

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

Securities Act of 1933
Release No. 9033 / May 28, 2009

Securities Exchange Act of 1934
Release No. 59998 / May 28, 2009

Administrative Proceeding
File Number 3-11893

In the Matter of	:	ORDER MAKING FINDINGS,
	:	IMPOSING REMEDIAL SANCTIONS,
	:	AND IMPOSING A CEASE-AND-DESIST
David A. Finnerty,	:	ORDER PURSUANT TO SECTION 8A OF
Donald R. Foley II,	:	THE SECURITIES ACT OF 1933 AND
Scott G. Hunt,	:	SECTIONS 15(b)(6), 21C AND 11(b) OF THE
Thomas J. Murphy, Jr.,	:	SECURITIES EXCHANGE ACT OF 1934 AND
Kevin M. Fee,	:	RULE 11b-1 THEREUNDER AS TO
Frank A. Delaney IV,	:	DAVID A. FINNERTY
Freddy DeBoer,	:	
Todd J. Christie,	:	
James V. Parolisi,	:	
Robert W. Luckow,	:	
Patrick E. Murphy,	:	
Robert A. Johnson, Jr.,	:	
Patrick J. McGagh, Jr.,	:	
Joseph Bongiorno,	:	
Michael J. Hayward,	:	
Richard P. Volpe,	:	
Michael F. Stern,	:	
Warren E. Turk,	:	
Gerard T. Hayes, and	:	
Robert A. Scavone, Jr.	:	
	:	
	:	
Respondents.	:	
	:	

I.

On April 12, 2005, the Securities and Exchange Commission (“Commission”) entered an Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933 and Sections 15(b)(6), 21C and 11(b) of the Securities Exchange Act of 1934 and Rule 11b-1 Thereunder (“OIP”) against respondent David A. Finnerty (“Finnerty”).

II.

Finnerty has submitted an Offer of Settlement (“Offer”) in these administrative proceedings, which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission’s jurisdiction over him and the subject matter of these proceedings, which are admitted, Finnerty consents to the entry of this Order Making Findings, Imposing Remedial Sanctions, and Imposing a Cease-and-Desist Order Pursuant to Section 8A of the Securities Act of 1933 and Sections 15(b)(6), 21C and 11(b) of the Securities Exchange Act of 1934 and Rule 11b-1 Thereunder as to David A. Finnerty (“Order”), as set forth below.

III.

On the basis of this Order and Finnerty’s Offer, the Commission finds¹ that:

FACTS

1. Finnerty is one of several respondents in pending administrative and cease-and-desist proceedings, file number 3-11893, who have been charged with fraudulent and other improper trading during the period from at least 1999 through June 30, 2003, while they were acting as specialists on the New York Stock Exchange (“NYSE”).
2. Finnerty, age 42, of Weehawken, New Jersey, acted as a specialist at Fleet Specialist, Inc. (now known as Banc of America Specialist, Inc.) (“Fleet”) and a Fleet predecessor firm from at least January 1, 1999 to approximately April 2003 (the “Relevant Period”).
3. During the Relevant Period, Finnerty acted as a specialist in PE Biosystems (“PEB”) (from approximately November 1999 to approximately September 2000), Applera Corp. – Celera Genomics Group (“CRA”) (from approximately November 1999 to approximately February 2002), and General Electric (“GE”) (from approximately September 2000 to approximately April 11, 2003).

¹ The findings herein are made pursuant to Finnerty’s Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

