INITIAL DECISION RELEASE NO. 381
ADMINISTRATIVE PROCEEDING
FILE NO. 3-11893

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

In the Matter of	:	
	:	
DAVID A. FINNERTY, DONALD R. FOLEY II,	:	INITIAL DECISION AS TO
SCOTT G. HUNT, THOMAS J. MURPHY, JR.,	:	DONALD R. FOLEY, II,
KEVIN M. FEE, FRANK A. DELANEY IV,	:	SCOTT G. HUNT,
FREDDY DeBOER, TODD J. CHRISTIE,	:	FRANK A. DELANEY, IV,
JAMES V. PAROLISI, ROBERT W. LUCKOW,	:	JAMES V. PAROLISI,
PATRICK E. MURPHY, ROBERT A. JOHNSON, JR.,	:	ROBERT W. LUCKOW,
PATRICK J. McGAGH, JR., JOSEPH BONGIORNO,	:	ROBERT A. JOHNSON, JR.,
MICHAEL J. HAYWARD, RICHARD P. VOLPE,	:	RICHARD P. VOLPE, and
MICHAEL F. STERN, WARREN E. TURK,	:	ROBERT A. SCAVONE, JR.
GERARD T. HAYES, and ROBERT A. SCAVONE, JR.	:	July 13, 2009

APPEARANCES: Scott L. Black, Richard Primoff, Allan Kahn, and Mona Akhtar for the Division of Enforcement, Securities and Exchange Commission

George O. Richardson, III, and Franklin B. Velie of Sullivan & Worcester LLP and Adam B. Oppenheim of Baker Hostetler LLP for Respondent Donald R. Foley, II

Henry Putzel, III, and Lucia T. Chapman of the Law Office of Henry Putzel, III, for Respondent Scott G. Hunt

Thomas J. McCabe of McCabe Flynn & Arangio, LLP, and Thomas P. Puccio of the Law Offices of Thomas P. Puccio for Respondent Frank A. Delaney, IV

Paul F. McCurdy, Evan F. Barnes, and Julian Solotorovsky of Kelley Drye & Warren LLP for Respondent James V. Parolisi

Stephen J. Crimmins, Peter H. White, and Heather H. Martin of Mayer Brown LLP for Respondent Robert W. Luckow

David Rivera, Paul E. Minnefor, and Walter Mack of Doar Rieck Kaley & Mack for Respondent Robert A. Johnson, Jr.

Richard I. Janvey, Joan M. Secofsky, Reda M. Hicks, and J. Maxwell Beatty of Diamond McCarthy LLP for Respondents Richard P. Volpe and Robert A. Scavone, Jr.

BEFORE: Carol Fox Foelak, Administrative Law Judge

SUMMARY

This Initial Decision orders broker-dealer bars as to Donald R. Foley, II (Foley), Scott G. Hunt (Hunt), Frank A. Delaney, IV (Delaney), James V. Parolisi (Parolisi), Robert W. Luckow (Luckow), Robert A. Johnson, Jr. (Johnson), Richard P. Volpe (Volpe), and Robert A. Scavone, Jr. (Scavone) (collectively, Respondents).[1] The charges concerned Respondents' trading, to the disadvantage of customer orders, on behalf of their firms' proprietary accounts in their roles as specialists at the New York Stock Exchange (NYSE), at various times, between 1999 and June 30, 2003 (relevant period). The Decision concludes that the trading violated NYSE Rules pertaining to specialists, but clears Respondents of charges that they violated the antifraud provisions of the securities laws. The Decision also orders the Division of Enforcement (Division) to request the Securities and Exchange Commission (Commission) to order the NYSE to discipline those Respondents whom it has not disciplined of its own accord.

I. INTRODUCTION

A. Procedural Background

The Commission issued its Order Instituting Proceedings (OIP) against Respondents on April 12, 2005, pursuant to Section 8A of the Securities Act of 1933 (Securities Act) and Sections 15(b), 21C, and 11(b) of the Securities Exchange Act of 1934 (Exchange Act) and Rule 11b-1 thereunder. The proceeding was stayed pending the prosecution of parallel criminal proceedings against fifteen of the original twenty captioned respondents.[2] David A. Finnerty, Admin. Proc.

[1] The proceeding has ended as to the remaining captioned respondents. David A. Finnerty, 90 SEC Docket 2062, 2069 (May 23, 2007), 92 SEC Docket 2, 10, 17 (Nov. 27, 2007), 93 SEC Docket 7726, 7812 (July 16, 2008), 94 SEC Docket 10684, 10815, 10822, 10828 (Oct. 15, 2008), Securities Act Release No. 9033 (May 28, 2009).

[2] Over time, the criminal proceedings and/or this proceeding were resolved as to all of the fifteen indicted respondents, and the stay was lifted on September 16, 2008, following the September 11, 2008, issuance of the mandate of judgment of the United States Court of Appeals for the Second Circuit in United States v. Finnerty, 533 F.3d 143 (2d Cir. 2008) that affirmed the judgment of acquittal of the United States District Court for the Southern District of New York in the criminal proceeding against David A. Finnerty.

No. 3-11893 (A.L.J. June 7, 2005) (unpublished). The stay was modified as to fourteen of the twenty, and the hearing as to them commenced on February 11, 2008.

The undersigned held hearing sessions in New York City as to fourteen captioned Respondents on forty-one days between February 11 and May 5, 2008; evidence relating to all Respondents in general was taken at initial hearing sessions (Stage or Phase I), from February 11 to March 4, followed by hearing sessions relating to individual Respondents (Stage or Phase II), from March 4 to May 5.[3] Testimony was taken from numerous witnesses, and numerous exhibits were admitted into evidence.[4]

The findings and conclusions in this Initial Decision are based on the record. Preponderance of the evidence was applied as the standard of proof. See Steadman v. SEC, 450 U.S. 91, 97-104 (1981). Pursuant to the Administrative Procedure Act, 5 U.S.C. § 557(c), the following post-hearing pleadings were considered: (1) the parties' August 1, 2008, Proposed Findings of Fact and Conclusions of Law and Post-Hearing Briefs; and (2) their September 15, 2008, Replies. All arguments and proposed findings and conclusions that are inconsistent with this Initial Decision were considered and rejected.

B. Allegations and Arguments of the Parties

This proceeding concerns Respondents' actions as specialists at the NYSE in what are identified as "trading ahead" of customer orders for more favorable prices and "interpositioning" trades between customer bids and offers so as to profit from the spread at customer expense in contravention of their "negative obligation" to refrain from such trades while acting as agents for customers. As defined in the OIP, "interpositioning" involved two trades for the specialist's principal account, with both buy and sell agency orders that could have been paired off, while "trading ahead" involved one trade in which the specialist traded with an agency buy or sell order that could have been matched with an agency order on the other side, thus stepping ahead of that order. The alleged misconduct concerned Respondents' handling of so-called "DOT" orders, which the specialists received through the NYSE's electronic order handling system. The OIP alleges that Respondents violated the antifraud provisions of the federal securities laws as well as various NYSE rules.

Respondents argue that their role in the questioned transactions is unproven and that, in any event, they committed no violations.

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[3] Six of the fourteen reached settlements with the Division of Enforcement that the Commission accepted: Warren E. Turk and Gerard T. Hayes during the hearing, and Kevin M. Fee, Thomas J. Murphy, Jr., Todd J. Christie, and Patrick E. Murphy, after the hearing was closed. David A. Finnerty, 93 SEC Docket 7726, 7812 (July 16, 2008), 94 SEC Docket 10684, 10815, 10822, 10828 (Oct. 15, 2008).

[4] Citations to the transcript will be noted as "Tr. __." Citations to exhibits offered by the Division and Respondents will be noted as "Div. Ex. __" and "Resp. Ex. __," respectively.

II. FINDINGS OF FACT

The evidence in this proceeding consists of (1) computer data, extracted from the NYSE's records, purporting to show information about trades in stocks assigned to Respondents during the relevant period, along with fact and expert testimony concerning the computer data, and (2) testimony of Respondents, clerks, and others who knew Respondents concerning Respondents' actions on the trading floor. Following a background discussion, the computer evidence is addressed first; it is found that the computer evidence, culminating in the "exception reports," is reliable to show that numerous trades occurred as recorded. This is followed by findings of fact as to individual Respondents, grouped according to the specialist firms with which they had been associated.

A. Definitions and Background Facts[5]

1. Specialists' Role at the NYSE

Respondents were specialists, associated with registered broker-dealers that were specialist firms on the floor of the NYSE during the relevant period between 1999 and mid-2003. At that time, trading at the NYSE was organized as follows: each listed company was assigned to one specialist, who manned a panel that was grouped with several other panels at a post on the trading floor during the trading day. Every order to trade that specialist's stock went to his panel. The specialist was assisted by a front-line and a backup clerk, also referred to as trading assistants. A variety of information was available to the specialist and clerks, including on the Display Book (DB), an electronic workstation that had a screen and a special keyboard, as well as on other screens. The DB allowed specialists to receive and process orders, disseminate quotes, report trade executions, and view their dealer account's profit and loss.

The NYSE is described as an auction market, in which buyers enter competitive bids and sellers enter competitive offers at the same time. During the relevant period specialists consummated trades orally. Specialists bought and sold for customers as agents, used their firm's capital to buy and sell as principals, and collected and published bids and offers as auctioneers. The specialist was supposed to match up offers to sell with offers to buy in the same price range. If there was no matching order, he could trade the proprietary account of his own firm to fill the void to "maintain a fair and orderly market" pursuant to NYSE Rule 104. However, he was prohibited from engaging in a proprietary trade when he had "knowledge of any particular unexecuted customer's order [that] could be executed at the same price" pursuant to NYSE Rule 92(a).

During the relevant period, some orders arrived via the "crowd" – the group of floor brokers at a panel who may be interested in offering for, bidding for, or obtaining information about the specialist's stock. Other orders arrived electronically via the NYSE's order processing

[5] Multiple citations, passim, are found throughout the record of evidence for the definitions and background facts in this section.

system, the Super Designated Order Turnaround System (referred to as "DOT"),[6] which provided automated order routing and reporting and is addressed in NYSE Rule 123B. DOT orders, including limit orders and market orders, were displayed on the screen of the DB; limit orders were sorted and displayed in price/time priority. Due to the orientation of the DB screen, the DOT orders were not visible to the crowd. Generally, larger orders came in through the crowd, while DOT orders, which were more numerous, were generally smaller. Respondents referred to "Your word is your bond" as the basic NYSE principle guiding their activities as specialists. However, that principle is more applicable to specialists' face-to-face dealings with floor brokers – especially to not backing out of a trade once orally agreed to – than to handling the electronic DOT orders.

At issue in this proceeding is NYSE Rule 92, which forbade specialists from trading for the dealer account (so as to profit from the spread) ahead of pre-existing customer buy and sell orders that could have been executed against each other or that could have been executed at a more favorable price to the customer. Also at issue is the specialist's "negative obligation," embodied in NYSE Rule 104, which required him to refrain from trading for the dealer account unless necessary to maintain a fair and orderly market in his stock.[7] NYSE Rules 92 and 104 derived from the requirements placed on the NYSE by Exchange Act Rule 11b-1(a)(2).[8]

In their role as agent, and pursuant to NYSE Rule 123B, specialists were supposed to expose DOT orders to the crowd, so that floor brokers had the opportunity to participate, possibly offering price improvement to the DOT orders. To "cross" DOT orders in which specialists represented both sides of a potential trade, specialists used special shorthand language (spoken at lightning speed, but understood by floor participants). For example, to indicate a bid of $100.29 and an offer of $100.30, each for 1,000 shares, a specialist would say, "twenty-nine for a thousand, a thousand at thirty." (Participants would be cognizant that the stock was trading around $100, so the specialist could save time by stating only the twenty-nine and thirty cents part of the prices.) "Take 'em" indicated a trade at the offer; "sold," a trade at the bid. If there was no crowd present, the specialist would announce the trade to his clerk without crossing the orders. As time went on through the relevant period, an increase in DOT orders made it impossible to cross every order; clerks entered trades on their own within parameters set by their specialists.

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[6] Recently, the NYSE announced the replacement of the DOT system and the associated Post Support System, discussed infra, with the new NYSE Super Display Book system. See http://www.nyse.com/press/1246442836537.html (July 1, 2009).

[7] The specialist's "affirmative obligation," also embodied in NYSE Rule 104, required him to trade for the dealer account to assist in the maintenance, so far as reasonably practicable, of a fair and orderly market in his stock, for example, to ameliorate an imbalance between supply and demand or a lack of liquidity.

[8] The statutory basis for Exchange Act Rule 11b-1 is Exchange Act Sections 11(a), 11(b), and 23(a). Regulation of Specialists, 29 Fed. Reg. 15862, 15863 (Nov. 26, 1964), as amended at 46 Fed. Reg. 15134 (Mar. 4, 1981).

The posts at which specialists' panels were arrayed were vaguely circular. Generally, specialists stood outside the post while clerks were inside, behind the counter that marked the circumference of the post. A specialist would keep aware of the DOT orders by glancing at the DB screen or instructing his clerk to inform him of developments. The DB displayed what is referred to as the "8 price window" in which the volume of buy and sell market orders and limit orders at eight price points was displayed. The user could query the DB for more depth information.

The DB was also used to report trades. Generally, the front-line clerk operated the DB keyboard, but some specialists operated the keyboard themselves some or most of the time. The DB keyboard was not a conventional "qwerty" keyboard; it had numerous function keys and alphabet keys arranged alphabetically.[9] To report trades at issue in this proceeding, the clerk (or specialist) pressed the Report key (later labeled "Trade"), which caused the screen to display the "Smart Report" template. DOT buy and sell orders that could be paired off were displayed and such trades could be executed by pressing the Done key. If an imbalance (of the number of shares) existed between the buy and sell orders, the user could direct the principal account to trade with the imbalance using an additional two keystrokes. To trade ahead of or interposition between DOT orders required additional keystrokes. While pairing off was easier and required fewer keystrokes, the clerks could execute several keystrokes per second, and the actual time required for trading ahead and interpositioning was hardly longer than for pairing off.

The DB was "frozen" when the Report key was pressed to enter the Smart Report template (implicit freeze) or the Freeze key was pressed (explicit freeze). (The DB exited an implicit freeze when the Done key was pressed and an explicit freeze when the Freeze key was pressed again.) When the DB was frozen, the DB screen indicated this. During a freeze, no new orders were displayed and no orders could cancel. Orders that arrived during a freeze were displayed simultaneously when the DB was unfrozen. To ascertain the actual sequence of arrival of orders that first appeared out of a freeze, the user could employ the Fast Find key.

When a specialist orally consummated a DOT trade, a clerk completed reporting it in less than five seconds.[10] (Reporting a crowd order that required identifying parties and might require information as to multiple parties' participation took longer.)

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[9] Div. Exs. 2 and 2A are a photograph and diagram, respectively, of the DB keyboard as it existed in the earlier and later parts of the relevant period. In conjunction with those exhibits, the use of the keys is briefly explained at Tr. 356-63.

[10] Numerous clerks testified as to timing: Tr. 3402 (within five seconds); Tr. 3966 (three, five seconds; clerk who regularly took more than ten seconds would be removed); Tr. 4350 (less than one second); Tr. 4930 (three, five seconds); Tr. 5214 (seconds); Tr. 6391 (not even seconds); Tr. 6720 (a second or two); Tr. 7110-12 (less than one second, but if several trades piled up, five to fifteen seconds); Tr. 7145 (two seconds, but up to thirty or forty seconds for crowd trades); Volpe Tr. 283-84 (less than a second).

The role of specialists diminished after the relevant period.[11] Recently, the NYSE phased out the specialist role and, in its stead, created the Designated Market Maker (DMM),[12] an employee of Designated Market Maker Units. Five such DMM firms (some of which retain "Specialist" in their names) will remain following the recently announced acquisition of Bear Wagner Specialists LLC by Barclays Capital, Inc. DMMs retain the specialist's "affirmative obligation" to maintain a fair and orderly market, including by means of trading for the proprietary account when necessary. However, DMMs do not have the negative obligation, the alleged violation of which is at issue in this proceeding.

2. Miscellaneous

A "breakout" situation occurs with market-moving news that affects a stock – a rush of brokers assembles in the crowd and there is either oversupply or overdemand that must be handled by the specialist, sometimes with the help of additional specialists. A "wheel" or "relief" specialist or clerk relieved a specialist or clerk on breaks or days off but was not assigned to a particular panel.

