NYSE ARCA, INC.

NYSE ARCA HEARING PANEL DECISION 09-ARCA-02 **February 13, 2009**
DARREN MARCARIO STORY

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Violated NYSE Arca Options Rules 11.2(b), 6.47(b), 6.69(a), 6.94(a), and 6.46(a) – Censure and $10,000 fine.

Appearances:

For the Division of Enforcement
Steven M. Tanner, Esq.
Scott Miniter, Esq.

For Respondent
Darren Marcario Story

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A Hearing Panel on behalf of the NYSE Arca, Inc. ("NYSE Arca" or the "Exchange") considered a Charge Memorandum issued by NYSE Regulation, Inc.'s Division of Enforcement ("Enforcement") charging Darren Marcario Story ("Story"), Floor Broker with Student Options, LLC ("Student Options"), a member organization, with having:

I. Violated NYSE Arca Options Rule 11.2(b) by, on one occasion, engaging in conduct inconsistent with just and equitable principles of trade by:

   a. effecting a cross transaction outside of the National Best Bid or Offer that he knew, or should have known, was impermissible; and/or,
   b. having the execution of the cross transaction reported to his customer even though he knew, or should have known, that the execution of the cross transaction was impermissible; and/or,
   c. acting to conceal his violative conduct by causing the reporting of the cross transaction to NYSE Arca to be delayed until it appeared that the transaction was properly effected within the National Best Bid or Offer.

II. Violated NYSE Arca Options Rule 6.47(b) by, on one occasion, failing to follow proper procedures in crossing an order and/or by effecting the transaction outside of the National Best Bid or Offer.

III. Violated NYSE Arca Options Rule 6.69(a) by, on one occasion, failing to report to the Exchange an option transaction immediately after its execution without reasonable justification or excuse.

IV. Violated NYSE Arca Options Rule 6.94(a) by, on one or more occasions, effecting trade-through transactions outside of the National Best Bid or Offer without a reasonable justification.

V. Violated NYSE Arca Options Rule 6.94(a) by, on one occasion, failing to fill a Satisfaction Order after having effected a trade-through transaction.

VI. Violated NYSE Arca Options Rule 6.46(a) by, on one or more occasions, failing to use due diligence to execute orders at the best prices available.

Respondent filed an Answer on January 22, 2008 denying the charges.

Based on the pleadings and/or the evidence and argument presented at the hearing, the Hearing Panel[1] made the following findings:

Background and Jurisdiction

1. Darren Marcario Story was born in [redacted]. He entered the securities industry in February 2000 as a Floor clerk for Firm A.

2. In August 2000 he went to work for Firm B as a clerk and Floor Broker on the floor of what was then known as the Pacific Exchange, Inc. ("PCX," currently known as "NYSE Arca").

3. In June 2003, Story went to work as a Floor Broker on the PCX with Student Options, LLC ("Student Options" or the "Firm"), where he is currently employed.

4. Student Options is an NYSE Arca member firm.[2]

5. During all relevant times, Story was an Options Trading Permit Holder of NYSE Arca.

6. By letter dated March 24, 2006, NYSE Arca advised Story that it was investigating matters pertaining to a cross of 45 XYZ Jul 27.5 call options (the "XYZ Calls") that was

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[1] After the Panel's deliberations began, but prior to a decision being reached, one Panel member passed away. Each Party agreed to allow deliberations to continue and each Party further agreed to accept a unanimous decision of the remaining two Panel members (if one was reached) as the decision of the Panel. The remaining Panel members did reach a unanimous decisions, the details of which are detailed herein.

[2] Prior to the closing of the merger between the New York Stock Exchange and Archipelago Holdings, Inc. on March 7, 2006, the exchange now designated as NYSE Arca was known as the Pacific Exchange. The applicable rules were not changed by the merger, and for convenient reference, this document consistently refers to the former Pacific Exchange as "NYSE Arca" and the governing rules as "NYSE Arca Options Rules," even when referring to pre-merger periods.

effected on June 14, 2005 (the "XYZ Cross").[3]

7. Additionally, by letters dated August 19, 2005 and May 24, 2006, NYSE Arca advised Story that it was investigating whether, on July 27, 2005 and August 2, 2005, he failed to fill a Satisfaction Order after he traded through the national best bid offer ("NBBO").

