sell order elected the stop orders—demonstrated that Respondent “knew or should have known” that his trading improperly influenced the price of XYZ. See Motion at 21. In support of this argument, Enforcement pointed to Respondent's background and experience in the securities industry and on the NYSE Floor, and the fact that he had Series 7, 12, 14, and 63 securities licenses. Enforcement further pointed out that Respondent did not attempt to obtain clarification or guidance from anyone at Princeton (other than from a booth clerk), nor did he consult with a Floor Official or Floor Governor before effecting the trades in question. Finally, Enforcement asserted that precedent cases establish the principle that a respondent's motive or intent need not be established in order to find a violation of NYSE Rule 476(a)(6). See Calvin David Fox, Exchange Act Release No. 48,731, 81 S.E.C. Docket 1511, 2003 WL 22467374, at *3 (Oct. 31, 2003); Robert Cutler Matlock, Jr., Decision 06-19 (NYSE

Hearing Board Mar. 27, 2006). In Enforcement’s view, Respondent knew or should have known that his acknowledged behavior in using a customer’s sell order to elect stop orders, and then purchase them for that customer, was unethical.

In arguing that there was no violation of NYSE Rule 476(a)(6), Respondent contended that the trading at issue was conducted ethically and in good faith. Respondent made several arguments. First, Respondent maintained that the buy and sell orders at issue were executed at the risk of the market and at prices established by the market. He contended that the two sales and one purchase of XYZ were in accord with prevailing bid-ask quotes and in line with market prices immediately preceding and following election of the stop order. Thus, according to Respondent, public information and the natural forces of supply and demand determined the prices at which respondent executed the orders. In his view, therefore, these executions—which took place in the time span of approximately 75 seconds—did not interfere with the normal functioning of XYZ in the marketplace. He also contended that the two sales at issue, representing a two-cent differential between the highest price at which he traded and the electing sale price, represented a .0046% movement in XYZ’s price. Thus, according to Respondent, the price movement was not excessive or disproportionate to either XYZ’s stock price or quotations and could not have constituted undue interference with XYZ’s price.

Moreover, Respondent argued that the Gutman and Anderson precedents cited by Enforcement were distinguishable on their facts, as Gutman involved a scheme to establish artificial prices, and, in Anderson, the conduct had had a much greater effect on the price of the stock in question, creating what Respondent termed an “artificially” low price, as opposed to what he deemed a price established by “natural market forces” in the instant matter.

2. Decision on the Rule 476(a)(6) Charge: Enforcement Is Entitled to Summary Judgment

With regard to the Rule 476(a)(6) charge (Charge II), I find that there are no genuine issues of material fact.¹ There is no dispute as to the orders in question or the trading sequences. Enforcement does not have to establish that Respondent acted with wrongful intent with respect to the Rule 476(a)(6) charge, and thus there are no issues of material fact in that regard with respect to this charge. Moreover, there has been no undue delay in this matter, as Enforcement deposed Respondent less than two months after the trades at issue, and he has demonstrated no prejudice as to his ability to prepare his defense.

Respondent’s actions in using HF’s sell order to exhaust market bids in order to elect stop orders that Respondent could then purchase on HF’s behalf constitute a violation of just and equitable principles of trade and, therefore, a violation of NYSE Rule 476(a)(6). Respondent admitted that he understood he was using HF’s sell order for the purpose of moving the market down so that large stop orders would be elected, which he could then

¹ Because I have found that there is no genuine issue of material fact, there is no need for the additional discovery that Respondent was seeking. Respondent’s pending motion to compel was therefore dismissed.

purchase for HF. Respondent did, in fact, improperly influence the price of XYZ, and should have known that his behavior did not meet the requisite ethical standards required of an NYSE Floor broker. Therefore, Enforcement's motion for summary judgment with respect to the Rule 476(a)(6) charge is granted.