During the relevant period, a specialist swiped his badge at a turnstile to enter the trading floor (proceeding directly from the turnstile to the panel took no more than a minute or two), but

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[11] The Wall Street Journal (Journal) recently reported, "The NYSE floor had just 1,200 individuals at the start of this year, down from 3,000 five years ago before electronic trading eliminated many physical positions." Serena Ng & Geoffrey Rogow, *NYSE Speeds Trades to Meet Competitors*, WALL ST. J., Mar. 2, 2009, at C3. The Journal further noted,

> The Big Board hit a low point in October 2008 when the volume of trades handled by its floor dropped to 24% of the market, from 80% three years ago. The rise of high-speed and automated electronic trading and better technology at its rivals was pulling volumes away and diminishing the role of NYSE's specialist firms, which were trading as little as 2% to 3% of the exchange's volume.

Id. The Journal observed,

> The 216-year-old Big Board, whose historic trading franchise took a hit in recent years due to outmoded technology and trading models, is in the midst of an ambitious plan to remake itself as a central trading venue – even if most trading no longer happens physically on the floor. The exchange, part of NYSE Euronext Inc., is doing so as rivals with much lower overhead costs continue to gain share through aggressive pricing and faster technology.

Id.

[12] "The term 'specialist' also includes any market maker deemed to be or treated as a specialist for purposes of the [Exchange] Act by an exchange." Regulation of Specialists, 46 Fed. Reg. 15134 n.3 (Mar. 4, 1981).

did not badge out on leaving the floor, or on arriving at and departing from his post and panel. Nor was there any method of capturing the exact time of the oral consummation of a trade before it was entered in the DB. During the relevant period the NYSE strongly encouraged fast execution of trades, to avoid losing market share to competing trading venues that did not use human intermediaries in executing trades.

The NYSE conducted an investigation into interpositioning and trading ahead; the record in this proceeding does not establish when or why its investigation began. As a result of the events in question, the NYSE reached a settlement with the Commission in which it agreed to various undertakings to closely track specialists' activities at their panels and to inhibit inappropriate trades.[13]

The trades at issue accounted for a small percentage of Respondents' trading – both of the volume of shares traded and of the number of trades – and the gains, if any, from the trades at issue were a small percentage of any Respondent's compensation. Until the NYSE investigation became known, however, there was no particular reason for any Respondent to expect any negative consequences from the type of trading that is at issue.

During and before the relevant period, a specialist's career path often started with employment as a backup clerk, followed by promotion to a front-line clerk, followed by promotion to specialist. Decimalization, that is, pricing stocks in dollars and cents, occurred during the relevant period, on January 29, 2001. Respondents had a negative attitude toward decimalization, stating that it was difficult to work with the greater number of price points of 100 cents per dollar, as compared with eighths or sixteenths of a dollar. (None mentioned that the potentially narrower spreads decreased potential profits.)

B. Computer Evidence

1. DOT Order Flow; Databases

Orders originate from NYSE member firm customers, who send their orders to the member firms, which electronically sent the orders to the Common Message Switch (CMS) during the relevant period. Tr. 658, 2664. Orders were routed through the CMS to the DOT system, where they were stored and an order history is created. Id. The DOT system processed the order for particular handling instructions and appended information including time of handling and priority of sequence. Tr. 2664. Orders were then distributed to the Post Support System (PSS) at each specialist post. Tr. 659, 2664. Orders from the PSS were distributed to individual DBs, where they were displayed, and PSS data additionally went to the Broker Booth Support System (BBSS). Id. Once in the DB, orders were processed and could either be executed or cancelled. Tr. 659. At the end of the day, all data contained in the DB was downloaded into the DB log file, discussed in greater detail under Screenshots. Tr. 660, 2665.

[13] New York Stock Exch., Inc., 85 SEC Docket 714 (Apr. 12, 2005).

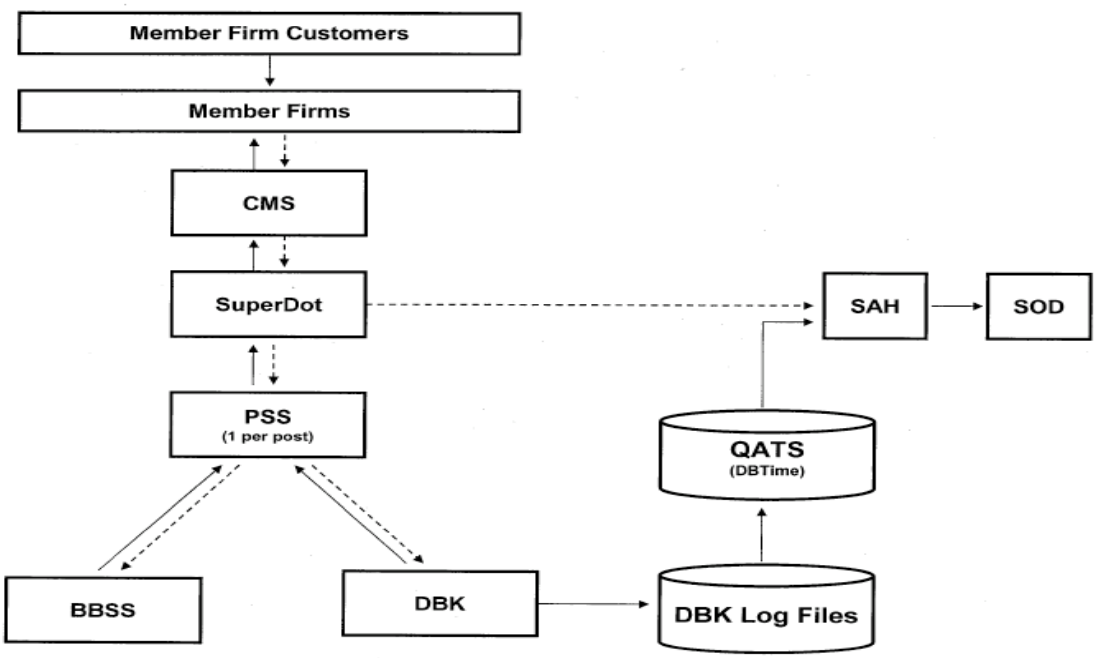
Certain information from the DB log files was extracted into the Quote Assist Time Stamp (QATS) database, in which each marketable and quotable order will be given a turnaround number and timestamp, to the nearest hundredth of a second during the relevant period, and, at which time, the order was made available to the DB (DBTime). Tr. 660-62, 1708, 2668-69. QATS additionally had information regarding freezes, such as when an implicit or explicit freeze begins or ends. Tr. 660-61.

Once order information left the QATS database, it arrived at the Switching After Hours system (SAH), a collection point of data that, when processed, resulted in a file called System Order Data (SOD). Tr. 661. The SOD master file contained order history for all DOT orders, such as order time, size, and type, with times being stored to the nearest second during the relevant period. Tr. 661, 994-96, 2676.

a. Additional Databases

In addition to the QATS database and SOD file mentioned above, the Consolidated Audit Trail (C-AUD) database and the Consolidated Quote (CQ) database also played an important role. The C-AUD database contained buy and sell side information, including clearing firm information, each participating firm's number of shares, and the turnaround number that matched to the order given in the SOD table. Tr. 995, 2677. The CQ database gave quotation information for a particular stock in addition to providing badge information and other information for the related broker and firm. Tr. 997.

Division Exhibit 11 illustrates the DOT order flow process.



Div. Ex. 11

b. Timestamps

i. Trading Ahead

Upon arrival at the DB, the order received a DBTime timestamp from QATS, showing the order is marketable and quotable. Tr. 1295, 1955-57. While DBTime is the time an order became available on the DB, there is technically no record that indicates the exact time the order became visible on the DB. Tr. 1289-92, 1329, 1352. However, the difference between an order's DBTime in QATS and the time the order became visible on the screen is no more than two to three hundredths of a second, making DBTime, as a practical matter, the time an order appeared on the DB. Tr. 1710. The time that PSS received an acknowledgement from the DB that the order had been received is referred to as OTime. Tr. 1295. RTime stands for report, or order execution, time and represents the time that PSS stamped an executed trade arriving from the DB. Tr. 1019, 1033, 1955-57, 2562.

ii. Interpositioning

OTime has been discussed previously. For interpositioning, DBTime 1 represents the time that the DOT order with which the specialist traded on the first proprietary trade arrived at the DB, and DBTime 2 represents the time the order with which the specialist traded on the second proprietary trade arrived at the DB. Tr. 756-59. RTime 1 is the execution time for the first proprietary trade, and RTime 2 is the execution time for the second proprietary trade. Tr. 756, 759.

c. Timestamp Order

The correct order timestamp sequence is DBTime, followed by OTime, followed by RTime. Tr. 1295, 3224. In general, when the DB was not frozen, OTime and DBTime were equal, due to truncation discussed below. Tr. 686, 3264-65. When the DB was frozen, however, OTime was generally earlier than DBTime because the order does not appear on the DB until the DB is unfrozen. Tr. 686-87.

Additionally, when the exception report algorithm, or logic, which will be discussed shortly, was applied, OTime and DBTime were truncated (28.07 and 28.99 both truncate to 28, while 28.99 and 29.01 truncate to 28 and 29, respectively). Tr. 3254. With respect to the exception reports, only trades having OTimes prior to or equal to DBTime, were eligible for inclusion. Tr. 3254-55.

d. DBTime Substitution

For those records in which no matching orders were found in QATS, mostly non-marketable and non-quotable orders, a DBTime had to be assigned.[14] Tr. 696, 1296-97. In order

[14] A marketable order is one that is executable in the existing market. Tr. 106. A quotable order is an order that has a limit price and a quantity such that either a bid or an offer can be posted. Tr. 105-06.

to determine the order's DBTime, the NYSE employed DBTime Substitution. Tr. 696-99, 1298-99, 1308. If an order did not arrive during a freeze, its DBTime was set equal to OTime; the rationale being that the order should have gone to the DB immediately. Tr. 697, 1245. If an order did arrive during a freeze, its DBTime was set to the end of the freeze time found in the QATS database; the rationale for using the end of a freeze time was because the order would not be available to the specialist until the end of the freeze. Id.

DBTime Substitution occurred in a small percentage of exceptions. Tr. 1301-02, 1963-75, 2288-89, 2338-39; Resp. Ex. 452-C at 7.

2. Exception Reports

The computer data at the heart of the Division's case are the exception reports, which list alleged violative trades for each Respondent. Div. Exs. 185A-C (Foley), 187A-C (Hunt), 190A-C (Volpe), 191A-C (Scavone), 224A-C (Delaney), 226A-C (Johnson), 227A-C (Luckow), 229A-C (Parolisi).

a. Overview

The exception reports, generated by Roken Ahmed, Ph.D. (Ahmed),[15] Managing Director of Regulatory Technology at the NYSE, comprise a list of trading events, drawn from the SOD file and QATS[16] database, that had been identified in accordance with certain parameters Ahmed had been given, most often by the NYSE Division of Market Surveillance. Tr. 635-36, 640-41, 858; Div. Ex. 8.

Three types of exception reports were generated for trading ahead and interpositioning for each Respondent: (1) customer disadvantaged, (2) customer advantaged, and (3) customer breakeven. Tr. 647. The Division only charged Respondents with interpositioning and trading ahead violations for those exceptions appearing on the customer disadvantaged exception reports, which list trades in which the dealer account profited. Tr. 647-48.

b. Interpositioning Algorithm

To result in an interpositioning exception, the specialist must have had in his possession both buy and sell customer orders that could have been traded against each other, and, instead of trading these customer orders against each other, the specialist bought from the customer sell

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[15] Ahmed earned his undergraduate degree in Physics, with minors in Mathematics and Statistics, from Dhaka University, Bangladesh; he earned a Ph.D. in Business Administration from Columbia University. Tr. 636; Div. Ex. 8.

[16] QATS information was not available for certain stocks on certain dates; such dates and stocks were listed in a file called "QATSPROB text" and were ineligible to be included in the exception reports. Tr. 663; Div. Ex. 44.

order and sold to the customer buy order, or vice versa. Tr. 644; Div. Ex. 10. Only orders appearing on the DB within one second of the end of a freeze were eligible to be captured by the algorithm.[17] Tr. 644, 684-85; Div. Ex. 10.

The specialist must have executed a proprietary trade with a DOT order for both the first and second trades; many trades, such as CAP orders and orders manually executed by brokers, were ineligible. Tr. 675-78; Div. Ex. 10. The logic required that the first and second trades be available simultaneously in the DB and, rather than pairing them off, the specialist instead traded with each of them for his own account. Tr. 684; Div. Ex. 10. The logic also captured proprietary trades with public orders having different DBTimes; in these cases, the interpositioning logic only included trades where the maximum difference in DBTime was one second and the specialist traded first with the later pairable order, excluding those trades where the specialist traded first with the earlier pairable order. Tr. 699-700. Although a specialist might trade ahead of several different orders through a single trade, as well as trade ahead of the same order on separate trades, the interpositioning logic filtered the trades to ensure that it captured customer disadvantage only once. Tr. 706-08.

c. Trading Ahead Algorithm

To result in a trading ahead exception, a specialist must have bought or sold for his proprietary account when he had a customer order, present and visible on the DB, already in his possession, that could have bought or sold instead. Tr. 641-42. The specialist must have had the customer order in hand fifteen seconds prior to any proprietary trades executed in the year 1999 or if the trade occurred in the crowd, and for all trades executed from 2000 to 2003, the DOT orders that the specialist traded ahead of had to have been visible ten seconds prior to the time the proprietary trade was reported (TA Parameter). Tr. 642-43, 2149-50.

The TA Parameter rationale is relevant when orders were traded in sequence because it was possible for the specialist to orally consummate a trade for the proprietary account when a competing DOT order became visible after the oral consummation but prior to the clerk's recording the trade. Thus, the TA parameter, by requiring the DOT order to have been visible on the DB for ten or fifteen seconds before the specialist's clerk completed recording the trade (by selecting the Done key), allows the clerk a minimum of ten to fifteen seconds to record the proprietary trade, thus significantly reducing the possibility for false positives. Tr. 727-31. The TA Parameter does not apply to trades where the specialist trades first with the later of the two matchable DOT orders since oral consummation of the trade with the later order could not precede the arrival of the earlier order. Tr. 733-34.

[17] The algorithm provided for three different scenarios with respect to the interplay between the freeze requirement and DBTimes: (1) if both orders the specialist traded with appeared on the DB out of the same freeze and had the same DBTimes, they were eligible to generate an interpositioning exception; (2) if both orders the specialist traded with appeared on the DB out of the same freeze but had different DBTimes, the orders could only generate an interpositioning exception if the specialist traded with the order that appeared later first; and (3) if both orders the specialist traded with appeared on the DB out of different freezes, the orders could only generate an interpositioning exception if the specialist traded with the later order first. Tr. 699-700.

The trading ahead logic identified specialist proprietary trades in a similar manner to the interpositioning logic. Div. Ex. 10 at 9-11. Types of orders discussed above in connection with interpositioning were disqualified. Tr. 722-23; Div. Ex. 10 at 11-13. Further, the DOT order the specialist allegedly traded ahead of could not have been subsequently cancelled or unexecuted. Tr. 724-25.

The logic applied the TA Parameter and additionally ensured that the DOT order was eligible to trade at the same price as the proprietary trade and that the specialist traded on the same side of the market as the order that was traded ahead of. Tr. 725; Div. Ex. 10 at 14. The logic then used data from C-AUD to add certain information when the specialist executed the proprietary trade with the crowd. Div. Ex. 10 at 16. As with interpositioning, the trading ahead logic filtered out certain orders to ensure that any share could only be disadvantaged once. Tr. 738; Div. Ex. 10 at 17. Finally, the logic filtered out all trades appearing on the interpositioning reports so that they did not reappear on the trading ahead reports. Id.

d. Backout Process

i. Computer Code

Randall Shane, Ph.D. (Shane), earned his Ph.D. in Computer Science and is currently employed by Base XVI;[18] he testified on behalf of the Division with respect to the exception report backout process. Shane wrote a computer code that compared badge swipe records with trades in order to remove certain trades from the exception reports pursuant to a prescribed set of rules for the database. Tr. 1362-63, 1369, 1448, 1454-55; Div. Exs. 156-57, 160-62, 166-67.