XYZ Cross Transaction

8. On June 14, 2005 at about 8:45 a.m.,[4] Story entered the trading crowd on the Floor of NYSE Arca and announced that he wanted to effect a cross of 45 XYZ Call contracts at a price of $1.45 per contract.

9. The order to sell the XYZ Calls at $1.45 was for a customer of Morgan Stanley & Co. Incorporated ("Morgan Stanley").

10. The Morgan Stanley trader that entered the order for the XYZ Calls was "committed on the trade;" *i.e.*, if a member of the trading crowd did not want to purchase the options, Morgan Stanley would "facilitate the order" by buying the option contracts from its customer.

11. NYSE Arca Options Rule 6.47(b), as it was in effect in June 2005, sets forth the "facilitation procedure" for a Floor Broker to effect a cross transaction.[5] The Floor Broker must first request bids and offers from the trading crowd for the option involved. The Floor Broker must then bid above the highest bid in the crowd, or offer below the lowest offer. If a member in the crowd does not take the higher bid or lower offer, the broker may cross the order at the higher bid (or lower offer). However, the execution price must be equal to or better than the NBBO.[6]

12. At the time that Story entered the trading crowd, the NBBO for the XYZ Calls was $1.30- $1.40.

13. At the time that Story entered the trading crowd, he was aware that that the price at which he announced he wanted to cross the XYZ Calls, $1.45, was higher than the national best offer by five cents.

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[3] NYSE Arca Rule 6.76(c) defines a "cross order" as two orders with instructions to match the buy-side with the sell-side at a specified price.

[4] All times refer to Pacific Time. During all relevant times, the PCX market for equity options opened at 6:30 a.m. and closed at 1:00 p.m.

[5] NYSE Arca Rule 6.47(b) states that the "Facilitation Procedure is a process by which a Floor Broker who holds an order for a customer…and an order for the proprietary account of an OTP Holder or OTP Firm or an organization under common control with a Market Maker that is representing that customer (the 'Facilitation Order') may cross those orders. The Floor Broker may do so by following the Facilitation Procedure outlined in this subsection (b) of this rule." The Rule further states that although the size of the customer order subject to facilitation must be at least fifty contracts, smaller orders may be facilitated pursuant to the Rule, but are not subject to certain firm guarantees.

[6] Rule Adoption Notice 04-47, October 21, 2004, pertaining to the facilitation crossing rule, states in part: "Customer Orders may never get filled outside of the Exchange's disseminated market at the time of a request for a market."

14. The trading crowd objected to Story effecting the transaction in the XYZ Calls outside of the NBBO.

15. After the trading crowd objected to Story effecting the XYZ Cross, Story announced that he would wait to effect the transaction until the NBBO of the option series rose to the price at which Story intended to effect the cross.

16. Despite the XYZ Cross not being executed in the trading crowd, Student Options reported to Morgan Stanley, for whom the transaction was to be effected, that the XYZ Cross was executed at 8:47 a.m., approximately two minutes after Story had entered the trading crowd.

17. In an apparent effort to make it appear that a XYZ Cross had been effected within the NBBO, Story subsequently gave the trade tickets for the XYZ Cross to the Firm's booth clerk and told him to wait "to print" the order until the proposed price ($1.45) of the XYZ Cross was at or within the NBBO quotation.

18. Over the next few hours, the price of the XYZ Calls declined, and during that trading day the NBBO quotation did not rise to $1.45.

19. The XYZ Cross was not reported by Story or Story's clerk to NYSE Arca until 1:37:20 p.m., after the end of the trading day, and almost five hours after the time of the execution as reported by the Firm to Morgan Stanley.

20. NYSE Arca Options Rule 6.69(a) states in pertinent part:

> All option transactions must be immediately reported to the Exchange, in a form and manner prescribed by the Exchange, for dissemination to the Options Price Reporting Authority…Transactions not reported to OPRA within 90 seconds after the execution will be designated as "1ate." An OTP Holder or OTP Firm who is responsible for late reporting of an option transaction, without reasonable justification or excuse, will be subject to a fine pursuant to Rule 10.12.

21. Regulatory information Bulletin RBO-02-31, dated August 12, 2002, states:

> The Pacific Exchange, Inc. ("PCX") reminds Members that PCX Rule 6.69 requires that all options transactions be immediately reported to the Options Price Reporting Authority ("OPRA"). Transactions not reported to OPRA within 90 seconds will be designated as late.