While Respondent is correct that it is possible to point to factual differences between, on the one hand, Gutman and Anderson, and, on the other, the instant matter, the fundamental principles established in those cases cannot be distinguished and are fully applicable herein. Both of those cases clearly stand for the proposition that it is a violation of just and equitable principles of trade to circumvent normal and legitimate price movement by using a customer's sell orders solely to influence market prices such that a stop order is elected, to the benefit of the ostensible "seller," who then purchases stock advantageously, at a discount from prices existing in the market before the "seller" began exhausting higher price levels.

Respondent's arguments that the trades at issue could not be violative because they were executed at the risk of the market and at prices established by the market, are misplaced. Essentially, these arguments are little more than meaningless truisms. All trades effected by Floor brokers on the NYSE, whether to improperly influence prices or not, must be effected pursuant to auction market rules, are at the risk of the market, and are priced at or within the prevailing bid-ask quotation. These are simply the mechanics of putting any trade on the tape. Indeed, an argument similar to the one advanced by Respondent was rejected by the SEC in a case involving a trader who claimed that orders entered at or near the close were executed at market or market-risk prices and could not thereby have improperly influenced market prices. See Peter Martin Toczek, Exchange Act Release No. 33,176, 55 S.E.C. Docket 1126, 1993 WL 468656, at *5 (Nov. 9, 1993) (upholding finding of violation of NYSE Rule 476(a)(6)).

Respondent clearly, and improperly, influenced the price of XYZ. It is well-settled law that regulatory proscriptions against the improper influencing of market prices are rooted in the need "not to prohibit market transactions which may raise or lower the price of securities, but to keep an open and free market where the natural forces of supply and demand determine a security's price." Trane Co. v. O'Connor Secs., 561 F. Supp. 301, 304 (S.D.N.Y. 1983).

In the instant matter, Respondent clearly interfered with the "natural forces of supply and demand." The HF sell order did not represent "natural" supply, but was simply HF's vehicle to wipe out existing market demand (bids) to effectuate HF's true objective—the purchase of a large amount of stock at a discount from the then-current market price. It is incorrect to say that Respondent could not have "improperly influenced" the price of XYZ simply because his two sales were to bids established independently by other market participants. A "bid" is simply an indication of a price at which a trade may take place. The actual market price that appears on the tape is established by the trade initiator (in this case, Respondent), who trades with the bid. The trade initiator transforms the potential price represented by a bid into the actual market price on the tape that other market participants will see and to which they will react.

It was Respondent who made the decision to put the \$4.27 price on the tape, and it was also he who then decided to put the \$4.25 price on the tape, thereby electing the stop order. Respondent thus clearly and directly influenced the trade prices of XYZ, and did so, as he admitted, for the purpose of electing the stop order for his customer's benefit.

Respondent's arguments that he could not have "improperly influenced" the price of XYZ because the two-cent price movement was de minimis and that XYZ traded at the electing sale price after his purchase of the stop orders are similarly misplaced. It is a violation of just and equitable principles of trade to improperly influence the price of a security, regardless of the amount involved, as any artificial price sends a misleading signal to market participants as to the natural state of supply and demand in the subject security and undermines the integrity of the NYSE market.

It should also be noted that Respondent's argument as to the post-election trading of XYZ ignores the "but for" factor, which makes any assessment of the subsequent market impact of Respondent's conduct essentially a matter of speculation. Notwithstanding Respondent's attempt to characterize the post-election trading in XYZ as somehow a validation of his order execution decisions, it must be emphasized that it cannot be ascertained with any degree of certainty how XYZ would have traded, pursuant to the interaction of natural supply and demand, but for the improper influence that Respondent exerted on XYZ's price.

NYSE Rule 435(3) (Charge I)

1. The Parties' Arguments

Enforcement charged Respondent with violating NYSE Rule 435(3), which proscribes, inter alia, trading effected "for the purpose of unduly or improperly influencing the market price of [a] security." Enforcement noted that NYSE Rule 435(3) is modeled exactly after a model rule originally drafted by the SEC. See Untitled Release, SEC Release No. 179 (Apr. 17, 1935) (Enf. Ex. 12). That SEC rule was adopted verbatim by the NYSE. See NYSE Memorandum to Members (May 27, 1935) (Enf. Ex. 11).