As found above, during the relevant period, a specialist swiped his badge at a turnstile to enter the trading floor, but his whereabouts was not tracked beyond his entry; he did not badge out upon leaving the floor, nor was his arrival at and departure from his post and panel tracked. Tr. 1502-03, 1579-80. Shane was instructed to use certain turnstiles for his analysis, those that provided direct access to the trading rooms at the NYSE. Tr. 1376, 1502, 2283; Div. Ex. 171. Using what badge swipe records existed, Shane's activities were intended to remove exceptions attributed to a specialist that occurred at times when he was not at his post and panel. Shane used four categories of badge swipes for his analysis: (1) non-swipes; (2) first swipe of the day; (3) badge swipes after 4:00 p.m.; and (4) intraday swipes. Tr. 1376-78, 1386-87. Where there is no record of a badge swipe for a specialist on a particular day, all trades were removed for that day. Tr. 1376-78. The second category dealt with removing all trades prior to the first badge swipe of the day, and the third category caused Shane to remove all trades and badge swipes after 4:00 p.m. Tr. 1377-78, 1383, 1386. Finally, Shane considered intraday badge swipes occurring after the first swipe of the day and before 4:00 p.m. Tr. 1387. Under these circumstances, trades were removed twelve minutes prior to the intraday swipe and three minutes after to approximate the

[18] Base XVI is a boutique consulting firm that performs programming database developments and data analytics. Tr. 1363.

length of a short break off the floor and allowing the specialist three minutes to walk from the turnstile to his panel. Tr. 1387, 1504.

ii. Attendance Records

Melissa Coppola (Coppola) and Roseanne Daniello (Daniello) are employed as staff accountants by the Commission. Tr. 1525-26, 1626. Coppola performed an attendance analysis to further back out trades from the exception reports for the Fleet Specialist, Inc. (Fleet) specialists, created summary charts, and plugged numbers into disgorgement charts. Tr. 1526-31; Div. Exs. 180, 182. Daniello performed a backout analysis and summary chart analysis with respect to the Bear Wagner Specialists LLC (Bear Wagner) and Spear, Leeds & Kellogg Specialists LLC (SLK) specialists.[19] Tr. 1626-27.

Coppola used Fleet-maintained daily post and panel attendance sheets and vacation calendars as well as personal calendars provided by Foley. Tr. 1527-31; Div. Exs. 177, 179. When a specialist's calendar indicated he was out for a portion of the day, Coppola consulted badge swipe records; generally, there were no badge swipes on days she had listed as a specialist not being present; if there was a discrepancy, she backed out the entire day if there was one badge swipe, and, if there was more than one, she left the day in. Tr. 1532-34. Coppola estimated the time it would take for a specialist to get to a meeting and return to the office based on what she felt was reasonable, given the meeting location. Tr. 1544-45.

If a specialist shared a panel with another specialist on a particular day, Coppola consulted the badge swipe records and the entire day's trading activity was removed. Tr. 1545-46, 1549-50.

Bear Wagner provided daily attendance records, automated records for a period in 2003, employee calendars, and vacation calendars. Tr. 1627. Also included were documents from predecessor firms that contained post and panel records. Tr. 1627-28. Daniello reviewed NYSE post and panel assignments to get stock information. Tr. 1628. Daniello erred on the side of excluding trades when a specific daily report was involved, and further investigated badge swipe records if a general daily report was involved. Tr. 1634-35.

Daniello performed a similar backout analysis for the SLK Respondents using SLK vacation calendars, relief records, and attorney records, which included personal documents such as a declaration from Luckow's wife speaking to his absences from the floor. Tr. 1638-40. Walter N. Frank & Company provided detailed attendance records relating to Parolisi prior to the firm's acquisition by SLK. Tr. 1638-40.

[19] Van der Moolen Specialists, USA, LLC, did not provide daily post and panel attendance sheets as it did not keep contemporaneous attendance records. Tr. 1530, 8162-63; Resp. Ex. 755 at 2. Therefore, no backout was done for its specialists, Volpe and Scavone.

iii. One-Second Reports

The final backout analysis was performed using the one-second reports, which captured trades in which OTime was not equal to DBTime and in which an exception was not within one second of the end of a freeze. Div. Exs. 51-52, 55-56. Coppola and Daniello deleted trades involving either one of these scenarios. Tr. 1549-51.

The backout parameters assumed that, while a specialist was on the floor, he was at his panel, and made no allowance for a specialist being a captain or floor broker. Tr. 1590, 1640. Except for Fleet, there was no data to establish a specialist's presence at his post at any particular time during the day, and it is not known whether specialists changed panels, unless noted in their calendars. Tr. 1580, 1612, 1622-25, 1648.

e. Master Exception Report

The Master Exception Report covered all trading ahead and interpositioning activity on the NYSE from January 1999 through December 2003. Tr. 6000-02; Resp. Ex. 1526. It reflected exceptions in either trading ahead or interpositioning in every stock traded during this period, while showing that the most actively traded stocks accounted for 78% of the exceptions. Tr. 6000-02.

3. Screenshots

The Division offered numerous screenshots that were received into evidence; each screenshot illustrates trading activity corresponding to at least one exception from the exception reports. Div. Exs. 130A-T (Delaney), 132A-X (Foley), 134A-X (Hunt), 135A-CC (Johnson), 137A-Z (Parolisi), 138A-GG (Scavone), 141A-GG (Volpe).

a. Screenshot Overview/Features

A screenshot is a picture that captures what happens in the main window of the DB screen, at a particular point in time, as a result of a keystroke on the DB keyboard. Tr. 1676, 1796-99. A screenshot report shows what happens on the DB screen as a result of the selection of keystrokes identified on the accompanying keystroke report. Tr. 1676; Div. Exs. 130A-T, 132A-X, 134A-X, 135A-CC, 137A-Z, 138A-GG, 141A-GG. For purposes of this Initial Decision, reference to "screenshot(s)" will refer to a screenshot report.

On average, each screenshot captures a time period of five to thirty seconds, sometimes longer. Tr. 1678. The underlying source of data for a screenshot is the DB log file, a computer file maintained by the Security Industry Automation Corporation (SIAC)[20] which dates back to October 1, 2002; screenshots are not available prior to this date. Tr. 1681-83, 1762; Div. Exs. 114-128. The DB log file shows the various messages the DB uses for its processing and to share information with itself. Tr. 1681-82. A DB log file covers one stock for one day and captures

[20] SIAC is the IT arm of the NYSE. Tr. 1664.

events such as incoming orders just reaching the DB, time stamps, messages from other systems coming into the DB, communication amongst parts of the DB, and updates to the screen. Tr. 1682-83.

The screenshot shows the number of stocks traded at the panel, the number of substations,[21] and which stock is active, as it appears in the 8 price window (which displays interest at eight price points). Tr. 1692, 1720, 1800. The time is reflected, as are the current quote for the stock,[22] the specialist position, the last sale price, and a plus or minus sign indicating that a price is higher or lower than the previous trade price. Tr. 1720-22. Buy side limit orders appear to the left of the 8 price window, all or none orders are reflected in a column captioned "A," while stop orders are reflected in a column captioned "X," and stop limit orders are reflected in column "L." Tr. 1722.

Price points, including the best bid and the best offer, are highlighted in blue. Tr. 1723-24. A red border around the 8 price window, usually flashing, represents the stock is currently frozen. Tr. 1724. To the right is the depth window, which shows additional price points, and an arrow points up or down to the next highest or lowest price points. Tr. 1725. The depth window includes different columns; for example, the "CLMT" column represents the cumulative amount of public shares available to trade at any price point. Tr. 1725-26.

The Smart Report template is opened to the last sale price and is populated with those eligible to participate on the DB at specific price points. Tr. 1732-34. Any imbalance in the bid and offered shares is reflected in the column labeled "Imb." Tr. 1734. The row labeled "LSV" indicates the number of eligible limit orders that would remain on the DB as a result of executing the report template as-is. Tr. 1734-35. The DB operates on a general priority system. Tr. 1736.

b. Screenshot Generation and Verification

Joshua Seidel (Seidel), the Division witness for screenshots, worked for SIAC from September 2004 until March 2007. Tr. 1664, 1670; Div. Ex. 112.[23] Seidel began as a Programmer 3 in September 2004, where he became proficient in the DB, and, in November or December 2004, he began creating screenshots, to be used in this litigation and in parallel criminal cases. Tr. 1671-74. Seidel generated screenshots through January 2005 when he began verifying them; sometime around March, April, or May of 2005, Seidel began training others on

[21] Each DB can have from one to four substations and each substation can view updates to and certain aspects of the DB at the same time. Tr. 1692-93. However, only one substation can be used to execute a trade at a given time. Tr. 1693.

[22] When a red border surrounds a quote, it implies that the quote does not necessarily represent the best prices on the DB at that time. Tr. 1749-50.

[23] Seidel earned a B.S. in Computer Engineering from Polytechnic University in May 2004 and was in the process of completing a master's in Financial Engineering at the time of his testimony. Tr. 1668; Div. Ex. 112.

screenshot generation. Tr. 1675, 1678-79. In total, Seidel generated approximately seventy screenshots and verified about a thousand. Tr. 1681.

Screenshot generation begins with a request made for a specific stock, date, and time, and then the DB log file for that specific stock and that specific day is obtained. Tr. 1768. The keystroke report, a list of all keystrokes selected within the DB log file for all substations, is then created, and the substation, for which the screenshot should focus, is chosen by running the KeyStat program.[24] Tr. 1691, 1769. Seidel used a program called XVL to generate a keystroke report. Tr. 1691. For each keystroke contained in the keystroke report, there is just one screen image in the screenshot report. Tr. 1706.[25]

In addition to the keystroke reports that show the keystrokes pressed from the DB log file for a given substation, there are other keystroke reports that include additional information, mainly keys pressed at other substations in the same DB. Tr. 1704-05. If a screenshot is for a particular stock and the individual working the DB switches out of that stock into another, the selection in that other stock will not be included in the screenshot visual pages but it will be included in the keystroke report. Tr. 1706. Likewise, if the DB operator switches from the main stock and then switches back, the screenshot for the main stock would not show anything that happened during that time interval. Tr. 1790-91. Assuming the main stock is not frozen, updates and new orders, if they are in the price points available and the main stock is showing in the 8 price window, would be viewable on the DB. Tr. 1795-96. There is a lag in time of approximately two hundredths of a second, on average, between when the keystroke is hit and the screen is updated. Tr. 1812-13.

A program called Replay is then run to recreate the screenshot; the program, which can fast forward to a selected point, replays certain portions of the DB log file in order to show what happened on the DB through images. Tr. 1695, 1772-73. Each picture in a Replay printout corresponds to an update that occurred on the screen. Tr. 1695, 1772, 1777. Not all pictures reflect the full and complete update on the screen, so only the last picture, resulting from the final update and including all incremental updates, is included in the screenshot. Tr. 1695-97, 1777. While the process of selecting the page from the Replay report corresponding to the final update to the screen for the screenshot has moved toward greater automation, it requires individual judgment. Tr. 1703-1704.

In order to the ensure accuracy of the screenshot and keystroke reports, Seidel looked through each substation captured by the screenshot and then looked at the various messages inside the DB log file; he used the two to cross-reference with the screenshot in order to be sure

[24] The KeyStat program looks at the internal messages within the DB log file and gives an hourly breakdown of the activity in a stock on each substation; it also determines which substation had the most activity. Tr. 1692-94.

[25] Each keystroke report includes keystrokes for all keys pressed at the substation shown in the screenshot, and keystrokes for all keys pressed at any other substation for the stock at issue. Tr. 1704-05.

everything was correct and the appropriate update was selected. Tr. 1699-1700. Seidel corrected any errors he found, relating to things such as improper page selection and labeling. Tr. 1701-02.

c. Screenshot Limitations

Screenshots do not show who the specialist in the stock represented by the screenshot was or who was operating the DB. Tr. 1757-58. Screenshots do not show when the specialist may have orally consummated the trade evidenced by the screenshots. Tr. 1758. While the screenshots show what keys were pressed on the keyboard, they do not show whether a particular key was pressed intentionally or unintentionally. Id. The screenshots also do not show whether there was a crowd surrounding the post at the time of the screenshot trades. Tr. 1759. Seidel has never operated a DB on the NYSE floor and has only been on the floor for two tours totaling an hour and a half, one tour taking place after trading closed for the day. Tr. 1760-62.

The NYSE Division of Market Surveillance told Seidel which screenshots to create. Tr. 1764. Seidel did not match each screenshot that he either generated or verified to an exception report to make sure keystroke order correlated. Tr. 1765. Seidel was unable to tell whether the types of trades depicted on the screenshots are representative of the stocks at issue during the relevant period. Tr. 1767.

4. MARS Reports

The Market Analysis Reconstruction System (MARS) program is used by NYSE Market Surveillance analysts to observe trading activity; it does so through generating data the user may view on a computer screen or print out into a document (MARS Report). Tr. 986-91. The MARS program collects data from five sources: C-AUD, SOD, QATS, CQ, and the MARS master table, which shows the ticker symbol's company name. Tr. 993-98. The Division offered numerous MARS Reports that were received into evidence. Div. Exs. 143A-G (Delaney), 145A-J (Foley), 147A-K (Hunt), 148A-J (Johnson), 149A-AA (Luckow), 151A-CC (Parolisi), 152A-H (Scavone), 155A-J (Volpe). They depict trading activity in several securities traded by Respondents. The MARS Reports purport to provide greater detail as to certain trades included in the exception reports.

MARS Reports attempt to match buy and sell information from C-AUD with data from SOD but are frequently unable to do so; thus, many MARS Reports have a "no prints" page attached. Tr. 998, 1023-24, 1089. The "no prints" page lists any trades the MARS program failed to match with the prints. Tr. 998, 1089. An analyst must then use the "cut and paste" feature to manually pair any unmatched data on a best efforts basis. Tr. 1025-27, 1215-16. Since the timestamps will be preserved once they are cut and pasted into a new report, they will remain visually mismatched. Tr. 1025.

In addition to the analysts' using independent judgment to reconcile mismatched buy and sell data on a best efforts basis,[26] MARS Reports do not show cancelled orders or corrections to

[26] Although analysts may make mistakes when attempting to match up mismatched data, the underlying data remains unaffected. Tr. 1215-16.

orders, and do not identify the specialist, clerk, or DB keyboard operator who was involved in a particular trade. Tr. 1015, 1021-22. As with all reports during the time at issue, MARS Reports do not report the time when a specialist orally consummated a trade, only the time when the trade was reported in the system. Tr. 1015-16. Furthermore, analysts are able to change data such as the size of the trade field. Tr. 1026-27.

The MARS reports were generated prior to the time the exception reports were generated in the immediate matter. Tr. 1272. The DBTimes appearing on MARS Reports generated between September and December 2004 are not accurate. Tr. 1259-67.

The Division concedes that the MARS Reports are "far less precise depictions of market activity . . . because . . . Replay, the underlying MARS program pulls information from various databases and attempts to match buy and sell side information with tape information on a 'best efforts' basis; there is no assurance of accuracy." Div. Br. at 137.

Little weight has been placed on the MARS Reports as evidence of Respondents' trading.

C. Expert Testimony[27]

Mukesh Bajaj, Ph.D. (Bajaj), testified for Respondents. He was accepted as an expert in financial economics and statistical analysis of financial data, specifically as those disciplines relate to the NYSE.[28] Tr. 1907. He is employed as Senior Managing Director of LECG, a consulting firm specializing in economic and financial analysis, and with the University of California at Berkeley. Tr. 1897-99; Resp. Ex. 451. Bajaj received a Ph.D. in Business Administration with an emphasis in Financial Economics from the University of California at Berkeley, after having received a Bachelor of Technology from the Indian Institute of Technology in Delhi, India, and an MBA from the University of Texas at Austin. Tr. 1900; Resp. Ex. 451.

Bajaj opined that, on the whole, the data he studied is more consistent with the exceptions being errors rather than intentional wrongdoing, stating that the exceptions represent only 0.51% of the specialists' trades during the relevant period.[29] Tr. 1920-21, 2085. As he stated, however,

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[27] To the extent that the experts' evidence does not lead to findings of fact, either in this section or the Computer Evidence section, it will be summarized here and referred to as appropriate in the Conclusions of Law section of this Initial Decision. In addition to the expert witnesses whose testimony is discussed in this section, Mark Ready, Ph.D., testified on behalf of Delaney. His testimony will be addressed in the section, infra, concerning Delaney.

[28] Bajaj also testified as an expert witness in three criminal proceedings related to this proceeding: United States v. Hayward, 1:05-cr-00390-SHS (S.D.N.Y.); United States v. Scavone, 1:05-cr-00390-SHS (S.D.N.Y.), and United States v. Volpe, 1:05-cr-00390-SHS (S.D.N.Y.). Tr. 1904-05; Resp. Ex. 451.

