

**NYSE ARCA, INC.
and
NYSE ARCA EQUITIES, Inc.**

X.....X	.	
NYSE ARCA, INC.	.	Options Decision No. 08-AO-03
Complainant,	.	
v.	.	
Herbert C. Kurlan	.	
Respondent.	.	
X.....X		

X.....X	.	
NYSE ARCA EQUITIES, INC.	.	Equities Decision No. 08-AE-03
Complainant,	.	
v.	.	
Herbert C. Kurlan	.	
Respondent.	.	
X.....X		

Appearances:

For the Division of Enforcement:

Kenneth Bozza, Esq.
Craig T. Ellman, Esq.

For the Respondent:

Herbert C. Kurlan, *pro se*

This formal disciplinary action was instituted pursuant to NYSE Arca Options Rule 10.6 and NYSE Arca Equities Rule 10.6¹ by NYSE Regulation, Inc.’s Division of Enforcement (“Enforcement”).

¹ Prior to the closing of the merger between the New York Stock Exchange, Inc. and Archipelago Holdings, Inc. on March 7, 2006, the markets currently known as NYSE Arca, Inc. (hereinafter “NYSE Arca Options”) and NYSE Arca Equities, Inc. were known as Pacific Exchange, Inc. (“PCX”) and PCX Equities, Inc. (“PCXE”) respectively. During this time, Option Trading Permit (“OTP”) holders were governed by the rules of the PCX, and Equity Trading Permit (“ETP”) holders were governed by the rules of the PCXE. The applicable rules were not changed by the merger, and for convenient reference, this Decision refers to the former PCX as “NYSE Arca Options” and its governing rules as “NYSE Arca Options Rules,” and the former PCXE as “NYSE Arca Equities” and its governing as NYSE Arca Equities Rules,” even when referring to pre-merger periods.

In order to resolve this matter, Respondent Herbert C. Kurlan (the “Respondent”) has submitted an uncontested Offer of Settlement and Consent (“Offer of Settlement”), executed by the Respondent on November 14, 2008. Such Offer of Settlement was submitted for the sole purpose of settling this disciplinary proceeding, without adjudication of any issues of law or fact, and without admitting or denying any allegations or finding referred to therein. With due regard to the stipulated facts and violations and the proposed sanction contained therein, the Hearing Officer on behalf of Office of the General Counsel believes it is appropriate to accept the Offer of Settlement with respect to the File Number set forth above. This Offer of Settlement is made a part of this Decision by reference herein.

STIPULATION OF FACTS AND VIOLATIONS

BACKGROUND AND JURISDICTION

1. Respondent was born in 1950. In 1975, Respondent became a Certified Public Accountant (“CPA”), and one year later, in 1976, he entered the securities industry as a registered representative for a broker-dealer. In addition to numerous investment-related business interests undertaken shortly after entering the securities industry, Respondent also served as a Board Member for PCX Holdings from January 2001 through September 2005, and as a Board Member for PCX Options from January 2002 to December 2004. Currently, Respondent is employed in the securities industry as the CEO of an NYSE Arca, Inc. (“NYSE Arca Options”) firm.
2. For all relevant time periods herein, Respondent served as the financial and operations principal for MDNH Partners, L.P. (“Partners”), MDNH Traders LLC (“Traders”) and Vtrader LLC (“Vtrader”), three former separate but related NYSE Arca Options and/or NYSE Arca Equities, Inc. (“NYSE Arca Equities”) firms.² Respondent had indirect ownership interests in each of these three entities, and served as the President and Managing Member for Partners and Traders, as well as the President, COO and Managing Director for Vtrader. At all times up until each firm terminated its license with NYSE Arca Options and/or NYSE Arca Equities, Respondent was responsible for the accuracy of the books and records of Partners, Traders and Vtrader, which included, but was not limited to ensuring compliance relating to net capital computations, financial reporting requirements and insider trading procedures, the filing and accuracy of FOCUS Reports and oversight of written supervisory procedures.