The SEC's model rule was proposed pursuant to the Commission's authority under Section 9(a)(2) of the Securities Exchange Act of 1934. It is well-settled law that Section 9(a)(2) contains requirements of both manipulative intent and willfulness ("scienter") and that in order to sustain a scienter-based charge, the party making the charge must plead with particularity facts giving rise to an inference of intentional misconduct. See, e.g., Crane Co. v. Westinghouse Air Brake Co., 419 F.2d 787, 794 (2d Cir. 1969); Trane v. O'Connor Secs., 561 F. Supp 301, 304 (S.D.N.Y. 1983); Adrian C. Havill, Exchange Act Release No. 40,726, 68 SEC Docket 1934, 1998 WL 823070, at *4 (Nov. 30, 1998).

NYSE Rule 435(3) similarly requires a showing of wrongful intent, as the Rule's plain language refers to a member's "purpose" in improperly influencing the price of a security.

Enforcement contended that a strong inference of scienter could be drawn from Respondent's trading pattern and his admission that his purpose in executing HF's sell order at successively lower prices was to cause the election of the stop orders and allow him to purchase the stop orders for HF.

Respondent, however, contended that he did not act with scienter because he reasonably and justifiably relied on the opinion of MF, an NYSE Senior Floor Official, that it was permissible to execute HF's orders as he did.

2. Decision on the Rule 435(3) Charge: Dismissed for Failure to State a Cause of Action

During the pendency of this action, the U.S. Supreme Court clarified scienter pleading requirements. See Tellabs, Inc. v. Makor Issues & Rights, Ltd., 127 S. Ct. 2499 (June 21, 2007). The Court ruled that in order to sustain a scienter charge, any inferences drawn from the acts as to scienter must be at least as compelling as inferences that can be drawn from the facts indicating an absence of scienter. Id. at 2510. While the Tellabs case arose specifically in the context of litigation under the Private Securities Litigation Reform Act, I find its reasoning persuasive and will apply it to the scienter issue in the instant matter.

Enforcement did not plead facts demonstrating actual scienter. Respondent's admission that he acted for the purpose of electing the stop orders is not an admission that he had the mental state whereby he understood that it was improper to so elect the stop orders, but went ahead and executed the orders anyway. Enforcement is correct, however, in arguing that the trading pattern and Respondent's admission give rise to an inference of scienter.

Respondent, however, has set forth several facts that give rise to an inference that he did not act with scienter. Although Respondent never actually discussed the matter with an NYSE Floor Official—and thus could not have been sure that the facts had been clearly set forth and an informed opinion rendered—his actions nevertheless indicate that he had some basis for believing that his trading was proper. When he received HF's sell order, he did not immediately seek to execute it, but sought clarification from JB, the booth clerk, as to whom the seller was. He proceeded to execute the order only after JB expressed his understanding that MF, an NYSE Senior Floor Official, had indicated it was proper to do so. The 75-second time-frame suggests that Respondent felt some urgency as to the need to service his client under the active trading conditions in XYZ.

The facts set forth by Respondent, uncontroverted by Enforcement, bear on Respondent's actual mental state, and give rise to an inference that he did not act with scienter that is more compelling than the more circumstantial inference of scienter raised by Enforcement's pleadings.

Therefore, pursuant to the reasoning of the U.S. Supreme Court in Tellabs, the Rule 435(3) charge must be dismissed on the ground that Enforcement has failed to state a cause of action.

In accordance with the reasons set forth herein, Enforcement's Motion is granted in part, and denied in part, and Respondent's motion to dismiss Charge I is granted.

The hearing scheduled to be held on July 23, 2007 shall be limited to the issue of penalty.

SO ORDERED

Dated: July 19, 2007

Brian McNamara
Hearing Officer

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