

Judge Berman

'09 CIV 1711

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

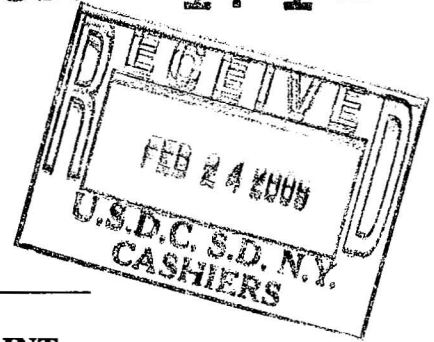
SECURITIES AND EXCHANGE COMMISSION)

Plaintiff,)

v.)

VICTOR P. MACHADO and FRANK LU)

Defendants.)



09 Civ. _____

COMPLAINT

The Securities and Exchange Commission ("Commission") alleges:

SUMMARY

1. This matter arises from a fraudulent scheme involving Frank Lu, a former salesperson at Oppenheimer & Co. Inc. ("OPCO"), and Victor P. Machado, a former trader at two related entities, Leumi Investment Services Inc. ("LISI") and Bank Leumi USA ("BLUSA") (LISI and BLUSA will be collectively referred to as "Leumi"). From May 2003 through mid-August 2004 (the "relevant period"), Machado and Lu engaged in a scheme to direct Leumi's order flow to OPCO in exchange for secret gratuities and entertainment that Lu provided to Machado. As part of the scheme, and in violation of his duties to Leumi and Leumi's customers, Machado routinely directed a substantial flow of orders to Lu's firm, OPCO, for execution at prices that were favorable to OPCO and detrimental to Leumi's customers. Lu was a knowing participant in this scheme as he provided Machado with secret gratuities and entertainment to induce Machado to direct Leumi's order flow to OPCO. Lu benefited from this scheme because he obtained increased compensation from the increased order flow from Machado. As a result of

Machado's and Lu's conduct, Leumi's customers were harmed by approximately \$1,113,036.

2. As part of their fraudulent arrangement, Machado and Lu also interpositioned OPCO between Leumi and firms that offered better prices for Leumi's customers. Specifically, Machado and Lu harmed Leumi's customers by unnecessarily using OPCO as a "middleman" to execute trades with other firms, when Machado could have executed those trades directly with the same firms at prices that were more favorable to Leumi's customers.

3. Additionally, Machado frequently changed Lu's quoted price to make the final price more favorable to OPCO, causing OPCO's price to become even less favorable to Leumi's customers. By engaging in this conduct, Machado and Lu ensured that OPCO realized a quick profit on Leumi's trading with little or no risk.

4. Both Machado and Lu concealed their fraudulent conduct from their firms. Machado hid his trading activities with Lu from his supervisors by falsifying LISI's order tickets, making numerous false entries on LISI's trade blotter, and changing the text of e-mails with Lu or deleting the e-mails from his computer. Neither Lu nor Machado reported the gratuities or entertainment to their firms, as required by their respective firms' policies. Lu lied to his firm in his written responses to compliance questionnaires that asked whether he had given gratuities to any customer.

5. By virtue of their conduct, Machado and Lu violated Section 17(a) of the Securities Act of 1933 ("Securities Act") [15 U.S.C. § 77q(a)], Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") [15 U.S.C. § 78j(b)] and Rule 10b-5 [17 C.F.R. § 240.10b-5] thereunder. Lu also aided and abetted Machado's violations of

Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. Machado aided and abetted LISI's violations of Section 17(a)(1) of the Exchange Act [15 U.S.C. § 78q(a)(1)] and Rule 17a-3 [17 C.F.R. § 240.17a-3] thereunder. Unless enjoined, Machado and Lu will likely commit such violations in the future. Machado and Lu should be enjoined from violating these provisions and rules. Machado and Lu should be ordered to disgorge any ill-gotten gains or benefits derived as a result of their violations, as well as prejudgment interest thereon, and Machado and Lu each should be ordered to pay appropriate civil money penalties.

JURISDICTION AND VENUE

6. This Court has jurisdiction of this action pursuant to Sections 20 (b), 20(d), and 22(a) of the Securities Act [15 U.S.C. §§ 77t(b), 77t(d), and 77v(a)] and Sections 21(d), 21(e), and 27 of the Exchange Act [15 U.S.C. §§ 78u(d), 78u(e), and 78aa].

7. Venue is proper in this district pursuant to Section 22(a) of the Securities Act [15 U.S.C. § 77v(a)] and Section 27 of the Exchange Act [15 U.S.C. § 78aa] because certain acts and transactions constituting the violations occurred in this district.

8. Machado and Lu, directly or indirectly, made use of the means or instrumentalities of interstate commerce, or of the mails, or the facilities of a national securities exchange in connection with the transactions, acts, practices, and courses of business alleged herein.