MDNH Partners, L.P.

3. Partners, a former NYSE Arca Options OTP firm, conducted off-floor proprietary trading at the Firm’s offices in San Francisco, Ca. and also provided financial

² Partners held only an OTP during the conduct at issue, and accordingly, was only subject to NYSE Arca Options rules. Traders held both an OTP and an ETP during the conduct at issue, and thus was subject to both NYSE Arca Options Rules and NYSE Arca Equities Rules. Vtrader held only an ETP during the conduct at issue, and as such, was subject to only NYSE Arca Equities Rules.

- backing to traders who were engaged in options market making. During the relevant time period, Partners did not clear transactions or carry customer accounts. As of March 2005, Partners employed two Trading Assistants, a Risk Officer and an Administrative Assistant. On May 8, 2006, Respondent filed a Broker-Dealer Withdrawal Form (“Form BDW”), terminating the Firm’s OTP license with NYSE Arca Options, and ultimately its status as a registered broker-dealer in the US securities industry.
4. By referral dated December 20, 2005 (the “2005 Partners Referral”), the Financial and Operational Compliance Department (“FOCD”) of NYSE Arca, Inc. referred Partners’ failure to timely submit its November 30, 2004 Financial and Operational Combined Uniform Single Report (“FOCUS Report”).
 5. In 2006, FOCD conducted a financial, operational supervisory standards/sales practice (“FinOp”) examination of Partners to determine, *inter alia*, the accuracy of the Firm’s first and second quarter 2005 FOCUS Reports. FOCD sent a letter to Respondent dated May 8, 2006 detailing the findings of the examination (the “2006 Partners Exam Report”).

MDNH Traders, LLC

6. Traders, a wholly owned subsidiary of Partners which provided trading facilities and housed proprietary traders who were members of Traders, was both an NYSE Arca Options OTP Firm and NYSE Arca Equities ETP holder during the relevant time period. Partners financed Traders’ operation and was the source of all its trading capital; Traders, in turn, provided floor expertise and trading ability for Partners, and would retain a certain percentage of the trading profits, if any. Traders, which employed no traders as of March 1, 2005 and did not clear transactions or carry customer accounts, was sold by Respondent to an individual named DP by contract of sale dated May 12, 2005, who renamed the Firm “Lionshare” and subsequently filed a Form BDW on February 22, 2006, terminating the Firm’s OTP and ETP licenses with NYSE Arca Options and NYSE Arca Equities respectively, as well as its license as a registered broker-dealer. Despite the aforementioned sale, Respondent signed Traders’ second quarter 2005 FOCUS Reports as the FinOp Principal, and as of June 30, 2005, he was still listed on the Central Registration Depository (“CRD”) as President of the entity that managed Lionshare.
7. By referral dated December 20, 2005 (the “2005 Traders Referral”), FOCD referred Traders’ failure to timely submit its November 30, 2004 FOCUS Report.
8. In 2006, FOCD conducted a FinOp examination of Traders to determine, *inter alia*, the accuracy of the firm’s first and second quarter 2005 FOCUS Reports. FOCD sent a letter to Respondent dated May 8, 2006 detailing the findings of the examination (the “2006 Traders Exam Report”).

Vtrader LLC

9. Vtrader was essentially used to replace Traders when the latter filed its Form BDW, and assumed the role of providing trading facilities and housing several of the proprietary traders formerly employed with Traders, who became members of Vtrader at the time of transition. During the relevant time period, Vtrader was an

NYSE Arca Equities ETP holder which traded for its own proprietary account, was allowed to effect trades as a broker-dealer in commodities futures, commodities and commodities options and did not clear transactions or carry customer accounts. As of February 2006, Vtrader employed approximately thirty-eight active traders. On December 18, 2006, Vtrader filed its Form BDW, terminating its ETP license with NYSE Arca Equities and ultimately its broker-dealer status.