[29] Bajaj's calculation divides the total number of exceptions by the total number of trade instances; it includes various types of trades ineligible to be considered by the algorithm. Tr. 1919-20, 2138-43, 3227-28, 3592-95.

the statistical data does not establish whether or not, in fact, the Respondents acted intentionally. Tr. 2084-85. Specifically, Bajaj considered whether the exceptions could be explained as errors resulting from the intensity and complexity of NYSE trading during the relevant period. Tr. 1908-10, 2370-77; Resp. Ex. 452-B. Concerning intensity, he determined that annual trading volume on the NYSE increased from 204 billion shares 1999 to 363 billion shares by 2003, and that there were thirty trades per minute over the relevant period in each of the twenty-five stocks traded by the fourteen Respondents at issue in the hearing. Tr. 1910, 1926. The significance of this is reduced because Bajaj did not analyze whether or not the exceptions rose in the same proportion as trading volume during those years. Tr. 2117-20. In addition to increased trading volume, Bajaj determined that trading complexity increased during the relevant period after decimalization when the minimum price increment became one cent. Tr. 1912. He found that traders, competing with specialists, began to use computerized trading strategies to submit large numbers of limit orders automatically and then cancel them, sometimes within seconds, if the price moved beyond the range where their trading would be profitable. Tr. 1912-13. It is not, however, clear how this development would explain interpositioning where, by definition, matchable buy and sell orders appeared simultaneously. In any event, the DB was frozen when trades were reported, such that new orders and cancellations were not displayed.

Bajaj testified to the existence of at least one timestamp anomaly, situations where timestamps were not in the order in which they should appear, in 2.24% of his observations, noting that OTime occurs after DBTime in 1.74% of observations and RTime precedes DBTime in 0.4% of observations. Tr. 2152-53, 2333-38; Resp. Ex. 452-C at 6. As previously noted, the correct timestamp sequence is for OTime to occur after DBTime by microseconds; however, the fact that the algorithm is technically incorrect with respect to the OTime/DBTime relationship does not affect the exceptions, except in limited circumstances. Tr. 1295-96. For instance, the interpositioning algorithm requires that OTime occur before DBTime because the order does not appear on the DB until the end of a freeze but the receipt acknowledging the order has arrived at the DB is processed immediately, making this a correct timestamp sequence rather than an anomaly for interpositioning exceptions. Tr. 686-87. With respect to trading ahead, OTime is not a part of the algorithm except in the small percentage of trades that involve DBTime Substitution, which Bajaj acknowledged occurs in few cases, concluding that DBTime accuracy is more important than OTime accuracy. Tr. 2339, 2396-97, 2411; Resp. Ex. 452-C at 7. Bajaj determined that 2.05% of all disadvantaged orders, during the relevant period, involve DBTime Substitution. Tr. 1968-70, 2288-89; Resp. Ex. 452-C at 7. Because OTime does play a role in the trading ahead algorithm under these circumstances, a 2.05% haircut will be applied in calculating any Respondent's gains attributable to trading ahead violations, in order to account for the algorithm's misrepresentation of the OTime/DBTime relationship. Finally, Bajaj included tick sensitive orders in his analysis of the RTime and DBTime relationship. Tr. 3225-26; Div. Ex. PR 1. Since tick sensitive orders can be executed in separate installments, RTime can precede DBTime; the algorithm did not, however, include tick sensitive orders. Tr. 3226-27; Div. Ex 10.

Bajaj noted a number of other statistics relating to trading. He testified that there was almost a 20% increase in the order arrival rate and an almost doubled price volatility during the minute of the exception. Tr. 1928, 1936-37. Also, a DOT order could arrive after oral consummation of a trade but before the clerk could start and complete the process of reporting that trade, giving the appearance of trading ahead. Tr. 1934-35. Bajaj questioned the use of the

TA Parameter, arguing, in essence, that the time allowed was too short. Tr. 1987-2006; Resp. Ex. 452-C at 10. He further questioned the application of the TA Parameter, stating that the TA Parameter "lookback" should begin at the start of freeze time (SOFTime) in determining whether a pairable customer order arrived, rather than RTime, as used by the algorithm and the point in time that Ahmed believed a trade was consummated, in contravention of the oral outcry nature of the NYSE. Tr. 539-43, 1987-88, 2005, 3436-37, 6933, 7439, 7858; Resp. Ex. 452-C at 10. As noted above, however, testimony from clerks called both by the Division and Respondents showed that allowing ten seconds back from RTime to report a trade was more than sufficient. Bajaj testified that 20% of the trading ahead exceptions involved trading ahead out of order time sequence and acknowledged that these could not be false positives created by oral consummation. Tr. 2323-24. Finally, Bajaj took issue with the Division's calculation of the customer harm that resulted from the trading ahead, stating that the public does not generally receive a price as good as the specialist does. Tr. 2011-28, 2215-16. Nonetheless, the Division's calculation does reflect known values rather than theoretical values and will be accepted.

Concerning interpositioning, Bajaj performed a number of calculations intended to show that the interpositioning trades did not guarantee a riskless profit because of such factors as a more than five, ten, or even thirty second time lag between the first and second legs of an interpositioning trade; at least one intervening undisputed trade or quote update that could not increase the specialist's profit; differing volume between the two legs; or failing to extract the maximum profit from each pair of interpositioning trades. Tr. 2029-63, 2236, 2243-45, 2304. Nonetheless, as found below, interpositioning exceptions were 89.66% (one Respondent) or more than 97% (seven Respondents) customer disadvantaged, and the percentage of customer advantaged interpositioning trades was infinitesimal (from 0.02% to 0.17%).

Sanjay Unni, Ph.D. (Unni), testified for Respondents. He was accepted as an expert in finance in the analysis of the underlying trading materials in this matter. Tr. 2891. He has been employed with LECG for eight years and is part of Bajaj's engagement in the immediate case. Tr. 2884, 2887-90; Resp. Ex. 501. Unni received his undergraduate degree in Economics from the University of Delhi, India, and his master's and Ph.D. in Economics, with a specialization in Financial Economics, from Southern Methodist University. Tr. 2885; Resp. Ex. 501.

Unni's testimony centered around an NYSE-filmed training video made of former Respondent Patrick Murphy trading. Tr. 2892-3031, 3070-143; Resp. Exs. 502, 502-A, 509, 512. Unni compared the video to the electronic data received from the NYSE for the same date. Tr. 2915-17, 2952; Resp. Exs. 502, 502-B. Unni found four alleged violations, three trading ahead and one interpositioning, to be captured by the video; one trading ahead and one interpositioning trade were established to be erroneous in his opinion. Tr. 2996; Resp. Exs. 502, 502-A, 502-B. The alleged trading ahead exception, for Respondent Luckow, was reported at a time when he is shown in the video to be away from his post, speaking with former Respondent Patrick Murphy. Tr. 2990-91; Resp. Ex. 512 at 53-55. The alleged interpositioning exception, for former Respondent Patrick Murphy, is a false positive because the video illustrates that he gave an instruction to the clerk to pair off DOT orders but the trade was executed for the principal account, contrary to instructions. Tr. 2986-89; Resp. Ex. 512 at 52. Unni found additional discrepancies between former Respondent Patrick Murphy's instructions as shown in the video and the electronically reported trades. Tr. 2926-27, 2953-57; Resp. Exs. 502, 502-A, 502-B, 512.

Concerning Respondent Luckow, as discussed below, a haircut was applied to exceptions attributed to him to take account of absences. Any other discrepancies apply only to former Respondent Patrick Murphy and the clerk who appeared in the video.

Richard Catrambone, Ph.D. (Catrambone), testified for Respondents. He was accepted as an expert in cognitive psychology.[30] Tr. 2417. He has been a professor of psychology, at both the undergraduate and graduate levels, at the Georgia Institute of Technology since 1988.[31] Tr. 2414-15; Resp. Ex. 254-A. Catrambone received a Ph.D. in Experimental Psychology from the University of Michigan in 1988. Tr. 2413; Resp. Ex. 254-A.

Factors identified by Catrambone that can lead to increased errors include multi-tasking, trying to pay attention to multiple sources of information, and ambient noise.[32] Tr. 2423-27, 2429-32, 2434, 2451-53; Resp. Exs. 152, 156. Likewise, verbal input with visual output (specialist instructs clerk, who enters trade on DB) and visual input with verbal output (clerk informs specialist of information appearing on DB) can result in overuse of scarce mental resources and lead to error. Tr. 2442-43; Resp. Ex. 254 at 8-10. Individuals are not always aware of the decline in their performance while multi-tasking. Tr. 2435. Catrambone opined that the recency effect (last item heard is most easily remembered) could lead a clerk to memorialize trades in reverse sequence. Tr. 2455-58; Resp. Ex. 254 at 19-20. However, this tendency would be counteracted by negative consequences attaching to reverse memorialization, such as running afoul of the tick rule on the next trade.

Frederick Dunbar, Ph.D. (Dunbar), testified for Respondents. He was accepted as an expert in statistics as applied to knowledge development from databases and fraud detection methods. Tr. 2525-26. He is a senior vice president at National Economic Research Associates, a consulting firm which focuses on the application of economics and related fields such as statistics, finance, and computer programming. Tr. 2521-22; Resp. Ex. 165. Dunbar received an M.A. and a Ph.D., both in Economics, from Tufts University. Tr. 2522-23; Resp. Ex. 165.

Stating that, because the data are not sufficiently precise, the rate of false positives is unknown, and the exception reports do not show intent, Dunbar opined that the exception reports could not show violations in themselves, that they should only be used as a surveillance technique, and that additional proof would be necessary to prove violative behavior. Tr. 2527-38.

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[30] Cognitive psychology, also known as experimental psychology, is the study of the human mental processes, such as how memory operates, how problems are solved, how stimuli are perceived in the world, and how decisions are made. Tr. 2414.

[31] Among the topics addressed in his teaching is human computer interaction, focusing on the effects of computer interface design on human performance. Tr. 2415. His understanding of how a clerk interacts with the DB is shaky, however. Tr. 2468-69.

[32] Catrambone does, however, find it reasonable to believe that someone trying to perform a task under a constant set of conditions could, over time, get better at that task given the same conditions. Tr. 2498.

However, additional evidence was introduced in Stage II as to the behavior of each individual Respondent.

Shane Shook, Ph.D. (Shook), testified for Respondents. He was accepted as an expert in the areas of reliability engineering, system design, and information management.[33] Tr. 2656-57. He is an independent contractor affiliated with LEGC, providing critical analysis and reporting in cases involving information management and governance, and technology issues for the financial services, health care, and telecommunications/information technology industries. Tr. 2647. Shook has worked with both the Hong Kong and Tokyo Stock Exchanges. Tr. 2651; Resp. Ex. 901. Shook received a Ph.D. in Communications Technology, the study of the management, analysis, and oversight of systems used to manage information in its electronic form, from Capella University. Tr. 2654-55; Resp. Ex. 901.

Shook testified that the DB log files, underlying the screenshots, had an average rate of data corruption of 4.78%.[34] Tr. 2684-90. But he then conceded that the DB log files he was analyzing were a fourth generation copy of the original source, which would be expected to be affected by data corruption. Tr. 2817-22. No specific evidence of data corruption was presented at the hearing. Tr. 2826-27. Shook could not speak to the corruption rate, if any, of the actual data used to generate the screenshots. Tr. 2821. In sum, there is no reliable evidence of data corruption in evidence.

Shook testified that he ran the same screenshot multiple times, yielding different results. Tr. 2699-02. However, these data corruption problems resulted in part from fast-forwarding through the data log, causing the application to crash, an event known to IT personnel as "abending"; there is no impact on the underlying data or screenshot. Tr. 3199-200.

Shook testified that clock synchronization (two systems, PSS and DB, synchronized with the reference clock at different intervals), clock drift (the result of two systems', PSS and DB, individual clocks drifting away from a synchronous setting), and system latency (the delay between one task and another caused by congestion, when the system has too many tasks and too few resources, slowing the clock down) have an effect on the exception reports, screenshots, and MARS reports because they affect the timestamps critical to the determination of the exceptions. Tr. 2710-20; Resp. Ex. 912. Since Shook could not separate clock drift from latency, he was unable to determine how significant it could be, if at all. Tr. 2846-47.

In related testimony, Shook testified that he believes timestamp anomalies exist in the data because it is possible to see when the clock was synchronized because it "reverts to an earlier time." Tr. 2715. However, as Ahmed testified, the computer clocks at issue never revert to an earlier time but rather slow down in order to synchronize to a reference clock. Tr. 3218-19.

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[33] Shook testified in United States v. Scavone, 1:05-cr-00390-SHS (S.D.N.Y.). Tr. 2655-56.

[34] Such a corruption rate would exceed the commercial standards, which Shook described as "one bit per million" and promulgated by IEEE. Tr. 2688-89, 2691-92.

Shook testified that screen painting – a portion of the screen appears, then another, and so on – was slow, taking from one to ten seconds, based on problem logs he viewed.[35] Tr. 2720-22, 2732; Resp. Ex. 910. Finally, Shook testified that the NYSE had records of technical issues relating to keyboards, such as wear and tear, keys popping off, replacement needs, and remapping[36] needs. Tr. 2736-37; Resp. Ex. 911. However, Shook is not sure whether remapping occurred in connection with the DB. Tr. 2861. The specialists and clerks who testified in Stage II, and who actually used the DB, did not mention these problems.

D. SLK

Robert W. Luckow, James V. Parolisi, and Robert A. Johnson, Jr., were associated with Spear, Leeds & Kellogg Specialists LLC (SLK).

1. Luckow

Luckow started as a page at the NYSE in 1966. Tr. 3608. Luckow became a specialist in 1977 and joined SLK in November 1979 where he remained until he retired on December 8, 2000. Tr. 3343, 3609, 3623, 3668-70. He rang the closing bell on that occasion. Tr. 3669-72; Resp. Ex. 482. Thus the relevant period as to Luckow is from 1999 to December 8, 2000; additionally, he was away from the NYSE during six months of that two-year period (June 18, 1999-September 13, 1999, and June through August 2000), and the exception reports do not contain any exceptions as to him during those absences. Tr. 3662. When he retired from SLK, Luckow left the securities industry. Tr. 3658. Luckow has donated a lot of money to charities. Tr. 3666-68.

Luckow was a senior partner of SLK's parent, Spear Leeds & Kellogg, which also had clearing house and over-the-counter market-maker units, and a member of its executive committee. Tr. 3612-14, 3620. Luckow's compensation was $18 million annually in 1999 and 2000. Tr. 3699. His compensation was based on a percentage of the entire firm's operation; as a partner he did not receive a bonus. Tr. 3617. Goldman Sachs Group, Inc. (Goldman Sachs), acquired SLK's parent, Spear Leeds & Kellogg, in October 2000. Tr. 3360. Luckow received over $300 million for his equity interest, of which $100 million was a return of his own capital. Tr. 3361-63. Luckow estimated that SLK contributed less than 20% of the parent firm's profit and loss. Tr. 3614.

More than three years after Luckow left the firm, SLK settled charges arising out of the trading of Luckow and other SLK specialists by, in addition to agreeing to various undertakings, paying $45,272,478 (consisting of disgorgement of $28,776,072 and a civil money penalty of $16,496,406). Spear, Leeds & Kellogg Specialists LLC, 82 SEC Docket 2097 (Mar. 30, 2004). There is no indication in the record that Luckow contributed to these payments. Luckow declined to testify before the NYSE in its investigation of SLK trading and, consequently, has been barred

[35] Shook never spoke to any of the users referenced as having problems. Tr. 2859-60.

[36] Keyboards are programmed for certain applications and receive instructions from those applications; application faults therefore can cause remapping of keys. Tr. 2737.

by the NYSE from the floor of the NYSE. Tr. 3363-64. Specifically, the NYSE imposed the penalty of a censure and a permanent bar from membership, allied membership, approved person status, and from employment or association in any capacity with any member or member organization.[37]

Luckow never operated the DB. Tr. 3346, 3416, 3627, 3735. Thus, all of his trades were entered by clerks. Luckow acknowledged that a specialist was responsible for trades entered by clerks at his panel. Tr. 3684, 3688. Luckow's clerks from whom evidence was received were Division witness Joseph Pape (Pape) (February to June 2000, Tr. 3387-3510) and Luckow witness Sarah Sheldon (Sheldon) (January to May 1999, Tr. 3700-3753).

Luckow traded American International Group, Inc. (AIG),[38] from the early 1990s until he retired; he also traded Safeway Inc. (Safeway) during the period from approximately January 1999 to June 2000. Tr. 3343-45.

Luckow's practice was to deal with the crowd, standing in front of the post facing the crowd and for his clerk to monitor and operate the DB. Tr. 3345-46, 3351-54, 3412-15, 3626-27, 3629. Sometimes he looked at the DB, however. Tr. 3417. He placed more importance on dealing with the crowd rather than viewing the DB screen. Tr. 3350-51. He relied on his clerk to tell him what was on the DB screen. Tr. 3350-52. Luckow crossed most orders, exposing DOT orders to the crowd. Tr. 3351-54, 3358-59, 3450, 3630, 3645-46, 3648-49, 3771. Luckow noted that if the DOT order cancelled after he announced the oral consummation, then the principal account had to trade in its stead. Tr. 3648.

Luckow conceded that his former clerk Pape, who testified that Luckow instructed him to trade ahead daily, had been a specialist at SLK for seven years and understood the language of the floor. Tr. 3678-80.