DEFENDANTS

9. Victor P. Machado is a resident of New Jersey. From September 1999 until August 2004, he was a fixed income trader employed by both LISI and BLUSA in New York, New York. LISI is a broker-dealer registered with the Commission with its principal office in New York, New York. BLUSA is a FDIC insured bank and LISI's parent company.

10. Frank Lu is a resident of New Jersey. From January 2003 until March 2006, Lu was a registered representative employed by OPCO at OPCO's office in Florham Park, New Jersey. OPCO is registered with the Commission as both a broker-dealer and investment adviser and has its principal office in New York, New York.

STATEMENT OF FACTS

A. Background

11. From September 1999 until he was dismissed on August 31, 2004, Machado was a fixed income trader on Leumi's trading desk in New York City primarily involved in executing orders in emerging market fixed income securities, and also in U.S. government-sponsored entities securities on behalf of customers. As a trader, Machado was responsible for determining the best prices available in the market and then executing the trades on behalf of Leumi's customers.

12. When Machado was not engaged in fraudulent conduct with Lu, he typically executed customer orders in the following manner. After receiving a customer order (usually, a limit order) from a Leumi representative, Machado would solicit at least three competing quotes from various broker-dealers as required by LISI's policy. After selecting the broker-dealer with the best available price, which typically included a

markup or markdown, Machado would execute the transaction with that broker-dealer, usually at a price that equaled the customer's limit order price.

13. During the relevant period, Lu was a salesperson at OPCO specializing in emerging market securities. As a salesperson at OPCO, Lu performed various services for his customers, including soliciting trades, presenting trading opportunities, and receiving and processing their orders. Lu did not execute the orders he received from customers, but sent them to an OPCO trader for execution.

14. During Lu's employment with OPCO, he was compensated solely based on a percentage of the revenue generated by his customers' executions through OPCO. Lu's compensation directly correlated to the volume of trades his customers executed through OPCO. To ensure that he continued to obtain adequate trading volume to sustain his income level, in mid-2003, Lu entered into a secret and improper order flow arrangement with Machado.

B. Machado and Lu's Illicit Trading Arrangement

15. In mid-2003, Machado and Lu agreed that Machado would direct orders to Lu for execution at prices favorable to OPCO, and Lu, in exchange, would provide Machado with frequent and costly gratuities and entertainment. Lu agreed to the arrangement because it ensured him steady and substantial order flow that directly produced higher compensation for Lu.

16. Pursuant to his arrangement with Lu, Machado not only provided Lu with substantial order flow, but also ensured that OPCO would make a quick profit on the trades that it executed for Machado by routinely changing Lu's quoted price to make it more favorable to OPCO and, consequently, less favorable to Leumi's customers. For

example, if Leumi's customer placed an order to buy a security and Lu offered to sell that security to Machado at a price of \$99.50, Machado instead would pay OPCO \$100, making the price more favorable to OPCO, and less favorable to Leumi's customers.

17. From approximately May 2003 through mid-August 2004, Machado and Lu engaged in their fraudulent trading scheme. Pursuant to their arrangement, Machado typically executed trades with Lu in the following manner: (i) Machado sent an e-mail to Lu requesting a quote from Lu on a particular security; (ii) Lu requested a quote from OPCO's trader; (iii) the OPCO trader searched for quotes generally from the same broker-dealers that Machado traded with when Machado did not trade with OPCO; (iv) Lu e-mailed the quote provided by the OPCO trader to Machado; (v) if Machado accepted the price, Machado then changed the price in Lu's e-mail to reflect a more favorable price to OPCO; (vi) Machado then sent the altered e-mail accepting the trade at the new price to Lu; (vii) Lu sent Machado an e-mail confirming the completion of the trade; (viii) Machado deleted from his computer Lu's original e-mail(s) reflecting Lu's initial quote, in order that his supervisor would not detect the trading arrangement; and finally, (ix) Machado filled Leumi's customer's limit order, but not at the best available price.

18. The number of trades that Machado executed through OPCO increased substantially after the implementation of their secret arrangement. Before the arrangement, from January through May 2003, Machado executed, on average, sixteen trades per month with Lu; after the arrangement began, from June through December 2003, Machado executed, on average, thirty-two trades per month with Lu, and from January through August 2004, Machado executed, on average, seventy-two trades per

month with Lu. Furthermore, the percentage of Lu's total trading volume attributable to Machado and Leumi increased substantially after the implementation of the trading arrangement. Before the arrangement, from January through May 2003, Lu's trades with Machado represented approximately fifty percent of Lu's total trading volume; after the arrangement began, from June through December 2003, Lu's trades with Machado represented approximately sixty percent of Lu's total trading volume, and from January through August 2004, Lu's trades with Machado represented approximately ninety percent of Lu's total trading volume.