4. As a specialist, Finnerty had an obligation to serve public customer orders over the proprietary interests of the firm with whom he was formerly employed, Fleet. In his role as a specialist, Finnerty had a general duty to match executable public customer or “agency” buy and sell orders and not to fill customer orders through trades from Fleet’s own account when those customer orders could be matched with other customer orders. In becoming a specialist, Finnerty represented to the NYSE that he would comply with the NYSE Rules, and thereby fulfill this duty. Finnerty violated his obligation by filling orders through proprietary trades rather than through other customer orders, through two types of improper trading referred to herein as “interpositioning” and “trading ahead.”
5. Interpositioning involves a two-step process that allows the specialist to generate a profit for the specialist firm from the spread between two opposite trades. Interpositioning can take various forms. In one form, the specialist purchases stock for the specialist firm’s proprietary account from the customer sell order, and then fills the customer buy order by selling from the specialist firm’s proprietary account at a higher price – thus locking in a riskless profit for the specialist firm’s proprietary account. A second form of interpositioning involves the specialist selling stock into the customer buy order, and then filling the customer sell order by buying for the specialist firm’s proprietary account at a lower price – again, locking in a riskless profit for the specialist firm’s proprietary account. In both forms of interpositioning, the specialist participates on both sides of the trade, thereby capturing the spread between the purchase and sale prices, disadvantaging at least one of the parties to the transaction.
6. Trading ahead involves a practice whereby the specialist fills an agency order through a proprietary trade for the specialist firm’s proprietary account – and thereby improperly ‘steps in front’ of, or ‘trades ahead’ of, another agency order – simply to allow the specialist firm to take advantage of market conditions promptly. Unlike interpositioning, the practice of “trading ahead” does not necessarily involve a second specialist trade for the specialist firm’s proprietary account into the opposite, disadvantaged agency order. For example, in a declining market, a specialist may “trade ahead” by filling a market buy order by selling stock from the specialist firm’s proprietary account in front of an agency market sell order. In so doing, the specialist would lock in a higher price for the proprietary trade, then fill the agency sell order *after* the proprietary trade, and thereby force the agency market sell order to accept a slightly lower price as the price of the stock fell.
7. During the Relevant Period, in PEB, CRA, and GE, Finnerty knowingly or recklessly engaged in approximately 26,300 instances of interpositioning, locking in a riskless profit of approximately \$4,500,000 for his firm’s proprietary account at the expense of customer orders, and approximately 15,000 instances of trading ahead, causing approximately \$5,000,000 in customer harm.

APPLICABLE LAW

Section 17(a) of the Securities Act of 1933 (“Securities Act”) and Section 10(b) of the Securities Exchange Act of 1934 (“Exchange Act”) and Rule 10b-5 Thereunder

8. The antifraud provisions of Section 17(a) of the Securities Act, and Section 10(b) of the Exchange Act, and Rule 10b-5 thereunder prohibit, among other things, any schemes to defraud or fraudulent or deceptive acts and practices in the offer or sale (Section 17(a)) or in connection with the purchase or sale (Section 10(b) and Rule 10b-5) of securities. Basic Inc. v. Levinson, 485 U.S. 224, 235 n.13 (1988) (citing SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 862 (2d Cir. 1968) (en banc)). To prove a violation of Section 17(a)(1) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, the Commission must prove that the respondent acted with scienter. Aaron v. SEC, 446 U.S. 680, 691 (1980). Scienter may be established by proof of conscious behavior or recklessness on the part of the respondent. SEC v. U.S. Environmental, Inc., 155 F.3d 107, 111 (2d Cir. 1998), cert. denied, 526 U.S. 1111 (1999). Scienter need not be shown in order to establish violations of Sections 17(a)(2) and (3) of the Securities Act. Aaron v. SEC, 446 U.S. 680, 696-97 (1980).
9. Pursuant to the NYSE rules described below and his duty as a specialist, Finnerty had a duty to fill customer orders solely in a manner that served the interests of customers or that helped maintain fair and orderly markets. Finnerty expressly represented to the NYSE that he would comply with its rules and thereby represented that he would fulfill these duties; he also held himself out as a member in good standing of the NYSE. As a result, absent disclosure to the contrary by Finnerty, those who submitted orders executed by him – including NYSE members and their customers – were entitled to believe that he would execute their orders in a manner consistent with these duties and would not profit at their expense. By engaging in undisclosed interpositioning and trading ahead in contravention of the duties and representations described above, Finnerty engaged in deceptive conduct. Accordingly, Finnerty willfully violated Section 17(a) of the Securities Act, and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

Section 11(b) of the Exchange Act and Rule 11b-1 Thereunder

10. Section 11(b) of the Exchange Act and Rule 11b-1 thereunder require various limitations on the operations of specialists, including limiting a specialist’s dealer transactions to those “reasonably necessary to permit him to maintain a fair and orderly market.” Section 11(b) and Rule 11b-1 permit a national securities exchange to promulgate rules that allow a member to register as a specialist and to act as a dealer. Under Rule 11b-1 if the Commission finds, after appropriate notice and opportunity for hearing, that a specialist has for any account in which he has an interest “effected transactions ... which were not part of a course of dealings reasonably necessary to permit such specialist to maintain a fair and orderly market,” and were “not effected in a manner consistent with the rules adopted by such exchange,” the Commission may order the exchange to suspend or cancel the specialist’s registration. If, however, the exchange itself has

suspended or canceled the specialist's registration, no further sanction shall be imposed unless the Commission finds "substantial or continued misconduct."