10. In 2006, Member Firm Regulation (“MFR”) conducted a FinOp examination of Vtrader for the 2006 year. FOCD sent a letter to Respondent dated May 8, 2006 with the findings of the examination (the “2006 Vtrader Exam Report”).

JURISDICTION

11. By letter dated October 6, 2006, Enforcement notified Respondent that it was investigating the findings delineated in the 2005 Partners Referral, 2006 Partners Exam Report, 2005 Traders Referral and 2006 Traders Exam Report. By way of letter dated March 30, 2007, Enforcement notified Respondent that it was investigating the matters referenced in the 2006 Vtrader Exam Report.

OVERVIEW

12. This matter primarily involves books and records and supervisory deficiencies caused by Respondent and disclosed in the referrals and FinOp examinations conducted of Partners, Traders and Vtrader, in 2005 and/or 2006.
13. For the 2005 Partners Referral and 2006 Partners Exam Report, Respondent caused violations relating to inaccurate net capital computations and/or methodology, the inaccurate and untimely submission of FOCUS Reports, the failure to properly retain/store certain books and records and the failure to reasonably supervise Partners’ associated persons to ensure compliance in connection with the foregoing violations.
14. For the 2005 Traders Referral and 2006 Traders Exam Report, Respondent caused violations relating to inaccurate net capital computations and/or methodology, the inaccurate and untimely submission of FOCUS Reports and the failure to reasonably supervise Traders’ associated persons to ensure compliance in connection with the foregoing violations.
15. For the 2006 Vtrader Exam Report, Respondent caused violations relating to inaccurate net capital computations and/or methodology, the failure to preserve certain business e-mails and instant messages, the failure to implement policies and procedures to prevent the misuse of material nonpublic information and the failure to reasonably supervise Vtrader’s associated persons to ensure compliance in connection with the foregoing violations.

VIOLATIVE CONDUCT

Inaccurate Net Capital Calculations

16. Section 15(c)(3) of the Securities Exchange Act of 1934 (“Exchange Act”) generally requires that broker-dealers observe Commission rules prescribed to provide safeguards for the broker-dealer’s financial responsibility and related practices when effecting the purchase or sale of securities. Rule 15c3-1, in part, obligates broker-dealers to maintain net capital at a required level when securities transactions are effected, and sets forth a specific methodology detailing how broker-dealers shall calculate minimum net capital, including, *inter alia*, paragraph (c)(2)(iv)(B) thereunder, which requires a broker-dealer to deduct from its net worth certain unsecured and partly secured receivables when computing net capital.
17. Section 17 of the Exchange Act and Rule 17a-3 require broker-dealers to make and keep current records of their net capital computations, including, but not limited to general ledgers reflecting all assets and liabilities, income and expense capital accounts. In relevant part, Exchange Act Rule 17a-3(a)(11) requires broker-dealers to maintain "a record of the computation of aggregate indebtedness and net capital, as of the trial balance date, pursuant to Rule 15c3-1."
18. NYSE Arca Options Rule 11.16 and NYSE Arca Equities Rule 2.24 together require OTP Holders, OTP Firms and ETP Holders to make, keep current and preserve such books and records as the Exchange may prescribe and as may be prescribed by the Securities Exchange Act of 1934 and the rules and regulations thereunder, as though such OTP Holders, OTP Firms and/or ETP Holders were brokers or dealers registered with the SEC pursuant to Section 15(c)(3) of the Exchange Act.
19. In 2005, Respondent inaccurately calculated and reported Partners’, Traders’ and Vtrader’s monthly net capital computations by reflecting only balances held at each firm's clearing firm and futures accounts, and failed to include any other financial statement balances and adjustments, such as cash, accrued expenses and accounts payable.
20. As a result of the inaccurate net capital computations, undue concentration charges were understated for the first and second quarters of 2005 for Partners. Furthermore, Respondent failed to take any undue concentration charge at June 30, 2005 on behalf of Traders, and Vtrader’s undue concentration charge was also understated at December 31, 2005.
21. Consequently, Respondent caused violations of Section 15(c)(3) of the Exchange Act and Rule 15c3-1 thereunder, Section 17(a) of the Exchange Act and Rule 17a-3 thereunder, NYSE Arca Options Rule 11.16 (Partners and Traders only) and

NYSE Arca Equities Rule 2.24 (Traders and Vtrader only) by inaccurately calculating net capital and creating and maintaining inaccurate books and records with respect to net capital computations on behalf of Partners, Traders and Vtrader.