22. Because the XYZ Cross was not reported until after the end of the trading day, the transaction did not appear in the NYSE Arca Time and Sales Report, and thus was not reported to OPRA.[7]

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[7] The Time and Sales Report is a chronological report of information such as completed transactions and quotes. OPRA is a service that disseminates quotations and last sale data for options.

Trade-Throughs and Failure to Satisfy a Satisfaction Order

23. NYSE Arca Options Rule 6.94(a) states that, "[a]bsent reasonable justification and during normal market conditions, OTP Holders and OTP Firms should not effect trade-throughs."[8]

24. NYSE Arca Options Rule 6.92(a)(12)(iii) defines a "Satisfaction Order" as "an order sent through the Linkage to notify a Participant Exchange of a Trade-Through and to seek satisfaction of the liability arising from that Trade-Through."[9] NYSE Arca Options Rule 6.94(a)(l) states that *if* an OTP Holder effects a trade-through, the OTP Holder who initiated the trade-through must satisfy the aggrieved party by filling the Satisfaction Order.

25. On July 27, 2005, Story held orders to sell a total of 1,000 ABC Oct. 35 puts. In executions reported at or about 10:15:19 a.m., Story sold 800 puts at a price of $.80, and 200 puts at a price of $.75; at the time, the National Best Bid was $.80.

26. Thus, Story traded through the NBBO in connection with the 200 puts executed at $.75, and failed to use due diligence to execute his customer's order at the best price available.

27. In connection with the trade-through referred to in Paragraphs 25 - 26, at or about 10:16:23 a.m., NYSE Arca received a Satisfaction Order from another exchange to buy 10 ABC Oct. 35 puts at $.80.

28. An NYSE Arca Order Book Official ("OBO") approached Story to inquire about the Satisfaction Order not being filled. Story, in an apparent effort not to have to fill the Satisfaction Order, told the OBO that the order had been executed earlier but had been reported late at or about 10:15:19 a.m. This was not true.

29. Thus, Story failed to fill the Satisfaction Order referred to in Paragraph 27.

30. On August 2, 2005, Story effected a purchase of 500 DEF Oct 85 calls at a price of $1.90, when the National Best Offer was $1.85. Thus, Story traded through the NBBO, and failed to use due diligence to execute his customer's order at the best price available.

31. Additionally, as discussed above, Story traded through the NBBO in connection with the XYZ Calls on June 14, 2005.

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[8] NYSE Arca Rule 6.92(a)(19) defines a "trade-through" as "a transaction in an option series at a price that is inferior to the NBBO."

[9] NYSE Arca Rule 6.92 describes the Linkage system as the systems and data communications network that electronically links together participating securities exchanges.

32. Story also claimed that because both the ABC and DEF option orders were connected to transactions in the underlying stock, it was part of a "complex transaction" and, thus, exempt from the trade-through rules.

33. A Letter of Information, dated February 2, 2005, had been issued to Story in connection with a similar event that occurred in July 2004. In that instance, Story had claimed that he did not have to fill the Satisfaction Orders because the option order was connected to a transaction in the underlying stock and, thus, was part of a "complex order" and exempt from the trade-through provisions. The Letter of Information, however, advised Story that, pursuant to NYSE Arca Options Rule 6.92(a)(4), a "complex order" does not include option orders that are connected to transactions in the underlying stock.

34. Thus, Story traded-through the NBBO on three occasions during a two-month period.

<u>DECISION</u>

The Hearing Panel unanimously finds Story guilty of Charges I – VI.

I. Story Executed an Impermissible XYZ Cross Transaction in Violation of the Allegations set forth in Charges I, II, and III.

The acts, practices, and conduct described in Paragraphs 16, 17, and 22 above constitute violations of Exchange Rule 11.2(b) by Story when Story effected an impermissible cross transaction, reported that transaction to his customer, and acted to conceal his conduct by delaying the reporting of the transaction to the Exchange until after the end of the trading day.