Luckow recognized that the alleged interpositioning and trading ahead conduct was improper. Tr. 3354-55, 3359-60. He denied ever encouraging a clerk to engage in such conduct. Tr. 3656-57. He suggested that every exception was either a mistake,[39] the result of the clerk's misunderstanding his instructions, or occurred when he was away from his post. Tr. 3681, 3698. Sheldon[40] clerked for Luckow from January to May 1999, when she became a specialist herself.

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[37] See NYSE Hearing Panel, Exchange Hearing Panel Decision 04-187: Robert William Luckow (2004), available at 2004 WL 3185889, of which official notice is taken, pursuant to 17 C.F.R. § 201.323.

[38] AIG was then a respected company and traded at around $100. Tr. 3637, 3640. Luckow's typical overnight position in AIG was as high as 150,000 to 250,000 shares. Tr. 3640.

[39] Questioned trades (QTs) generally involved floor trades rather than DOT orders, however. Tr. 3499.

[40] Sheldon started as a backup clerk on the floor in 1996; she joined SLK in 1998 as a front-line clerk, and became a specialist in May 1999. Tr. 3702-04. She ceased to be a specialist in 2006,

Tr. 3706. She testified that Luckow never endorsed trading ahead of public orders. Tr. 3747-49. On some individual occasions, he instructed her to trade in a manner that, if executed, would have traded ahead of the public; however, she informed him that she could not enter the trade consistent with the NYSE rules, and he accepted the correction. Tr. 3748-49.

The DB was more rudimentary in 1999 than in later years. Tr. 3709-14. For example, there was no Smart Report key; a clerk had to look up orders to determine their priority and had to enter individual trades manually. Tr. 3710-11. Additionally, the clerk carried out some processes on paper. Tr. 3716-24. These activities increased the possibility of error. Tr. 3724.

Pape[41] testified that Luckow instructed him to interposition between pairable orders that appeared simultaneously out of a freeze multiple times daily. Tr. 3396-99. Luckow explained that if such activities, which individually yielded a small profit, were repeated several times each trading day at each of the firm's panels, the firm would gain over a million dollars a year in profits.[42] Tr. 3397. To do this, he would either communicate that the principal was to trade with a DOT order by saying "you" or "I" bought or sold or cross each of two DOT orders that could have traded against each other. Tr. 3399-3400, 3431-434. "You" or "I" could also refer to DOT orders when the other side of the trade is in the crowd. Tr. 3432-35, 3496. Pape interpreted the meaning of these pronouns based on context and experience.[43] Tr. 3434. Pape conceded that he did not attempt to correct Luckow when instructed to trade ahead of public orders and that he entered such orders on his own at times. Tr. 3423-24, 3426. Nor did he tell anyone in a position of responsibility at SLK or the NYSE. Tr. 3428. Pape became acquainted with the practice of "DOT arbitrage" before he was Luckow's clerk. Tr. 3468. Pape also recalled an instance where a backup clerk was trading Safeway and Luckow instructed her to trade ahead of a DOT order for

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having moved to Fleet in 2002. Tr. 3705-06. She was still employed in the financial industry at the time of the hearing. Tr. 3701.

[41] Pape started as a backup clerk on the floor in 1996; he became a front-line clerk in 1997, and was Luckow's clerk from February to June 2000. Tr. 3388-89. Thereafter he was a clerk to three other specialists and became a specialist himself in December 2000. Tr. 3390. He ceased being a specialist in January 2007; he was still employed in the financial industry at the time of the hearing. Tr. 3391.

[42] In countering Pape's recollection, Luckow claimed Pape had misunderstood the conversation; that in fact Luckow had explained that it was necessary to think ahead of the effect the price set in the current trade will have on future trades, the crowd, the company, and the market in the stock. Tr. 3654-55, 3665-66, 3696-97. He noted that selling high followed by buying low will have the effect of marking down the principal account if it is long. Tr. 3654-55. However, such a series of trades results in a realized gain while a panel's profit and loss was not marked intraday but rather at the end of the day. Tr. 3498-99.

[43] As Luckow and the two clerks, Pape and Sheldon, agree, "you" or "I" could mean either the principal account or the book, and the clerk would understand what it meant depending on the circumstances in which it was used. Tr. 3431-35, 3634-35, 3744.

100,000 shares or more; she did not act quickly enough, and Luckow instructed Pape to complete the transaction. Tr. 3500-01, 3504-09. However, the customer, Goldman Sachs, complained, and as a result, Safeway was taken away from Luckow. Tr. 3506, 3509-10.

Starting in the early 1990s, Luckow was also in charge of running the floor, with the responsibility to control risk and monitor the positions and trading of all SLK stocks. Tr. 3612-14, 3620-22. He was managing director and CEO of SLK and a general partner and member of the executive committee of SLK's parent, Spear, Leeds & Kellogg. Tr. 3348, 3620. He would leave his post to assist with breakout situations. Tr. 3407, 3457. Such situations occurred at least once a week. Tr. 3457. This meant he spent less time at his specialist post. Tr. 3613, 3620-23. An example of Luckow's absence from his panel at a date and time when an exception is ascribed to him is seen in the Patrick Murphy video, Resp. Ex. 502. His absences also included going to meetings at SLK's offices three or four times a week. Tr. 3622-23. He was generally at his panel at the opening and at the closing, if there was not a situation that demanded his attention in other stocks. Tr. 3347-48, 3394, 3651-52. Also, for a year during the relevant period he napped during the trading day in the afternoon, off the floor. Tr. 3666.

Bajaj testified on behalf of Luckow, using the same analysis he used to analyze the computer data in Phase I but tailoring his analysis to Luckow's trading data only. Tr. 3511, 3537; Resp. Ex. 452-E. Thus, Bajaj's discussion of the exception reports is incorporated by reference herein. Bajaj ultimately concluded, particularly based upon his regression analysis,

> Even if we disregard all the data errors, all the computer system errors, all the problems with the algorithm used by the government to identify [the] alleged exceptions, the number of exceptions is well explained by variables that measure intensity and complexity of trading, and the overall evidence is more consistent with these exceptions being a byproduct of [a] hectic trading environment and innocent errors rather than profit-motivated wrongful trading.

Tr. 3587; Resp. Ex. 452-E. Bajaj calculated an exception rate of 0.97% for Luckow, a rate approximately twice the exception rate Bajaj calculated for all Respondents he analyzed together in Phase I. Tr. 3592l; Resp. Ex. 452-E at 3. As in Phase I, Bajaj hypothesized that the exceptions could represent errors which occurred in a trading environment characterized by increased volatility and complexity rather than intentional violative trades but conceded that further analysis had to be done in order to distinguish between the two hypotheses. Tr. 3596-98; Resp. Ex. 452-E at 4-8. Finally, Bajaj determined that, with respect to interpositioning, Luckow left $7.5 to $31 million on the table through voluntary price improvement when Bajaj analyzed Luckow's undisputed trades during the relevant period; however, this analysis did not take into account Pape's testimony that Luckow told him trading ahead of the DOT orders would yield a profit of over a million dollars a year if done a certain number of times a day, given the number of panels and days in a week. Tr. 3575-80, 3604-05; Resp. Ex. 452-E at 28.

The Division ascribes 3,639 interpositioning exceptions and 8,372 trading ahead exceptions to Luckow from February 1999 to December 2000 (excluding June 18 through September 13, 1999, and June through August 2000). Div. Exs. 234-A, 234-B. Of the interpositioning exceptions, 97.22% were customer disadvantaged, 0.05% were customer

advantaged, and 2.72% were break-even, and of the trading ahead exceptions 47.25% were customer disadvantaged, 2.03% were customer advantaged, and 50.72% were break-even. Div. Exs. 234-A, 234-B.

Each of the two clerks, Pape and Sheldon, clerked for Luckow for several months and thus had ample exposure to his trading. Pape testified that Luckow did instruct him to trade ahead and interposition while Sheldon testified that Luckow eschewed such trading. However, the lopsided proportion of customer disadvantaged exceptions to customer advantaged exceptions corroborates Pape's testimony and compels the finding that Luckow did, in fact, trade improperly.

The amount of time Luckow was absent from his panel on supervisory duties is not quantified in the record, although he napped off the floor in the afternoon for about a year during the relevant period and Pape estimated that Luckow was called away to breakout situations in other panels at least once a week. Using the Division's exception figures as a starting point, a 25% haircut will be applied to take account of Luckow's absences from his panel for these reasons.

The amount of SLK's profits from Luckow's trading at issue during approximately eighteen months during the period from February 1999 to December 2000 as identified by the Division is $1,045,081 - $358,756 from interpositioning and $686,325 from trading ahead. Div. Ex. 227-A. Applying the 2.05% haircut to trading ahead profits to compensate for timestamp anomalies reduces SLK's trading ahead profits to $672,255 - $306,406 in 1999 and $365,849 in 2000; the total is reduced to $1,031,011.

Using the Division's reasoning, set forth in Div. Ex. 200, the amount of gains Luckow received as his partnership share of firm profits from the trading at issue is $93,542. Div. Ex. 200. The Division calculated the percentage of firm profits from Luckow's trading at issue and applied that percentage to his partnership distribution. Div. Ex. 200. For example, in 2000, using the Division's method, SLK's profit from Luckow's trading at issue was about $538,230, or 0.2% of total firm profits of about $267 million. Div. Exs. 200, 227-A. Thus, according to the Division's reasoning, 0.2%, or $36,225, of his partnership distribution of $18 million resulted from his violative trading. Div. Ex. 200. (The Division claims his partnership distribution for 2000 was $28.9 million, but, as found above, Luckow's partnership distribution for 2000 was $18 million. There is no evidence in the record to support a different figure.) Also, the firm profits the Division used in its calculations were the profits of SLK, but Luckow's partnership distribution derived from his status as a partner in SLK's parent, Spear Leeds & Kellogg, which had other business segments in addition to the SLK specialist business. Tr. 5335-46; Div. Exs. P SLK 9, P SLK 10. According to the Division's own estimates, SLK accounted for about one-third of the parent's income. Div. Exs. P SLK 9, P SLK 10. Thus, the $93,542 figure should be reduced by 67% to $30,869. Applying a 25% haircut to that figure results in Luckow's gains of $23,152 from his trading at issue.

The Division also urges that Luckow received additional gains of $611,170 related to the trading at issue attributable to his share of the purchase price Goldman Sachs paid for SLK in 2000. Div. Ex. 200. This is rejected as speculative as unsupported in the record. While the Division argues that the price Goldman Sachs paid for SLK would have been lower absent

Luckow's trading at issue, there is no evidence in the record as to the value Goldman Sachs placed on SLK in its purchase of SLK's parent. For instance, the Division's calculation assumes that the purchase price of SLK was fourteen times earnings, but the selection of fourteen rather than another multiple is unexplained in the record. Tr. 3524-25, 5364-68. There was no testimony from anyone associated with Goldman Sachs concerning the purchase. Additionally, the Division calculated SLK's profits from Luckow's questioned trading for the year ended June 30, 2000, by annualizing such profits for the nine months ended June 30, 2000; the figure for such profits for the actual twelve months ended June 30, 2000, would have been significantly less because Luckow did not engage in any trading from July through mid-September 1999; the rationale for the Division's calculation is not explained in the record. Tr. 3662, 5360-61; Div. Exs. 200, 227-A. Thus, no gains related to the trading at issue are attributable to Luckow's share of the price Goldman Sachs paid for SLK.

2. Parolisi

Parolisi started in 1982 as a backup clerk with Walter N. Frank & Company (Walter Frank). Tr. 4713. He became a specialist and a partner at Walter Frank in May 1987; in June 2002 Walter Frank was sold to SLK; he remained at SLK until July 2003, when he retired. Tr. 4713-14, 4721. Subsequently, the NYSE barred him from the floor of the NYSE, based on his failure to cooperate with the NYSE investigation into the matters at issue in this proceeding. Tr. 4745. Specifically, the NYSE imposed the penalty of a censure and a permanent bar from membership, allied membership, approved person status, and from employment or association in any capacity with any member or member organization.[44]

Parolisi's compensation was about $2 million in 1999, about $4 million in 2000, about $3 million in 2001, and a lot less in 2002. Tr. 4720-21, 4723-24. The profitability of his stock Teradyne, Inc. (Teradyne), was very good in 2000. Tr. 4721. At Walter Frank, his compensation (draw as a partner) was a percentage of the firm's profitability, not of the profitability of his individual trading. Tr. 4720, 4724-25. There is no indication in the record that Parolisi contributed to the SLK settlement payments.

Parolisi never operated the DB keyboard. Tr. 5114, 5154-55. Thus, his trades were entered by clerks. Parolisi's clerk from whom evidence was received was Division witness Michael Shearin (Shearin) (late 2000 to late 2002, Tr. 5023-56, 5140-94).

During the relevant period, among other stocks, Parolisi traded Amdocs sometime in 1999, Teradyne from 1999 to November 1, 2002, and Boston Scientific Corporation (Boston Scientific) from August 29, 2002, to January 31, 2003. Tr. 4714-19, 5025-26; Div. Ex. P SLK 31 at 2, 12, Div. Ex. P SLK 32. Teradyne was quite volatile, had high volume, and often had a crowd. Tr. 4744, 5113, 5143-44, 5179. Boston Scientific was often volatile, as well. Tr. 5177-78.

[44] See NYSE Hearing Panel, Exchange Hearing Panel Decision 05-26: James Vincent Parolisi (2005), available at 2005 WL 856393, of which official notice is taken, pursuant to 17 C.F.R. § 201.323.

Parolisi concentrated on the crowd, while his clerk concentrated on the DB. He faced the crowd, with his back to the DB. Tr. 4742-44, 4748, 5107, 5144, 5422-23; Resp. Ex. 630-A. When at his panel, Parolisi stood about two and a half feet from the clerk; his attention was mostly focused on floor brokers in the crowd. Tr. 4742-44. He did not monitor or have an understanding of the DB screen.[45] Tr. 4742-44. He monitored the positions in his stocks but did not notice small changes; large unexplained changes were errors to be corrected. Tr. 4750-54.

At the hearing Parolisi guardedly conceded that the alleged interpositioning and trading ahead conduct could be improper as a violation of the negative obligation. Tr. 4741. His clerks were experienced, and he assumed they were reporting trades correctly in compliance with NYSE rules. Tr. 4738-41, 4748-49. He testified that he instructed his clerks "to keep a fair and orderly market along with me. If there were times when pair-offs were necessary to keep a fair and orderly market, then they knew enough to do it." Tr. 4741. He denied trading ahead or interpositioning or instructing clerks to do so. Tr. 4738.

Shearin,[46] Parolisi's former front-line clerk, testified that Parolisi did instruct him to trade improperly. He testified generally that the proprietary account traded with DOT orders in order time sequence on occasion depending on the context, such as a feeling that the stock was going to go higher or lower or if trading was slow. Tr. 5028-31. This type of trading occurred even in circumstances where there was a crowd present and Parolisi crossed the DOT orders. Tr. 5186-87. At the time they were doing this, Shearin did not believe they were doing anything wrong and believes that Parolisi did not believe he was asking Shearin to do anything he thought was improper. Tr. 5141. Contemporaneously, Shearin had the highest possible opinion as to Parolisi's trust and integrity. Tr. 5182-84; Resp. Ex. 627 at 11.

Sometimes Parolisi would tell Shearin, "We don't pair off orders or DOTs." Tr. 5032. However, one day Parolisi returned from a specialists' morning meeting and told him that they would no longer trade DOTs in order; instead they would pair them off. Tr. 5033, 5186. Thereafter, Shearin was able successfully to pair off DOT orders. Tr. 5186. As found above, Shearin's tenure in Parolisi's panel ended at the end of 2002.

Parolisi was a floor official and was also called to assist other Walter Frank specialists, which took him away from the panel. Tr. 5161-62, 5191-94; Resp. Ex. 626.

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[45] Parolisi testified clearly as to his disinterest in, and lack of knowledge concerning, the DB screen. Tr. 4742-44. To the extent there was any testimony to the contrary, it was in the form of general responses to leading questions. Tr. 5033-34.

[46] Shearin was a specialist at SLK at the time of the hearing; he started as a backup clerk at Walter Frank in 1998, became a front-line clerk in 1999, and became a specialist in August 2004. Tr. 5023-25. He was Parolisi's front-line clerk from approximately late 2000 to late 2002. Tr. 5025, 5143; Div. Ex. P SLK 31 at 14.