11. Where specialists make trades for their firm's proprietary accounts that are not "reasonably necessary to permit [such specialists] to maintain a fair and orderly market," they have violated Section 11(b) and Rule 11b-1 of the Exchange Act. The Commission has brought settled actions for sanctions under Exchange Act Section 15(b) against specialists under Section 11(b) and Rule 11b-1. See In the Matter of Albert Fried & Co. and Albert Fried, Jr., 1978 WL 196046, S.E.C. Release No. 34-15293 (Nov. 3, 1978).
12. Several NYSE rules prohibit a specialist from trading ahead of a customer order, as well as from engaging in interpositioning, and require agency orders to be matched whenever possible, consistent with a specialist's duty to maintain a fair and orderly market.
13. NYSE Rule 104 (Dealings by Specialists), which sets forth specialists' obligations, prohibits specialists from trading for their own accounts unless it is reasonably necessary to maintain a fair and orderly market. This is known as the negative obligation. Rule 104 states in relevant part: "No specialist shall effect . . . purchases or sales of any security in which such specialist is registered . . ., unless such dealings are reasonably necessary to permit such specialist to maintain a fair and orderly market."²
14. NYSE Rule 92 (Limitations on Members' Trading Because of Customers Orders) generally prohibits a member from entering a proprietary order to buy (or sell) a security while in possession of an executable buy (or sell) agency order that could be executed at the same price. During the Relevant Period, Rule 92 stated in relevant part:

No member shall personally buy . . . any security . . . for his own account or for any account in which he is . . . interested . . . while such member personally holds or has knowledge that his member

² Rule 104.10(3), which describes specialists' affirmative obligations, also expands on the negative obligation:

Transactions on the Exchange for his own account effected by a member acting as a specialist must constitute a course of dealings reasonably calculated to contribute to the maintenance of price continuity with reasonable depth, and to the minimizing of the effects of temporary disparity between supply and demand, immediate or reasonably to be anticipated. Transactions not part of such a course of dealings . . . are not to be effected.

organization holds an unexecuted market order to buy such security . . . for a customer.³

15. Similarly, NYSE Rule 92 also applies to the specialist buying or selling a security while holding an unexecuted market buy or sell order, as well as to circumstances where the specialist holds unexecuted customer limit orders at a price that could be satisfied by the proprietary transaction effected by the specialist.
16. NYSE Rule 123B (Exchange Automated Order Routing System) requires specialists to cross orders received over the DOT system. Rule 123B(d) states in relevant part: “a specialist shall execute System orders in accordance with Exchange auction market rules and procedures, including requirements to expose orders to buying and selling interest in the trading crowd and *to cross orders before buying or selling from his own account.*” (Emphasis added).
17. NYSE Rule 401 requires NYSE members to “adhere to the principles of good business practice in the conduct of his or its business affairs.” Similarly, NYSE Rule 476(a)(6) provides sanctions if NYSE members are adjudged guilty of “conduct or proceeding inconsistent with just and equitable principles of trade.”
18. As a result of the conduct described above, Finnerty violated the aforementioned NYSE rules and violated Section 11(b) of the Exchange Act and Rule 11b-1 thereunder.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Finnerty’s Offer.

Accordingly, it is hereby ORDERED that:

1. Pursuant to Section 8A of the Securities Act and Section 21C of the Exchange Act, Finnerty shall cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Securities Act, and Sections 10(b) and 11(b) of the Exchange Act and Rules 10b-5 and 11b-1 thereunder.

³ Rule 92 was amended on January 7, 2002 to read in relevant part:

[n]o member or member organization shall cause the entry of an order to buy (sell) any Exchange-listed security for any account in which such member or member organization or any approved person thereof is directly or indirectly interested (a “proprietary order”), if the person responsible for the entry of such order has knowledge of any particular unexecuted customer’s order to buy (sell) such security which could be executed at the same price.

2. Pursuant to Section 15(b)(6) of the Exchange Act, Finnerty be, and hereby is, barred from association with any broker or dealer.

Any reapplication for association by Finnerty will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against Finnerty, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

3. It is further ordered that Respondent shall, within 10 days of the entry of this Order, pay a civil money penalty in the amount of \$150,000 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3711. Such payment shall be: (A) made by United States postal money order, certified check, bank cashier's check or bank money order; (B) made payable to the Securities and Exchange Commission; (C) hand-delivered or mailed to the Office of Financial Management, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, VA 22312; and (D) submitted under cover letter that identifies Finnerty as a Respondent in these proceedings, the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Scott L. Black, Division of Enforcement, Securities and Exchange Commission, 3 World Financial Center, Suite 400, New York, NY 10281.

By the Commission.

Elizabeth M. Murphy
Secretary