C. Lu Provided Illicit Gratuities to Machado in Exchange for Order Flow

19. Pursuant to their fraudulent arrangement, Lu provided secret gratuities and entertainment to Machado as an incentive to direct a steady flow of orders to OPCO for execution, at prices that were favorable to OPCO and detrimental to Leumi's customers. During 2003 and 2004, Lu entertained Machado six to seven times per year. The costs associated with each evening of entertainment generally ranged from \$1,000 to \$1,500, which Lu always paid for in cash.

20. In addition, approximately half a dozen times per year, Lu purchased gratuities for Machado such as expensive bottles of liquor and ties, which Lu mailed to Machado's residence. Neither Lu nor Machado reported the gratuities as required by Leumi's and OPCO's respective policies. Indeed, Lu lied to his firm when he failed to disclose on OPCO's 2003 and 2004 employee integrity questionnaires the gratuities that he provided to Machado.

21. The illicit gratuities that Lu provided to Machado induced him to direct a significant amount of order flow to Lu's firm for execution at prices that were favorable

to OPCO. For example, from May 7, 2003 through February 9, 2004, Machado and Lu had the following e-mail communications:

May 7, 2003

Machado: I fell off my chair yesterday. I'm assuming you know why?

Lu: Hey take your wife out

Machado: dude. I almost fainted. "Thank You" just doesn't cover it. It really doesn't. Wow! But I'll say thank you anyhow. Thank you very much. But I have better ways of showing appreciation just you wait!

June 6, 2003

Machado: As another horrible day ended for me the nicest thing happened to me yesterday, extremely unexpected and undeserved. It gave me a goal to reciprocate [sic] threefold in the least.

February 9, 2004

Lu: The plane landed?

Machado: It did. I figured we'd do a cost benefit analysis. Maybe more flow?

Subsequent to the June 2003 e-mail, Machado doubled the number of trades that he executed with Lu, from nineteen (for the three months prior to June) to forty-one (for the three months from June through August 2003). Similarly, following the February 2004 e-mail, Machado tripled the number of trades he executed with Lu.

22. During the course of their fraud, Machado and Lu caused Leumi's customers to incur losses totaling approximately \$1,113,000.

D. Machado Altered LISI's Trading Documents to Conceal His Trading Activities with Lu

23. To prevent his supervisor from detecting that he was trading with Lu, Machado often would not enter OPCO's name on LISI's trade blotter. Instead, Machado would insert the name of another broker-dealer, that was not involved with the trade, that

he knew would be acceptable to his supervisor. In those instances when Machado did list OPCO on the blotter, he would report the OPCO price as he had changed it, and not at Lu's initial quoted price. On other occasions, when Machado listed other dealers' quoted prices on the blotter, consistent with LISI's requirement of obtaining three competing price quotes prior to executing a trade, Machado often intentionally listed incorrect prices for the other dealers' quotes in order to create the false appearance that Lu's quote was the best available price. As a result, Machado entered false and misleading information into LISI's trade blotter.

24. In an effort to conceal his trades with Lu from his supervisor, Machado, after executing a trade with Lu, often prepared a counterparty trade ticket that falsely stated that he had closed the trade with a different counterparty. Machado then obtained the necessary initials from his supervisor on the falsified counterparty trade ticket. Machado would then cross out the name of the bogus counterparty on the ticket and write in the names of OPCO/Lu, the true counterparty.

25. Machado and Lu conducted their trading and most of their communications by e-mail using the Bloomberg messaging system. To avoid detection by his supervisor, Machado also deleted from his computer the e-mails with Lu that reflected Lu's original price, in violation of the LISI's e-mail retention policy.

E. Lu Included Undisclosed Markups and Markdowns in the Prices He Charged Machado

26. Pursuant to their illicit arrangement, Lu agreed to quote prices to Machado at OPCO's cost, which meant the price that Lu was quoted from the OPCO trader for the security, and that Machado would then include a markup or markdown at his discretion. Notwithstanding his agreement with Machado, Lu secretly included a markup or

markdown to Leumi on approximately thirty of his trades with Machado. Machado was unaware that Lu was doing so.

27. As a result, when Machado changed Lu's quoted price to make it more favorable to OPCO, Leumi's customers were doubly disadvantaged because they incurred two unnecessary costs that were secretly embedded in the price of their securities transactions – from the markup or markdown that Lu included without Machado's knowledge, and from Machado's agreement with Lu to ensure favorable pricing to OPCO. The prices paid by Leumi's customers on these transactions included both of these undisclosed costs, along with Leumi's standard markup or markdown. Neither Leumi nor its customers were advised of these additional costs on their trading. The additional markups or markdowns that Lu secretly included in his quotes to Machado caused Leumi customers to overpay on these trades by approximately \$24,000.