Bajaj testified on behalf of Parolisi, using the same analysis he used to analyze the computer data in Phase I but tailoring his analysis to Parolisi's trading data only. Tr. 5996-98; Resp. Ex. 1641. Thus, Bajaj's discussion in Phase I is incorporated by reference herein. The conclusions Bajaj reached with respect to Parolisi were generally consistent with those conclusions he reached with respect to Luckow. Tr. 5998. Again, such discussion is incorporated by reference herein. Bajaj additionally concluded that the exception rate is slightly higher for Parolisi when he was absent from his post than when he was present. Tr. 6031; Resp. Ex. 1641 at 3-4. For that analysis, Bajaj did not consider which specialists were trading in the panel when Parolisi was absent, any instructions Parolisi may have left, or any clerk testimony. Tr. 6039-40. Parolisi traded Teradyne and Amdocs stock during the relevant period, and Bajaj compared the number of exceptions in one to the trading activity in the other, ultimately concluding that during the minute of and surrounding minutes of exception in Teradyne, trading in Amdocs tended to be busier than average and vice versa. Tr. 6031-34, 6042; Resp. Ex. 1641 at 29-31. Finally, Bajaj concluded, using the same variables that measure intensity and complexity of trading he previously discussed, that "when the specialist is under pressure and there is competition for his attention because one of his panel stocks is very busy, other things being equal, it tends to result in [a] larger number of exceptions in the stock that is at issue." Tr. 6034-35; Resp. Ex. 1641 at 32. No evidence of an exception rate was presented for Parolisi, as had been done for all other Respondents for whom Bajaj performed an analysis.

The Division ascribes 2,898 interpositioning exceptions and 19,901 trading ahead exceptions to Parolisi from February 1999 through June 2003. Div. Exs. 236-A, 236-B. Of the interpositioning exceptions, 98.82% were customer disadvantaged, 0.17% were customer advantaged, and 1.00% were break-even, and of the trading ahead exceptions, 71.90% were customer disadvantaged, 3.45% were customer advantaged, and 24.64% were break-even. Div. Exs. 236-A, 236-B.

While Shearin had a high opinion of Parolisi's integrity and testified that he and Parolisi believed he was trading properly at the time, the manner of trading that Shearin described was, in fact, improper. Additionally, the lopsided proportion of customer disadvantaged exceptions to customer advantaged exceptions corroborates Shearin's testimony and compels the finding that Parolisi did, in fact, trade improperly.

Using the Division's exception figures as a starting point, a 25% haircut will be applied to take account of Parolisi's absences from his panel on floor official duties and for other reasons.

The amount of his firms' profits from Parolisi's trading at issue during the period from February 1999 to June 2003 as identified by the Division is $2,184,680.50 - $217,088.50 from interpositioning and $1,967,592 from trading ahead. Div. Ex. 229-A. Applying the 2.05% haircut to trading ahead profits to compensate for timestamp anomalies reduces the firms' trading ahead profits to $1,927,256 - $387,937 in 1999, $1,113,857 in 2000, $291,365 in 2001, $121,493 in 2002, and $12,604 in 2003; the total is reduced to $2,144,344.50.

The Division contends that Parolisi received $485,995 as a result of the trading at issue. Div. Ex 208. This amount is based, in part, on gains estimated to be included in Parolisi's bonus payments that he received for 1999, 2000, 2001, and 2002. Div. Ex. 208. The remainder is

related to Parolisi's share of Walter Frank's profit earned in 1999 that he received as a partner in the firm. Div. Ex. 208. The figures for Parolisi's compensation in Div. Ex. 208 are roughly consistent with Parolisi's rough estimates of his compensation for the years 1999 to 2002.

With respect to the gains related to Parolisi's bonus at Walter Frank, during the years 1999 to 2001, the Division calculates it as the amount that it assumes Parolisi's bonus was increased as a result of his violative trading by calculating the percentage relationship of the bonus to his trading profits. For example, in 1999, Parolisi's bonus of $1.3 million was approximately 32% of his trading profits of $4,091,320.[47] Div. Exs. 208, P SLK 21. Therefore, the Division argues, Parolisi received gains of 32% of SLK's profits from his trading at issue in 1999. Div. Ex. 208.

While acknowledging that his individual trading profit was a component that factored into total compensation, Parolisi contends that there was no direct correlation between his bonus and his trading profits; rather there is a correlation between his compensation and total profits of Walter Frank, of which he was a partner. Tr. 4724-25. The compensation of Walter Frank specialists and their individual trading profits in 1999 support Parolisi's assertion that his bonus was not tied directly to his individual trading profit. Div. Ex. P SLK 21. There is no evidence in the record to support a direct correlation between his bonus and his trading profits. Tr. 5378, 5380-81. Accordingly, any gains related to Parolisi's bonus for 1999, 2000, and 2001, as well as any gains related to his partnership distribution should be calculated in a manner similar to that described for Luckow.

Accordingly, based on figures in Div. Ex. 208, the firm's profits from Parolisi's trading at issue in 1999 ($399,087) were 1.52% of total firm profits of $26,192,213; 1.52% of his total compensation of $2.5 million is $38,000 in gains related to the trading at issue. The record contains no evidence as to total firm profits in 2000; thus no gains from the trading at issue for 2000 can be calculated. For 2001, the firm's profits from Parolisi's trading at issue ($340,834) were 1.08% of total firm profits of $31,478,818; 1.08% of his compensation of $1.4 million is $15,120. For 2002, Parolisi received a bonus of $75,390 from SLK; there is no evidence in the record to correlate this with SLK's profits from his trading at issue of $167,419. Parolisi, who retired from SLK during 2003, did not receive a bonus for that year. Accordingly, these total $39,512; when reduced by a 25% haircut, his proven gains from the trading at issue during the years 1999 to 2003 were $29,634.

3. Johnson

Johnson started as a backup clerk at SLK in October 1987 and remained there until 1990 when he joined Benjamin Jacobson & Sons (Ben Jacobson), which was acquired in March 2001

[47] The individual trading profit for Parolisi of $3,725,907 used by the Division in its disgorgement chart does not agree with another exhibit that shows profits of $4,091,320 for 1999. Div. Exs. 208, P SLK 20, P SLK 21. This is because the profit amount used in the disgorgement chart represents profits through November 30, 1999, and the larger amount represents profits for the entire year. Tr. 5372-73. Use of the smaller number was to Parolisi's disadvantage and unnecessary, thus profits of $4,091,320 was accepted.

by SLK (which had already been acquired by Goldman Sachs). Tr. 4646, 5459-69, 5490. He became a specialist in 1992 while at Ben Jacobson. Tr. 4646, 5469-70. From 1999 to March 2001 Johnson was a partner in Ben Jacobson. Tr. 5487-88. Johnson left the NYSE floor in July 2003.[48] Tr. 4705. There is no indication in the record that he contributed to the SLK settlement payments.

During the relevant period Johnson traded Verizon Communications (Verizon), the stock that the Division alleges he traded improperly, and other stocks. Tr. 4647, 5199, 5485-87, 5706. Johnson traded Verizon until February 2003. Tr. 4647. Johnson operated the keyboard in Verizon most of the time when he was at the post, increasingly after 2000, especially after decimalization in 2001. Tr. 4696-98; 4711-12. However, at times his clerks took over, if his attention was focused on the crowd or if one of his other stocks demanded attention. Tr. 4699, 5491-96, 5706-07. Johnson's clerks from whom evidence was received were Division witnesses Stephen Martini (Martini) (seven to fifteen days between February and April 2001, Tr. 4914-5018) and Christopher Cornall (Cornall) (February 2000 to March 2001, Tr. 5195-5246) and Johnson witness Jason Elkas (Elkas) (June 2002 to January 2003, Tr. 5704-23). Additionally, Benjamin Jacobson III, grandson of Ben Jacobson's founder, clerked for Johnson in 1994 or 1995, and testified that Johnson never instructed him to interposition or trade ahead. Tr. 5684, 5689-90. Benjamin Jacobson III's cousin, James Jacobson, currently vice chairman of SLK and formerly a senior managing member of Ben Jacobson, testified favorably as to Johnson's integrity. Tr. 5692, 5951-66; Resp. Ex. 1639.

Cornall testified pursuant to a non-prosecution agreement with the Office of the United States Attorney for the Southern District of New York (U.S. Attorney's Office). Tr. 5197-98. To the extent that Martini's[49] testimony differs from Cornall's or Elkas's, it was discounted. Martini worked for Johnson as a relief clerk for a total of not more than fifteen days in early 2001, when Cornall was the assigned clerk. Tr. 4916-17. During his career he clerked for forty or fifty specialists altogether, many for short periods. Tr. 4919, 5015-17. His memory of three meetings he had with Commission staff and others during the years 2006 to 2008 was sketchy. Tr. 4974-5004. He recalled Johnson's panel as being in the portion of the trading floor known as the garage. Tr. 4931. Cornall, who was Johnson's assigned clerk during the same period and clerked for Johnson for more than a year, testified that the panel was in the main room. Tr. 5215. Neither has any motive to misrepresent the location, but Cornall, who clerked for Johnson for more than a year, would be unlikely to recall the location incorrectly. The fact that Martini did suggests that his recollections of other facts concerning Johnson may not be reliable.

[48] Johnson was indicted on April 12, 2005, based on the conduct at issue in this proceeding. Subsequently, on review of the evidence in the case and information pertaining to him subsequent to the filing of the indictment, the Government concluded that further prosecution of Johnson would not be in the interests of justice, and an order of Nolle Prosequi was entered on November 21, 2006. United States v. Johnson, No. 1:05-cr-00392-NRB (S.D.N.Y. Nov. 21, 2006).

[49] Martini started as a backup clerk in 1995 and became a front-line clerk in 1998; from 2003 until he was laid off in 2007, he was a specialist himself. Tr. 4914-15.

When at his panel, Johnson stood about a foot from his clerk but might move away if there was a crowd. Tr. 4695-96, 5210-11, 5712. Also, at times he looked away from the DB screen to other screens that displayed market data. Tr. 5544-46.

At the hearing Johnson recognized that the alleged interpositioning and trading ahead conduct could be improper as a violation of the negative obligation. Tr. 4658, 4662-63. However, his understanding of the applicability of the negative obligation to DOT orders changed over time, in that it focused more on DOT orders around the time of the NYSE investigation. Tr. 4659-64. He denied trading ahead or interpositioning or instructing clerks to do so. Tr. 4694-95.

Cornall[50] testified that pairing off DOT orders was not a common practice at Ben Jacobson, or at Walter Frank, where he had also clerked. Tr. 5200. Rather, orders were traded in time sequence with the proprietary account regardless of whether there were DOT orders that could have been paired with each other. Tr. 5201. The Fast Find key would be used, if necessary, to determine which orders came in first. Tr. 5201. Such trades ahead of pairable DOT orders would be executed between the bid and offer spread so as to yield a profit to the dealer account. Tr. 5202-05. Johnson instructed him to trade in this fashion daily. Tr. 5203. Cornall did not specify which stocks he was instructed to trade in this manner. Johnson conceded using the Fast Find key, but only to establish time priority for legitimate trading. Tr. 4702-05. At the time they were doing this, Cornall did not believe they were doing anything wrong and believes that Johnson did not believe he was asking Cornall to do anything he thought was improper. Tr. 5228. Cornall considered Johnson's reputation for truthfulness to be impeccable. Tr. 5232.

Johnson's use of the terms "I" or "you" in instructing a clerk about a trade could have different meanings depending on the context. Tr. 4691-93. Cornall believes he knew what Johnson meant when he used such terms. Tr. 5207-10. Johnson concededly had a quick temper on the floor. Tr. 5645-46.

Elkas, who later became a specialist himself, was front-line clerk to Johnson from about June 2002 to January 2003. Tr. 5705-06. Elkas never saw Johnson use the Fast Find key to trade ahead of customer orders, nor did Johnson instruct him to trade ahead of customer orders. Tr. 5716. Elkas assisted Johnson in trading Verizon infrequently, however. Tr. 5717. Elkas has a very high opinion of Johnson's integrity and believes he would never have traded ahead of customer orders. Tr. 5716.

Johnson became a floor official in early 2001. Tr. 5508. Like others, he took short breaks that did not involve leaving the floor. Tr. 5511-14. On days when he was at the NYSE, he was at his panel 75%-90% of the trading day. Tr. 4697-98.

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[50] Cornall was a specialist for Bear Wagner Specialists LLC (Bear Wagner) at the time of the hearing. Tr. 5195-97. He started in 1997 at Walter Frank as a backup clerk; after a year and a half he went to Ben Jacobson as a front-line clerk on the wheel, eventually becoming a front-line clerk for Johnson in February 2000; he returned to Walter Frank in March 2001, leaving again for Bear Wagner after Walter Frank was taken over by Goldman Sachs; he became a specialist in 2006. Tr. 5195-97.

Johnson recalled being advised at an SLK morning meeting sometime in late 2002 that the NYSE was looking into some kind of improper trading. Tr. 4684-85, 5527. He did not ask what type of improper trading was at issue. Tr. 4685-86. He officially learned about it in February 2003, the month that he stopped trading Verizon. Tr. 4685.

Bajaj testified on behalf of Johnson, using the same analysis he used to analyze the computer data in Phase I but tailoring his analysis to Johnson's trading data only. Tr. 5996-98; Resp. Ex. 1640. Thus, Bajaj's discussion in Phase I is incorporated by reference herein. The conclusions Bajaj reached with respect to Johnson were generally consistent with those conclusions Bajaj reached with respect to Luckow. Tr. 5998. Again, such discussion is incorporated by reference herein. Bajaj additionally concludes that the exception rate is slightly higher for Johnson when he was absent from his post than when he was present. Resp. Ex. 1640 at 35-36. Bajaj's discussion relating to such evidence is the same as his discussion regarding Parolisi and is incorporated by reference herein.

The Division ascribes 6,599 interpositioning exceptions and 9,584 trading ahead exceptions to Johnson from February 1999 through February 2003. Div. Exs. 233-A, 233-B. Of the interpositioning exceptions, 98.39% were customer disadvantaged, 0.02% were customer advantaged, and 1.59% were break-even, and of the trading ahead exceptions, 49.44% were customer disadvantaged, 1.07% were customer advantaged, and 49.49% were break-even. Div. Exs. 233-A, 233-B.

Factors impacting on the reliability of the testimony of Cornall and Martini were described above. Additionally, while both Cornall and Elkas each clerked for Johnson for several months, Johnson entered the trades himself during most of that time rather than instructing them to do so. Cornall testified that Johnson did instruct him to trade in a manner that he now understands to be improper while Elkas testified that Johnson eschewed such trading. Elkas, however, assisted Johnson infrequently in trading Verizon. Also, the lopsided proportion of customer disadvantaged exceptions to customer advantaged exceptions corroborates Cornall's testimony and compels the finding that Johnson did, in fact, trade improperly.

The amount of his firms' profits from Johnson's trading at issue during the period from February 1999 to February 2003 as identified by the Division is $755,637 - $364,442 from interpositioning and $391,195 from trading ahead. Div. Ex. 226-A. Applying the 2.05% haircut to trading ahead profits to compensate for timestamp anomalies reduces the firms' trading ahead profits to $383,176 - $76,284 in 1999, $181,863 in 2000, $94,537 in 2001, $28,732 in 2002, and $1,759 in 2003; the total is reduced to $747,618.

The amount of gains from the trading at issue that the Division identified for Johnson is $55,396. Div. Ex 207. The amount is based, in part, on $43,660 estimated to be included in Johnson's bonus payments that he received for 2001 and 2002. Div. Ex. 207. The remainder, $11,736, is related to Johnson's share of Ben Jacobson's profit earned in 1999 and 2000 that Johnson received as a partner in the firm. Div. Ex. 207.

The Division calculates Johnson's gains related to his bonuses at SLK and his share of Ben Jacobson's profits in a manner consistent with that of Luckow and Parolisi. Accordingly, based on figures in Div. Ex. 207, Ben Jacobson's profits from Parolisi's trading at issue in 1999 ($96,053) were 0.29% of total firm profits of $33,094,567; 0.29% of his partnership distribution of $301,707 is $875 in gains related to the trading at issue. In 2000, Ben Jacobson's profits of $273,863 from his trading at issue were 0.49% of total firm profits of $55,812,287; 0.49% of his partnership distribution of $2,180,068 is $10,682. Johnson received bonuses in 2001 and 2002 from SLK. Div. Ex. 207. However, there is no evidence in the record that provides a direct correlation between his bonuses and the profit and loss (P&L) from his trading. Accordingly, no gains related to his trading at issue during those years can be calculated. Because of that and because his floor official duties commenced in 2001, no haircut will be applied to the total proven gains of $11,557.

E. Fleet

Donald R. Foley, II, and Scott G. Hunt were associated with Fleet Specialist, Inc. (Fleet).[51]

1. Foley

Foley joined a predecessor of Fleet in 1982 and became a specialist in 1987. Tr. 6284. During the relevant period he was a vice-president and eventually a senior vice-president. Tr. 6285. He was terminated and indicted based on conduct at issue in this proceeding.[52] Tr. 6996. He has not worked since and has been personally devastated. Tr. 6997.