Rule 11.2(b) provides in relevant part that "Any OTP Holder…found guilty in accordance with the Rules and procedures of the Exchange of any of the following prohibited acts shall be subject to the imposition of penalties." The relevant prohibited act here is "(b) Conduct or proceedings inconsistent with just and equitable principles of trade." Subsection (b) may be satisfied by "willful violation of any provision of the federal securities laws, the regulations of the Securities and Exchange Commission and of the Federal Reserve Board, the Bylaws and Rules and procedures of the Exchange." (Rule 11.2(b)).

Here, Story's testimony shows that he was classified as an OTP Holder (Enforcement "Enf." Exhibit 46 at 59). Records show that Story did not execute the XYZ transaction at "equal to or better than the NBBO;" instead, the trade was executed at 8:47a.m., and at a higher rate than the NBBO. (*See* Enf. Exhibits 6, 12). When asked during his testimony whether he was aware that the trade was executed "outside of the prevailing quote," Story admitted that he was aware. (Enf. Exhibit 46 at 88). To conceal this impermissible trade, Story told Adam King to wait to print the order, and the transaction was reported to the customer before it was reported to OPRA. (Hearing Transcript ("Tr.") at 95, 103, 360, 378).

Story's testimony showed that he clearly understood today's rules regarding trading at the NBBO, but conveniently did not "recall" the rules surrounding 2005 transactions. (Enf. Exhibit 46 at 88-89). Story claimed that although the 2005 trade was outside the NBBO, the trade was permissible because of "extenuating circumstances" surrounding the transaction, even though the rule in force clearly provided no exception for "extenuating circumstances." (Enf. Exhibit 46 at 89). Finally, Story waited five hours, and until after the close of trading to report the trade to OPRA in violation of Rule 6.69(a). (*See* Enf. Exhibit 46 at 96).

The Panel finds Story was on sufficient notice that his conduct was violative. Aside from the routine federal regulatory notices of rule implementations and changes, the Exchange itself went beyond merely publishing the rule in its rulebook to notify traders of the reporting duties. It also distributed multiple memoranda regarding compliance procedures with the rule dating from 2002 to 2004. (*See* Enf. Exhibits 31 and 32). For example, an August 12, 2002 PCX Options Regulatory Information Bulletin states in its first paragraph that "[t]ransactions not reported to OPRA within 90 seconds will be designated as 'late'" as prescribed by Rule 6.69. Story testified that he received such periodic updates of Exchange Rules in 2005. (Enf. Exhibit 46 at 152-53). In addition to receiving paper updates, Story went on to state that he attended formal as well as informal compliance meetings to "go over any issues that might have arisen recently, any new rules, any delisted options, various compliance matters." (Enf. Exhibit 46 at 153). However, instead of complying with this highly publicized reporting Rule, and reporting the contested transaction within 90 seconds, records show that Story did not report the trade until after the close of trading, at 1:38p.m., over five hours after the trade was executed. (*See* Enf. Exhibit 46 at 96).

The Hearing Transcript shows that Story understood the late reporting requirements during 2005. While being examined, Story claimed to be unaware of the provisions of Exchange Rules, but while questioning a witness, Matt Kajiwara, Story displayed considerable knowledge of the 2005 rules. (Tr. at 314-29). Story, himself, further elicited testimony from David Sullivan that Story follows Exchange Rules and "knows the rules well." (Tr. at 74-76). Along with Story's own testimony that he received compliance notifications and attendance of informative meetings, the Panel finds Story's inconsistent rule recollections to be evidence of his knowing violation of the late reporting requirements.

Furthermore, Story conceded that the transactions were completed at the recorded times. (Tr. at 341). Those reported times show a lag of five hours between the transaction's execution and its reporting. (*See* Enf. Exhibit 46 at 96). Witness Peter Bijesse testified that four hours can constitute an aggravated violation of the late reporting requirements. (Tr. at 208-09). Bijesse further stated that intentional late reporting suffices for an aggravated violation as well. (Tr. at 209). Here, Story waited five hours to report the XYZ trade, and he most likely did so intentionally to conceal the trade that was outside the NBBO. (*See* Enf. Exhibit 46 at 96). Because of the distribution of memoranda regarding the requirements, and Story's inconsistent account of his rule recollections, it is inconceivable to the Panel that Story was unaware of the reporting requirements at the time of the transaction.