FIRST CLAIM

Violations of Section 17(a) of the Securities Act

28. Paragraphs 1 through 27 are hereby realleged and incorporated by reference.

29. Section 17(a) of the Securities Act makes it unlawful for any person in the offer or sale of any securities by the use of any means or instrumentality of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly, to use any device, scheme or artifice to defraud, or to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or to engage in any transaction, practice, or

course of business which operates or would operate as a fraud or deceit upon the purchaser.

30. By reason of the conduct described above, Defendants Machado and Lu violated Section 17(a) of the Securities Act [15 U.S.C. §77q(a)].

SECOND CLAIM

Violations of Section 10(b) of the Exchange Act and Rule 10b-5

31. Paragraphs 1 through 30 are hereby realleged and incorporated by reference.

32. Section 10(b) of the Exchange Act and Rule 10b-5 thereunder prohibit any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange, from employing any device, scheme or artifice to defraud, or from making any untrue statement of material fact or omitting to state a material fact necessary in order to make the statement made, in the light of the circumstances under which they were made, not misleading, or from engaging in any act, practice or course of business which operates or would operate as a fraud or deceit on any person, in connection with the purchase or sale of any security.

33. By reason of the conduct described above, Defendants Machado and Lu violated Section 10(b) of the Exchange Act [15 U.S.C. § 78j(b)] and Rule 10b-5 [17 C.F.R. § 240.10b-5] thereunder.

THIRD CLAIM

Aiding and Abetting Violations of Section 10(b) of the Exchange Act and Rule 10b-5

34. Paragraphs 1 through 33 are hereby realleged and incorporated by reference.

35. Section 20(e) of the Exchange Act [15 U.S.C. § 78t(e)] provides that any person who knowingly provides substantial assistance to another person in violation of a provision of the Exchange Act, or any rule or regulation issued under the Exchange Act, shall be deemed to be in violation of such provision to the same extent as the person to whom such assistance is provided.

36. By reason of the conduct described above, Defendant Lu knowingly provided substantial assistance to Machado's violations of Section 10(b) of the Exchange Act [15 U.S.C. § 78j(b)] and Rule 10b-5 [17 C.F.R. § 240.10b-5] thereunder.

FOURTH CLAIM

Aiding and Abetting Violations of Section 17(a)(1) of the Exchange Act and Rule 17a-3

37. Paragraphs 1 through 36 are hereby realleged and incorporated by reference.

38. Section 20(e) of the Exchange Act [15 U.S.C. § 78t(e)] provides that any person who knowingly provides substantial assistance to another person in violation of a provision of the Exchange Act, or any rule or regulation issued under the Exchange Act, shall be deemed to be in violation of such provision to the same extent as the person to whom such assistance is provided.

39. Section 17(a)(1) [15 U.S.C. § 78q(a)(1)] of the Exchange Act and Rule 17a-3 [17 C.F.R. § 240.17a-3] thereunder require that registered brokers and dealers make and keep current certain specified books and records relating to their business. Such books and records must be accurate.

40. Among the records that brokers and dealers are required to make and keep are: (1) blotters (or other records of original entry) containing an itemized daily record of all purchases and sales of securities [Rule 17a-3(a)(1)]; and (2) “[a] memorandum of each purchase and sale for the account of the member, broker, or dealer showing the price and, to the extent feasible, the time of execution” [Rule 17a-3(a)(7)].

41. By reason of the conduct described above, Defendant Machado knowingly provided substantial assistance to LISI’s violations of Section 17(a)(1) of the Exchange Act [15 U.S.C. § 78q(a)(1)] and Rule 17a-3 [17 C.F.R. § 240.17a-3] thereunder.

42. By reason of the conduct described above, Defendant Machado aided and abetted LISI’s violations of Section 17(a)(1) of the Exchange Act [15 U.S.C. § 78q(a)(1)] and Rule 17a-3 [17 C.F.R. § 240.17a-3] thereunder.

PRAYER FOR RELIEF

WHEREFORE, the Commission respectfully requests that the Court:

- (a) permanently enjoin Machado and Lu from violating Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder;
- (b) permanently enjoin Machado from aiding and abetting violations of Section 17(a)(1) of the Exchange Act and Rule 17a-3 thereunder;
- (c) order Lu to disgorge the proceeds of his ill-gotten gains, plus prejudgment interest;

(d) order Machado to disgorge the proceeds of his ill-gotten gains, plus prejudgment interest;

(e) order Machado and Lu each to pay a civil money penalty pursuant to Section 20(d) of the Securities Act [15 U.S.C. § 77t(d)] and Section 21(d)(3) of the Exchange Act [15 U.S.C. § 78u(d)(3)]; and

(f) grant such other relief as the Court deems just and proper.

Dated: February 23, 2009

Respectfully submitted,



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