Foley was compensated with an annual salary of $150,000, and bonuses of $1.9 million in 2000, $1.3 million in 2001, $2 million in 2002, and $250,000 for the first six months of 2003. Tr. 6286-87; Div. Ex. 204. Foley believed that his bonus was related to the profitability of the firm, not directly related to the profitability of his trading. Tr. 6288-89.

Foley did not use the DB keyboard. Tr. 6599, 6718, 6766, 7020, 7126, 7310. Thus, all of his trades were entered by clerks. Foley acknowledged that a specialist was responsible for trades in his panel entered by clerks. Tr. 6999. Foley was a fast trader and very demanding. Tr. 6596, 6746-47. In fact, his reputation was such that William Bryant (Bryant) attempted to turn down the assignment to be Foley's clerk. Tr. 6742. Foley treated his clerks no worse than he was treated when a clerk by a specialist from whom he learned a great deal. Tr. 6930-34, 6967. Foley's clerks from whom evidence was received were Division witness Bryant (July to

[51] Fleet is now known as Banc of America Specialist after its parent was acquired by Bank of America Corporation in 2004.

[52] Subsequently, on review of the evidence in the case and information pertaining to Foley subsequent to the filing of the indictment, the Government concluded that further prosecution of Foley would not be in the interests of justice, and an order of Nolle Prosequi was entered on October 10, 2006. United States v. Foley, No. 1:05-cr-00391-HB (S.D.N.Y. Oct. 10, 2006).

December 2002, Tr. 6707-6881, 6885-6920) and Foley witnesses Joe Wise (Wise) (two weeks in early 1999, Tr. 7012-7113) and Sean O'Brien (O'Brien) (1996 to May 1999, Tr. 7113-87). Additionally, John Osebeck (Osebeck), a former clerk of another Fleet specialist, Thomas Murphy, who was called by the Division against then-Respondent Thomas Murphy, testified tangentially as to Foley. Tr. 6553-67, 6595-6615. He clerked for Foley occasionally in late 1999. Tr. 6555.

Clerks whose evidence was offered by the Division testified pursuant to non-prosecution agreements with the U.S. Attorney's Office. Osebeck, who originally testified to the NYSE that he did not see former Respondent Thomas Murphy trade ahead of DOT orders, later changed his story. Tr. 6557-59. Bryant testified before the NYSE in the spring of 2003 that he had not seen Foley trade ahead of marketable DOT orders; at the hearing he characterized this testimony as untruthful. Tr. 6709-10.

During the relevant period Foley traded Chase Manhattan Bank and, after its merger with J.P. Morgan & Co., JPMorgan Chase (JPMorgan). Tr. 6940-42, 6990-91. At the same time, he traded some other stocks. Tr. 6945-58.

Generally Foley concentrated on the crowd, while his clerk concentrated on the DB. Foley focused on the DB when there was no crowd. Tr. 6718. Usually there was a crowd in JPMorgan, often of twenty or more, but sometimes only two or three. Tr. 6297-98, 6718-19, 6975. When at his panel, Foley stood in front of the clerk about two or three feet from the DB and the clerk; at times he was in the midst of the crowd; at times he turned and looked at the DB screen or other screens that displayed market data. Tr. 6309-11, 6718, 6744, 6975-76, 7033.

Foley recognized that the alleged interpositioning and trading ahead conduct was improper. Tr. 6296, 6300, 6302. He denied trading ahead or interpositioning or instructing clerks to do so or ever intentionally violating NYSE rules. Tr. 6308, 6997. He suggested that the interpositioning and trading ahead transactions that occurred while he was at his panel were errors. Tr. 6315, 6991. Indeed, Wise's[53] assignment to clerk for Foley was truncated to about two weeks, in 1999, because he could not keep up with Foley and made many errors. Tr. 7017-18, 7020-24, 7026, 7034-36. Foley was a very fast trader. Tr. 6600, 7148, 7173-74. As Foley noted, the NYSE was pressuring specialists to produce faster and faster executions during the relevant period. Tr. 6980-82.

O'Brien[54] testified that Foley never instructed him to trade ahead of a marketable public order. Tr. 7139-40. Wise testified that Foley never engaged in trading ahead or interpositioning during his tenure. Tr. 7050. He had seen other specialists do so; he told Fleet's compliance

[53] Wise started on the floor as a backup clerk in 1994. Tr. 7015. He became a specialist in the summer of 2002. Tr. 7013.

[54] O'Brien was a specialist himself at the time of the hearing. Tr. 7114. He started as a clerk in 1993, clerked for Foley from 1996 to May 1999, and became a specialist in January 2000. Tr. 7115.

officer and testified to the NYSE in 2003 that he had seen such behavior, but not by Foley. Tr. 7052-53, 7092-94. At the time, however, consistent with Fleet policy, he believed that trading ahead in order time sequence was legitimate. Tr. 7095-7100.

Foley did not allow his clerks to use the freeze key.[55] Tr. 6977-78, 7037-41, 7147. On one occasion he detected a clerk using it, and reprimanded the clerk with such vehemence that he broke the DB screen. Tr. 6978. Thus, he argues, any screenshots that include using the freeze key show instances where he was not there or was not aware that it was being done. Tr. 6979.

Foley tried to "do the right thing" in dealing with the floor, even when financially disadvantageous to Fleet. In one instance, Foley closed JPMorgan at the wrong price, insisted on taking responsibility for it, and, as a result, the firm lost $100,000, which was deducted from his capital account. Tr. 6991-96, 7324-25. In another, he stopped Fleet specialists from taking advantage of an error in a program trade of The Bear Stearns Companies, Inc. (Bear Stearns), that could have been immensely profitable to Fleet. Tr. 7325-26.

Witnesses called by the Division who clerked for Foley testified that he did instruct them to trade improperly. At times he indicated his intent by such comments as "screw the DOTs." Tr. 6563, 6610, 6685. The use of this phrase was not uncommon, including by Myles Gillespie (Gillespie), Fleet's president. Tr. 6222, 6656. Foley also paired off DOTs. Tr. 6607, 6716-17. Bryant[56] testified that Foley instructed him to trade for the principal account ahead of DOT orders daily. Tr. 6712-13. To do this, he would either communicate that the principal was to trade with a DOT order by saying "you" bought or sold, or cross each of two orders that could have traded against each other. Tr. 6713-16. To pair them off, which would be one trade, he would only cross once. Tr. 6715-17. Alternatively, he would say "pair them off" or "trade those there." Tr. 6717. Osebeck[57] also testified that Foley traded ahead of DOT orders daily; he stated that Foley communicated this by saying "I" bought or sold. Tr. 6560-65.

"You" or "I" bought or sold could indicate the book as well as principal participation. Tr. 7030-31. The clerk would understand through experience what a particular specialist meant each time he said "you" or "I." Tr. 6920, 7108-09.

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[55] Bryant testified that he tried not to use the freeze key, but sometimes it was necessary. Tr. 6762.

[56] Bryant started as a backup clerk on the floor in 1998; he became a front-line clerk in 1999, clerked for Foley from the summer of 2002 until December 2002, and became a specialist in September 2003. Tr. 6708. He ceased being a specialist in 2007; at the time of the hearing he was employed by Banc of America Specialist in another capacity. Tr. 6708-09.

[57] Osebeck started on the floor as a backup clerk in 1992, became a front-line clerk in 1997, and left Fleet as a front-line clerk in 2006. Tr. 6553-55. He clerked for Foley for a total of thirty days between July 1999 and January 2000. Tr. 6555, 6595.

Foley was a floor official and supervisor at Fleet, and the duties of these positions took him away from his panel from time to time. Tr. 6746, 6969-72, 7130-31, 7307-08. Such absences could occur anywhere from once to five times a week and last anywhere from three to forty-five minutes. Tr. 7131, 7307-08. While this amounts to an average of Foley's absence from the panel close to 10% of the time, Bryant estimated that Foley was at his panel 95% of the time. Tr. 6721.

Foley first learned of the NYSE investigation into improper trading in November 2002 when he was told by a Fleet compliance employee that the NYSE was investigating irregularities in trading DOT orders, including in JPMorgan. Tr. 6293. Foley testified, somewhat equivocally, that he did not have an understanding of the nature of the improper trading of DOT orders. Tr. 6293-96.

Foley's interpositioning and trading ahead exceptions dropped markedly after November 2002, when he learned of the NYSE investigation, and declined still further in the spring of 2003 when the NYSE Division of Enforcement was interviewing participants concerning interpositioning and trading ahead. Tr. 6314-16; Div. Exs. 192-A, 192-B.

Bajaj testified on behalf of Foley, performing the same analysis he performed on the computer data in Phase I and thus, that discussion and corresponding conclusions are incorporated by reference herein. Tr. 7596, 7645-46; Resp. Ex. Fleet 83. Bajaj's analysis with respect to Foley was tailored to Foley's trading only and similar to the analysis done for the other Respondents for whom he testified in Phase II; such discussions and corresponding conclusions are incorporated by reference herein. Tr. 7596; Resp. Ex. Fleet 83. Additionally, Bajaj presented three exception rates for Foley: 0.68% using his methodology from Phase I, 0.69% determined by dividing the number of shares allegedly disadvantaged by the total shares traded, and 0.00124%, determined by dividing the dollars allegedly disadvantaged by the total dollar value of shares traded. Tr. 7596-600; Resp. Ex. Fleet 83 at 3. In doing so, he felt he confirmed his Phase I methodology. Tr. 7597-98. Bajaj's dollar-based exception rate of 0.00124%, however, did not consider that customer harm is not a function of stock value. Bajaj also analyzed limit order participation during the minute of exception and found it to be lower, suggesting that the exceptions were not profit-motivated trades, as one would expect profit-motivated trades to be around periods of higher limit order activity. Tr. 7603-05; Resp Ex. Fleet 83 at 9. Bajaj further concluded that there were more unexecuted DOT market orders during the minute of the exception and, given such factors as a larger number of unrecorded trades, higher price volatility, fewer limit orders supplying liquidity, greater flow participation, and higher order arrival in the minute of the exception, this leaves a more acute possibility for false positives caused by reverse or delayed memorialization. Tr. 7605-06; Resp. Ex. Fleet 83 at 4-8, 10. Finally, Bajaj analyzed Foley's exception drop-off rate by dividing the disadvantaged dollars by total dollar traded for Fleet stocks at issue and for all stocks not charged, during the relevant period. Tr. 7637-38; Resp. Ex. Fleet 83 at 37. In doing so, Bajaj concluded that busier stocks have higher exception rates and, on a normalized basis, exception rates across the floor rise and fall during the same time periods. Tr. 7638; Resp. Ex. Fleet 83 at 37. However, one would expect a floor-wide drop-off in exceptions if information of a trading investigation were disseminated.

The Division ascribes 3,803 interpositioning exceptions and 18,364 trading ahead exceptions to Foley from February 1999 through June 2003. Div. Exs. 192-A, 192-B. Of the interpositioning exceptions, 97.76% were customer disadvantaged, 0.08% were customer advantaged, and 2.16% were break-even, and of the trading ahead exceptions, 48.95% were customer disadvantaged, 4.10% were customer advantaged, and 46.95% were break-even. Div. Exs. 192-A, 192-B.

Factors impacting on the reliability of the testimony of Bryant were described above. While O'Brien and Wise testified favorably as to Foley, Wise clerked for him for only a brief time and had difficulty keeping up with Foley's instructions. Nonetheless, the fact that Foley's exceptions declined markedly after he became aware of the NYSE investigation corroborates the testimony of Bryant that he did, in fact, trade improperly prior to that time. Additionally, as with other Respondents, the lopsided proportion of customer disadvantaged exceptions to customer advantaged exceptions also bolsters the finding that he traded improperly.

Using the Division's exception figures as a starting point, a 10% haircut will be applied to take account of Foley's absences from his panel on floor official and supervisory duties. The 10% figure is derived from witnesses' estimates of the frequency and length of his absences from the panel.

The amount of Fleet's profits from Foley's trading at issue during the period from February 1999 to June 2003 as identified by the Division is $2,167,893 - $319,693 from interpositioning and $1,848,200 from trading ahead. Div. Ex. 185-A. Applying the 2.05% haircut to compensate for timestamp anomalies reduces Fleet's trading ahead profits to $1,810,312 and the total to $2,130,005.

The Division contends that Foley received $373,241, included in bonus payments for the period from February 1999 through June 2003, as a result of the trading at issue. Div. Ex. 204. The figures for Foley's bonuses in Div. Ex. 204 are consistent with Foley's testimony as to his compensation.

Using the Division's reasoning, set forth in Div. Ex. 204, the amount of bonus payments Foley received for 1999 through June 2003 as a result of his trading at issue is $368,036. To estimate his gains related to that trading, the Division calculates it as the amount it assumes Foley's bonus was increased as the result of his violative trading by calculating the percentage relationship of the bonus to his trading profits. For example, for the period December 1, 2002, to June 30, 2003, Foley's bonus was 7.13% of his trading profits. Div. Ex. 204. Therefore, using the Division's reasoning, Foley's gains of 7.13% from his trading at issue during that period, $20,759, were $1,480. A similar procedure was followed for each of the bonus periods on Div. Ex. 204 to reach the total of $368,036.[58] Applying a 10% haircut to that total, it is found that Foley's proven gains from the trading at issue were $331,232.

[58] Div. Ex. 204 does not include Fleet's profits of $6,412 from Foley's trading at issue during the period November 27-30, 1999. Div. Ex. 185-A. Those profits were included in the calculation above, adding $1,373 to Foley's gains.

2. Hunt

Hunt joined a predecessor of Fleet in 1992 and became a specialist in May 1999. Tr. 6220-21, 7387. He was terminated in April 2004 based on conduct at issue in this proceeding.[59] Tr. 7384. Hunt, who has an engineering degree, found work in 2006 with a construction management firm, where he is currently employed. Tr. 7382, 7384.

Hunt was not a partner; he was compensated with a base salary and a bonus, which totaled $250,000 to $500,000 annually during the relevant period. Tr. 6227-28, 6280; Div. Ex. 206. It was his understanding that the bonus was supposed to represent 18% of the profit and loss of a specialist's principal account. Tr. 6229. Hunt was a relief specialist, so this would be difficult to calculate; in his opinion he received around 5%. Tr. 6229-30. When Hunt was at Fleet, the CEO was Chris Quick (Quick); their occasional interactions consisted of Quick's providing negative feedback as to his performance, complaining he was losing too much money. Tr. 6234-43.

Hunt, who had his own DB screen and keyboard, used the keyboard at times. Tr. 6389-90, 6392, 6415, 6431, 7428-29. However, he was also assisted by clerks. Hunt acknowledged that he was responsible for trades entered by clerks even if he did not orally announce them. Tr. 6262-63. Hunt's clerks from whom evidence was received were Division witness Richard Rufo (Rufo) (April 2002 to June or July 2003, Tr. 6364-93) and Hunt witnesses O'Brien (from time to time between May 1999 and January 2000, Tr. 7149-57, 7186) and Stacy Cunningham (Cunningham) (occasional relief clerk until she became a specialist in October 2000, Tr. 7334-81). Bryant, who was called by the Division in its case against Foley, and O'Brien, who was called by Foley in his case, testified briefly as to Hunt. Tr. 6881-85, 7149-57, 7186.

Division witness Rufo testified pursuant to a non-prosecution agreement with the U.S. Attorney's Office. Tr. 6367, 6418. In 2003 he testified before the NYSE in what he now characterizes in a manner that was misleading concerning trading ahead of DOT orders. Tr. 6367-70. In fact, he believed that trading ahead of DOT orders in time sequence, which was Fleet policy, was permissible until meeting with the U.S. Attorney's Office caused him to become concerned that he might be prosecuted for executing such trades and to talk about misconduct by Hunt. Tr. 6490-93.