Inaccurate and Untimely FOCUS Reports

22. Exchange Act Rule 17a-5(a)(2)(iii) requires that “[e]very broker or dealer who does not carry nor clear transactions nor carry customer accounts shall file [a FOCUS Report] within 17 business days after the end of each calendar quarter and within 17 business days after the date selected for the annual audit of financial statements where said date is other than the end of the calendar quarter.”
23. NYSE Arca Options Rule 4.5 and NYSE Arca Equities Rule 4.5 together state that every OTP Holder, OTP Firm or ETP Holder shall file with the Exchange its FOCUS Report.
24. NYSE Arca Options Rule 4.11(a) and NYSE Arca Equities Rule 4.11(a) together require each OTP Holder, OTP Firm and ETP Holder to periodically file “answers to Financial Questionnaires, Reports of Income and Expenses and additional financial information in the type, form, manner and time prescribed by the Exchange.”
25. The November 30, 2004 FOCUS Reports for Traders and Partners were each originally due on December 23, 2004. On August 23, 2005, Respondent submitted FOCUS Reports on behalf of both firms for the period of December 1, 2003 to November 30, 2004; however, these reports inaccurately consisted only of balance sheets and income statements, and failed to include net capital computations or statements of changes in ownership equity. On December 18, 2005, Respondent again submitted these FOCUS Reports; however, both contained financial reporting errors which, although they did not result in net capital deficiency, materially impacted each firm’s financial statements and/or net capital computations. On December 20, 2005, Respondent submitted each firm’s FOCUS Report to reflect audited balances as of November 30, 2004.
26. In addition, both Partners’ and Traders’ first and second quarter 2005 FOCUS Reports contained a number of financial reporting errors which, although they did not result in net capital deficiency, materially impacted each firm’s financial statements and/or net capital computations.
27. As detailed above, Respondent caused violations of Section 17(a) of the Exchange Act and Rule 17a-5 thereunder and NYSE Arca Options and Equities Rules 4.5 and 4.11(a) by, on three occasions, filing an inaccurate FOCUS Report on behalf of Traders, one of which was filed untimely.
28. Respondent also caused violations of Section 17(a) of the Exchange Act and Rule 17a-5 thereunder and NYSE Arca Options Rules 4.5 and 4.11(a) by, on three

occasions, filing an inaccurate FOCUS Report on behalf of Partners, one of which was filed untimely.