In defending his actions, Story claims that he did not execute the transaction. (Tr. at 321). This panel finds that it is indisputable that Story executed the transaction: Story communicated the proposed transaction to the Trading Crowd, the Trading Crowd refused the transaction, the trade was communicated with the Firm's customer, and the execution was reported after close with Story's number on it. Story's claims, therefore, are inconsistent and not credible. This panel consequently finds that Story's violations of the Exchange rules satisfy Rule 11.2(b) and warrant the imposition of penalties.

Along with his 11.2(b) offense, this panel also finds that Story is subject to discipline under NYSE Arca Options Rule 10.1(a) for his failure to follow the proper procedures required by 6.47(b) and his failure to report the transaction within the specified time as required by 6.69(a). Rule 10.1(a) states that "An OTP Holder…who is alleged to have violated…any provision of the Exchange's Bylaws or Rules…shall be subject to the disciplinary jurisdiction of the Exchange…and may be appropriately disciplined."

For the acts, practices, and conduct described in Paragraphs 16 and 17 above as well as that described in this decision, the panel has found Story's violations of Exchange rules to warrant discipline under Rule 10.1(a).[10]

II. Story's Multiple Trade-Throughs, Failures to Satisfy a Satisfaction Order and Failures to use Due Diligence Constitute Impermissible Violations of the Allegations set forth in Charges IV-VI.

One month after Story violated Exchange rules in executing the XYZ cross transaction discussed above, Story violated Rule 6.94(a). Rule 6.94(a) requires in relevant part that OTP Holders "should not effect trade-throughs" without "reasonable justification." Should an OTP Holder effect a trade-through, they must fill a Satisfaction Order. (Rule 6.94(a)(1)(i)).

During his testimony, Story admitted that he knew of and understood this rule by stating, "[t]he best practice is to not trade through the NBBO. That's all there is to it." (Enf. Exhibit 46 at 136). Yet Story's words and actions do not coincide. Story executed an order in ABC at five cents outside the NBBO on July 27, 2005, and thereby effected a trade-through. (Enf. Exhibits 13, 18, 22). He later failed to fill a Satisfaction Order. (Enf. Exhibit 46 at 130). Story provided no reasonable justification for his actions, and therefore, Story's conduct was a clear violation of Rule 6.94(a).

A few days later on August 2, Story executed an order in DEF outside the NBBO and after effecting this trade-through he again failed to fill a Satisfaction Order. (Enf. Exhibit 23). The Panel finds that Story had previously been warned about this type of behavior in a letter dated of February the same year (Enf. Exhibit 43). In considering this prior warning, along with Story's disregard for Exchange Rules and his words professing adherence to "best practice," the Panel is convinced of Story's guilt.

Aside from failing to fill a Satisfaction Order, Story also did not take the required due diligence to execute orders at the best prices. Such disregard for due diligence duties constitutes a violation Rule 6.46(a) "Responsibilities of Floor Brokers." This panel's review of the records has revealed that the prices at which Story executed the transactions did not match the

[10] The Panel also believes that there may have been others that were complicit with Mr. Story in violating these same rules.

correlating best price available (Enf. Exhibits 13, 18, 22, 23). This is clear evidence that Story disregarded his duty of due diligence.

For Story's multiple violations of NYSE Arca Options Rules 6.94(a) and 6.46(a), this panel has found that Story has engaged in a course of conduct that warrants discipline under NYSE Arca Options Rule 10.1(a).

SANCTION

Enforcement requested a penalty of a censure and a $30,000 fine.

In determining a reasonable and appropriate penalty, the Hearing Panel considered the factors enumerated in McCarthy v. SEC, 406 F.3d 179 (2d Cir. 2005):

> The seriousness of the offense, the corresponding harm to the trading public, the potential gain to the [respondent] for disobeying the rules, the potential for repetition in light of the current regulatory and enforcement regime, and the deterrent value to the offending [respondent] and others are all relevant factors to be considered in deciding whether the sanction is appropriately remedial and not excessive and punitive. Id. at 190.

In determining a reasonable and appropriate penalty, the Hearing Panel also considered the factors enumerated in NYSE Arca Options Rule 10.16 and the facts, evidence and arguments presented by the parties during the hearing. In light of the seriousness and severity of the conduct, the Hearing Panel finds that a penalty of a censure and a $10,000 fine is reasonable and appropriate.

For the Hearing Panel

Brian Gentile – Panel Chair
Matt McDermott - Panelist