Record Retention: The General Ledger; E-mails and Instant Messages

29. Section 17(a)(1) of the Exchange Act and Rule 17a-4(b) thereunder require broker-dealers to preserve for a period of not less than three years, the first two years in an easily accessible place “[a]ll trial balances, computations of aggregate indebtedness and net capital (and working papers in connection therewith), financial statements, branch office reconciliations, and internal audit working papers, relating to the business of such member, broker or dealer, as such.”
30. Exchange Act Rule 17a-4(b)(4) also requires broker-dealers to preserve for a period of not less than three years, the first two years in an accessible place “[o]riginals of all communications received and copies of all communications sent...by the member, broker or dealer (including inter-office memoranda and communications) relating to its business as such...” Internal electronic mail communications relating to a broker-dealer's "business as such" fall within the purview of Rule 17a-4.
31. Regulatory Information Bulletin RB-05-02, dated January 5, 2005 and entitled “Clarification Regarding Supervisory Obligations and Recordkeeping Requirements for E-Mail and Instant Messages,” states that if a firm “is unable to establish an adequate supervisory program, the [firm] must prohibit the use of instant messaging. OTP or ETP Holders must also ensure that their use of instant messaging complies with applicable SEC recordkeeping requirements.” Regulatory Information Bulletin – PCX Options RBO-04-04, dated January 7, 2004 and titled “Clarification for Members Regarding Supervisory Obligations and Recordkeeping Requirements for E-Mail and Instant Messages,” sets forth similar requirements for retaining e-mails and instant messages.
32. In 2005, Respondent converted Partners’ accounting records from one type of electronic financial accounting software to another, but failed to maintain a copy of the firm’s General Ledger created with the earlier software. In addition, Respondent created additional General Ledger accounts when preparing the new records whose numbers did not match the calculations delineated on Partners’ first and second quarter 2005 FOCUS Reports, and he also failed to keep a reconciliation between the old and new records to ensure the FOCUS Reports properly reconciled with the new General Ledger accounts.³
33. For the 2006 exam year, Vtrader’s e-mail retention system failed to retain e-mails sent to and from the firm's remote traders, and Respondent failed to retain and supervise instant messages sent to and from the firm’s associated person(s).

³ In May 2006, Respondent amended the firm’s 2005 FOCUS Reports to include all adjustments made to the new records that were initially not recorded. These revised calculations revealed a \$581,007 increase in equity on the firm’s revised first quarter 2005 FOCUS Report, and a \$88,293 increase in equity on the firm’s revised second quarter 2005 FOCUS Report.

34. In failing to preserve a copy of Partners' General Ledger after transitioning to new financial software, in addition to the financial accounting errors detailed above, Respondent caused violations of Section 17(a) of the Exchange Act and Rule 17a-4(b) thereunder and NYSE Arca Options Rule 11.16.
35. Respondent also caused violations of Section 17(a) of the Exchange Act and Rule 17a-4(b)(4) thereunder and NYSE Arca Equities Rule 2.24 by failing to preserve certain business e-mails and instant messages in connection with Vtrader.

Policies and Procedures Preventing the Misuse of Material, Nonpublic Information

36. NYSE Arca Equities Rule 6.3(a) states that “[e]very ETP Holder must establish, maintain and enforce written policies and procedures reasonably designed to... prevent the misuse of material, non-public information by such ETP Holder or persons associated with such ETP Holder.”
37. Commentary .03 to NYSE Arca Equities Rule 6.3, provides *inter alia*, that, at a minimum, each ETP Holder establish, maintain, and enforce the following policies and procedures:
 - A. All associated persons must be advised in writing of the prohibition against the misuse of material, non-public information;
 - B. All associated persons of the ETP Holder must sign attestations affirming their awareness of, and agreement to abide by the aforementioned prohibitions; and
 - C. Each ETP Holder must receive and retain copies of trade confirmations and monthly account statements for each account in which an associated person has a direct or indirect financial interest or makes investment decisions. The activity in such brokerage accounts should be reviewed at least quarterly by the ETP Holder for the purpose of detecting the possible misuse of material, non-public information.
38. In 2005, Respondent did not require Vtrader's employees and/or associated persons to be furnished with the most current version of the firm's policies and procedures on insider trading, or to sign attestations adhering to and acknowledging an understanding of said policies.
39. Additionally, Respondent failed to determine whether each of Vtrader's associated persons had an outside securities account(s) and failed to do a supervisory review of any such accounts.
40. Accordingly, Respondent caused violations of NYSE Arca Equities Rule 6.3(a), for failing to require Vtrader's employees and/or associated persons to be furnished with the most current version of the firm's policies and procedures on insider trading, failing to ensure attestations were signed by the Vtrader's employees acknowledging an understanding of said policies, and for failing to

receive, review and retain monthly account statements for Vtrader's associated persons.

Supervision

41. NYSE Arca Options Rule 11.18(b) and NYSE Equities Rule 6.18(b), both pertaining to supervision, state, in part, that each OTP Holder or OTP Firm, as well as each ETP Holder must establish and maintain a system to supervise the activities of its associated persons and the operations of its business. Such system must be reasonably designed to ensure compliance with applicable federal securities laws and regulations and NYSE Arca Options/Equities Rules.
42. As a part-owner, President, Managing Director and FinOp Principal for Partners, Traders and Vtrader, Respondent was responsible for supervision and compliance of all NYSE Arca Options and NYSE Arca Equities rules and federal securities laws discussed herein.
43. For the reasons set forth above, Respondent was deficient in carrying out these responsibilities, and caused each of the above-noted violations.
44. As such, Respondent caused violations of NYSE Arca Options Rule 11.18(b) and NYSE Arca Equities Rule 6.18(b) by failing to reasonably supervise associated persons for compliance with the above-referenced rules in connection with Partners, Traders and Vtrader for all relevant time periods.

VIOLATIONS

45. Respondent caused violations of Section 15(c)(3) of the Exchange Act and Rule 15c3-1 thereunder, Section 17(a) of the Exchange Act and Rule 17a-3 thereunder and NYSE Arca Options Rule 11.16 by, on a number of occasions, inaccurately calculating net capital and creating and maintaining inaccurate books and records with respect to net capital computations in connection with Partners and Traders.
46. Respondent caused violations of Section 15(c)(3) of the Exchange Act and Rule 15c3-1 thereunder, Section 17(a) of the Exchange Act and Rule 17a-3 thereunder and NYSE Arca Equities Rule 2.24 by, on a number of occasions, inaccurately calculating net capital and creating and maintaining inaccurate books and records with respect to net capital computations in connection with Traders and Vtrader.
47. Respondent caused a violation of Section 17(a) of the Exchange Act and Rule 17a-5 thereunder, NYSE Arca Options Rules 4.5 and 4.11(a) and NYSE Arca Equities Rules 4.5 and 4.11(a) by, on three occasions, filing an inaccurate FOCUS Report in connection with Traders, one of which was filed untimely.
48. Respondent caused a violation of Section 17(a) of the Exchange Act and Rule 17a-5 thereunder and NYSE Arca Options Rules 4.5 and 4.11(a) by, on three

occasions, filing an inaccurate and untimely FOCUS Report in connection with Partners, one of which was filed untimely.

49. Respondent caused violations of Section 17(a) of the Exchange Act and Rule 17a-4(b) thereunder and NYSE Arca Options Rule 11.16 by failing to preserve certain books and records in connection with Partners.
50. Respondent caused violations of Section 17(a) of the Exchange Act and Rule 17a-4(b)(4) thereunder and NYSE Arca Equities Rule 2.24 by failing to preserve certain business e-mails and instant messages in connection with Vtrader.
51. Respondent caused violations of NYSE Arca Equities Rule 6.3(a) by, on numerous occasions, failing to establish, maintain, or enforce written policies and procedures reasonably designed to prevent the misuse of material, non-public information by associated persons in connection with Vtrader.
52. Respondent caused violations of NYSE Arca Options Rule 11.18(b) and NYSE Arca Equities Rule 6.18(b) by failing to reasonably supervise associated persons for compliance with the above rules in connection with Partners, Traders and Vtrader.

SANCTIONS

Respondent, is hereby censured and fined \$20,000. This fine shall be invoiced and collected in accordance with NYSE Arca's standard billing and account practices no later than 30 days of the date of this Decision. In addition, within 90 days of this Decision, Respondent must re-take the Financial and Operations Principal Qualification Examination ("Series 27"). Respondent cannot act or serve as a Financial and Operations Principal for any OTP or ETP holder after 90 days beyond the date of this Decision unless he has passed the Series 27 examination and is properly approved and registered.

Dated on this 21st day of November, 2008

On behalf of the Office of the General Counsel,
NYSE Arca, Inc. and NYSE Arca Equities, Inc.

Signature: _____

Peggy Kuo
Chief Hearing Officer
NYSE Regulation, Inc.