Hunt traded Goldman Sachs and Cardinal Health, Inc. (Cardinal Health), from time to time, beginning as a relief specialist, during the relevant period. Tr. 6221-27, 7346. From May 1999 to about February 2001 he was a relief specialist, and his daily post and panel assignments were random. Tr. 7395-7400; Resp. Ex. Fleet 67. Gillespie was the specialist assigned to Goldman Sachs when it went public in May 1999. Tr. 6370-71, 7401-02, 7471-72, 7474-75. As time went on, Gillespie's time at the panel decreased, and Hunt's time increased, but Gillespie

[59] He also was indicted. Subsequently, on review of the evidence in the case and information pertaining to Hunt subsequent to the filing of the indictment, the Government concluded that further prosecution of Hunt would not be in the interests of justice, and an order of Nolle Prosequi was entered on November 21, 2006. United States v. Hunt, No. 1:05-cr-00395-DAB (S.D.N.Y. Nov. 21, 2006).

could reappear at any time and start trading the stock. Tr. 6371, 6424-26, 7402-03, 7347, 7377-78, 7475-77. Hunt also traded Cardinal Health. Tr. 7403. At times during the relevant period Cardinal Health was assigned to the same panel as Goldman Sachs, and at times they were at separate panels. Tr. 7359-60, 7404-05; Resp. Ex. Fleet 2. When they were at separate panels, it was not possible for one specialist to trade both; if Gillespie showed up, Hunt might trade in either panel. Tr. 7405-06. Goldman Sachs was a very active and volatile stock. Tr. 6425-26, 7348-49, 7416-19, 7478-80. At times Cardinal Health also became active and volatile and attracted large crowds. Tr. 7360, 7416.

Usually there were crowds in Goldman Sachs and Cardinal Health. Tr. 6273, 6431-32. The crowd in Goldman Sachs usually numbered five to fifteen, or even fifty, yelling. Tr. 6429, 6434, 7349-50, 7365-67, 7422-23, 7477, 7482, 7495. One day in July 2002 there were at least one hundred people in the crowd. Tr. 7420-22. When at his panel, Hunt stood about one and a half or two feet in front of his clerk; at times he was in the midst of the crowd; at times he looked at one or more DB screens or other screens that displayed market data. Tr. 6268-71, 6389-90, 6445-46, 7362-63. He did not notice small changes in his own stocks, such as 200 to 1,000 shares, but he would notice if his position changed by 5,000 shares. Tr. 6272-73.

Hunt recognized that the alleged interpositioning and trading ahead conduct was improper. Tr. 6234, 6258-62, 6266-67, 7391-92. He denied intentionally trading ahead of a customer order or interpositioning between two customer orders or instructing a clerk to do so. Tr. 7394. He suggested that the interpositioning and trading ahead transactions that occurred while he was at his panel were either errors or clerks trading on their own initiative. Tr. 6267-68, 6279-80, 6438-43. Due to increased volume, during the relevant period he often relied on clerks to execute DOT orders, rather than orally crossing each such trade. Tr. 6263-66.

Cunningham[60] clerked for Hunt from time to time between May 1999 and October 2000, when she became a specialist. Tr. 7341-42. Thereafter, as a relief specialist, until January 2002, she worked primarily with Hunt and Gillespie, backing Hunt up when Gillespie left the floor or when Hunt needed a second specialist in busy trading. Tr. 7342, 7352-53. She testified that Hunt did not direct, or advise, her to trade ahead of a marketable DOT order. Tr. 7355. Nor did she hear him tell anyone else to do so. Tr. 7359. In one instance, she was trading Cardinal Health, and Hunt was trading Goldman Sachs at the next panel; she asked him for advice on pricing a trade that involved a DOT order; finally she instructed her clerk as to the terms of the trade, but before the trade could be entered, a DOT order on the other side appeared. Hunt instructed her to pair off the DOTs as it was now inappropriate to trade ahead of the first DOT order. Tr. 7356-58. In doing so, the principal was foregoing a profit. Tr. 7358. Additionally, Bryant, who was called by the Division in its case against Foley, and who clerked for Hunt a few days at a time in 1999, testified briefly that he had a very high opinion of Hunt's integrity and that he knew of no instance in which Hunt traded ahead or interpositioned. Tr. 6881-85. Likewise, O'Brien, who

[60] Cunningham started at a predecessor of Fleet in 1996 as a backup clerk and became a specialist in October 2000. Tr. 7335, 7337-38. She left in 2005 and now works for the NASDAQ Stock Market as a liaison with the broker-dealer community; her job is to increase NASDAQ's market share. Tr. 7336-37.

was called by Foley in his case, and who clerked for Hunt for short periods between May 1999 and January 2000, after which he became a specialist himself, had a high opinion of Hunt's honesty and integrity; Hunt never instructed him to trade ahead or interposition. Tr. 7149-57.

Rufo,[61] who was Hunt's front-line clerk from April 2002 to June or July 2003, testified that Hunt did instruct him to trade improperly. Gillespie was formally assigned to the panel where Goldman Sachs was traded, but, by that time, Hunt was trading the stock most of the time. Tr. 6371. Trading ahead in time sequence was acceptable at the firm and practiced by Hunt. Tr. 6373-75, 6506. (Out of sequence trading was considered improper. Tr. 6484.) In addition, there were instances of interpositioning with respect to orders that appeared simultaneously out of a freeze. Tr. 6375-77. Rufo believes that Hunt was aware of the orders displayed on the DB at those times. Tr. 6375, 6378. At times Rufo questioned the trades Hunt ordered coming out of a freeze, asking him to explain why he was not pairing off the DOT orders; Hunt would instruct him to execute the trades he ordered and not pair off. Tr. 6378-79. Trading ahead in sequence occurred less often in times of high volume, because there was no time to determine the sequence of the orders.[62] Tr. 6380-81, 6496. Hunt did not like him to use the freeze key; sometimes he inadvertently hit the freeze key. Tr. 6436-37. If on unfreezing the book there were a lot of orders on both sides of the book, he would be more likely to pair them off to get rid of them than to trade ahead of them. Tr. 6497.

To instruct Rufo to trade ahead in sequence for the principal account when the book was unfrozen and when there was no crowd, Hunt would say "you" bought or sold, or a designated number of shares "trades" at a price that no order on the book could fulfill. Tr. 6381-82, 6506-07. If a crowd was present, Hunt would cross the orders and then instruct Rufo that "you," "I," or "we" bought or sold. Tr. 6382-85. If he meant to pair off, and there was an imbalance between the DOT buy and sell orders, he would specify the number of shares that would trade. Tr. 6385. If the book was frozen, became unfrozen, and orders of 1,000 to buy and 300 to sell appeared, and Hunt said 1,000 trades at a price, Rufo would include the 300 share DOT order in the trade; if he said "you" sold 1,000, the principal would sell 1,000 shares and the 300 share DOT order would not participate. Tr. 6386. If he meant to trade with both sides, he would announce two trades – one between the principal account and the sell order and one between the principal account and the buy order. Tr. 6386-87. If a crowd were present, similarly he would announce two trades, although the possibility existed that the crowd might participate in one or both of the trades. Tr. 6387-89. At times Hunt would point at Rufo's chest to indicate "you," that is, the principal account was to trade. Tr. 6391.

In August 2001 Hunt and his family moved, and he was away from the NYSE at times incident to purchasing and moving to the new residence. Tr. 7408-09. After September 11, 2001, he attended many memorial services, some of which were during work hours. Tr. 7414-15. In

[61] Rufo started as a backup clerk in 1996, became a front-line clerk at a predecessor of Fleet in 1997, and was a specialist from 2004 to 2007. Tr. 6365-67.

[62] Goldman Sachs's volume was record-breaking on July 19, 2002, and the exceptions pertaining to that stock for July 2002 were low compared to other months. Tr. 6497-99; Div. Exs. 194-A, B.

late 2001 and for much of 2002, he left the NYSE in the middle of the day and did not return, on many occasions, due to a medical problem of a family member. Tr. 7410-12. Throughout the relevant period he occasionally attended social functions, such as golf outings, for which he would leave in the middle of the day and not return. Tr. 7412-13. Reflecting the gradual diminution of Gillespie's trading of Goldman Sachs, during 1999, Hunt traded Goldman Sachs about 15% of the time. Tr. 7186, 7403. He continued as a relief specialist during 2000. Tr. 7395-96. During 2001 he traded the stock 50% of the time. Tr. 7377-78. During 2002 through the end of the relevant period, he traded the stock 90% of the time. Tr. 6371, 6417, 7449.

Hunt learned of the NYSE investigation in early December 2002. Tr. 6245, 6254, 7445-46. It was a topic of discussion among people on the floor. Tr. 6255, 7446. However, in March 2003 Fleet's compliance officer convened a meeting and formally informed the specialists of the investigation. Tr. 6283. He testified that he did not change his trading practices after learning about the investigation or being notified of it. Tr. 6276-77, 7446. Nor did he inform Rufo that they would have to trade differently. Tr. 6511-12, 7446-47. However, Hunt's interpositioning and trading ahead exceptions declined substantially in and after December 2002 and dropped almost to zero in and after March 2003. Div. Exs. 194-A, 194-B.

Bajaj testified on behalf of Hunt, performing the same analysis he performed on the computer data in Phase I and thus, that discussion and corresponding conclusions are incorporated by reference herein. Tr. 7596, 7645-46; Resp. Ex. Fleet 85. Bajaj's analysis with respect to Hunt was tailored to Hunt's trading only and similar to the analysis done for the other Respondents for whom Bajaj testified in Phase II; such discussions and corresponding conclusions are incorporated by reference herein. Tr. 7596, 7599-600, 7606, 7618, 7624, 7631-34, 7640-41; Resp. Ex. Fleet 85. Since Hunt has exceptions from two stocks that overlap, Bajaj had the computer data necessary to analyze whether exceptions can occur due to demands on the specialist rather than intentional profit-motivated trading. Tr. 7641; Resp. Ex. Fleet 85 at 39-43. Bajaj concluded that exceptions were likely in Cardinal Health stock during times when Hunt was busy with Goldman Sachs stock and vice versa. Tr. 7641-44; Resp. Ex. Fleet 85 at 40-41. Bajaj performed a regression analysis, using intensity and complexity in Cardinal Health stock, to conclude that those variables do indeed correlate to the exceptions in Goldman Sachs stock and vice versa. Tr. 7643-45; Resp. Ex. Fleet 85 at 42-43.

The Division ascribes 1,966 interpositioning exceptions and 7,532 trading ahead exceptions to Hunt from August 1999 through June 2003. Div. Exs. 194-A, 194-B. Of the interpositioning exceptions, 97.51% were customer disadvantaged, 0.05% were customer advantaged, and 2.44% were break-even, and of the trading ahead exceptions 80.51% were customer disadvantaged, 3.40% were customer advantaged, and 16.09% were break-even. Div. Exs. 194-A, 194-B. The period included 344 customer disadvantaged (and 2 break-even) exceptions in 1999 and 2000, 855 customer disadvantaged (and 8 break-even) exceptions in 2001, and 718 customer disadvantaged (and 1 customer advantaged and 24 break-even) exceptions in 2002 through June 2003. Div. Exs. 194-A, 194-B.

Factors impacting on the reliability of the testimony of Rufo, who clerked for Hunt for more than a year, were described above. Cunningham, Bryant, and O'Brien testified favorably as to Hunt, but clerked for him only briefly. However, the fact that Hunt's exceptions declined

markedly after he became aware of the NYSE investigation corroborates the testimony of Rufo that he did, in fact, trade improperly prior to that time. Additionally, as with other Respondents, the lopsided proportion of customer disadvantaged exceptions to customer advantaged exceptions also bolsters the finding that he traded improperly.

The amount of Fleet's profits from Hunt's trading at issue during the period from November 2000 to June 2003 as identified by the Division is $800,107 - $146,226 from interpositioning exceptions and $653,881 from trading ahead. Div. Ex. 187-A. Applying the 2.05% haircut to compensate for timestamp anomalies reduces the firm's trading ahead profits to $640,476 and the total to $798,277.[63]

The Division contends that Hunt received $126,144, included in bonus payments for the period from November 2000 through June 2003, as a result of the trading at issue. Div. Ex. 206. The figures for Hunt's bonuses in Div. Ex. 206 are roughly consistent with Hunt's rough estimates as to his compensation.

Using the Division's reasoning, set forth in Div. Ex. 206, the amount of bonus payments Hunt received for the period from November 1, 2000, to June 30, 2003, was $123,996. To estimate his gains related to that trading, the Division calculates it as the amount it assumes Hunt's bonus was increased as the result of his violative trading by calculating the percentage relationship of the bonus to his trading profits. (The value for his trading profits for the period December 1, 1999, to November 1, 2000, is not available. Div. Ex. 206. Therefore, gains cannot be calculated for this period.) For example, for the period December 1, 2002, to June 30, 2003, Hunt's bonus of $150,000 was 7.2% of his trading profits. Div. Ex. 206. Therefore, using the Division's reasoning, Hunt's gains of 7.2% from his trading at issue during that period, $4,918, were $354. Div. Ex. 206. For November 2000, the corresponding numbers are 16.89% of $107,034 in firm profits from his trading at issue, or $18,078; for December 2000 through May 2001, 16.89% of $341,443 in firm profits from his trading at issue, or $57,670; for June through November 2001, 16.79% of $215,193, or $36,131; for December 2001 through May 2002, 9.84% of $38,878, or $3,826; and for June through November 2002, 10.37% of $76,542, or $7,937. To account for any possibility that Gillespie was trading in Hunt's panel, any day that Fleet's records showed both Gillespie and Hunt assigned to the panel was backed out for Hunt. Tr. 1547-49. Because of this no haircut will be applied to the total proven gains of $123,996.

F. VDM

Richard P. Volpe and Robert A. Scavone, Jr., were associated with Van der Moolen Specialists, USA, LLC (VDM).[64] VDM was 75% owned, through a subsidiary, by Van der

[63] Division Ex. 206 contains information for prior periods, but, because the given information is incomplete, Hunt's gains are unable to be calculated for those periods.

[64] Pursuant to Stipulations 11 and 12, transcripts of selected testimony from United States v. Scavone, No. 1:05-cr-00390-SHS (S.D.N.Y.), and United States v. Volpe, No. 1:05-cr-00390-SHS (S.D.N.Y.) were received in evidence. Tr. 7705-11 (S-11, S-12). Citations to these transcripts will be noted as "Scavone Tr. __" and "Volpe Tr. __." Official notice, pursuant to 17

Moolen Holding N.V., a Dutch firm, and 25% owned by sixty-six VDM specialists and management individuals.[65] Resp. Ex. 755 at 1. In October 1998 Van der Moolen Holding N.V. purchased a controlling interest in Lawrence, O'Donnell, Marcus, LLC (LOM), and in July 1999 LOM changed its name to VDM. Tr. 7809 (S-18). By the end of the relevant period VDM had acquired a number of specialist firms, including Einhorn & Company, LLC (Einhorn) in 1999, Scavone, McKenna, Cloud & Co., LLC (SMC) in August 2001,[66] and Fagenson, Frankel, & Streicher, LLC (Fagenson Frankel) in June 2000. Tr. 7707 (S-11), 7712, 7900, 8127-28, Volpe Tr. 1053-54, 1071. In 2002 VDM had about sixty-five specialists. Volpe Tr. 1055.

Volpe arrived at VDM with Einhorn, and Scavone, with SMC. Tr. 7712; Scavone Tr. 754. Both were terminated on November 12, 2004. Tr. 7708 (S-11), 7834-36. Their arrests and trials in United States v. Volpe, No. 1:05-cr-00390-SHS (S.D.N.Y.) and United States v. Scavone, No. 1:05-cr-00390-SHS (S.D.N.Y.) have had a devastating effect on Volpe and Scavone professionally, financially, and personally. Tr. 7832-34. The news of their acquittals was much less publicized than the news of their arrests. Tr. 7833.

Day-to-day management of VDM was carried out by members of the Management Committee. Resp. Ex. 755 at 1-2, Resp. Ex. 783 at 12. Former LOM specialists dominated management and policies at VDM during the relevant period: the Management Committee consisted of Joseph Bongiorno (Bongiorno), James P. Cleaver, Jr. (Cleaver), Chairman, Michael J. Hayward (Hayward), Patrick J. McGagh, Jr. (McGagh) (as of January 1, 2003), Michael F. Stern (Stern), as well as Robert B. Fagenson (Fagenson), Vice Chairman, formerly of Fagenson Frankel, and a representative of VDM's Dutch parent. Tr. 7809 (S-18); Resp. Ex. 755 at 1-2; Volpe Tr. 559-60, 691, 1055-56. Cleaver, Bongiorno, Hayward, McGagh, and Stern were from LOM. Tr. 8128; Volpe Tr. 694-95, 703, 1049. They did not like Volpe. Tr. 7900-06, 8167-68; Volpe Tr. 1063-64. Bongiorno and Hayward, with Stern as the alternate, were in charge of trading policy and administration of the clerks and determined who was promoted from clerk to specialist. Volpe Tr. 1055-56. Before joining the Management Committee, McGagh directly supervised the clerks. Volpe Tr. 1056, 1060-61. Bongiorno and Hayward, primarily, and also Stern and McGagh, were responsible for ensuring compliance by clerks and specialists with NYSE rules pertaining to the DB. Volpe Tr. 1057.

C.F.R. § 201.323, is taken of the Judgments of Acquittal in Scavone and Volpe filed on August 2 and September 19, 2006, respectively.

Due to the serious medical condition of his father, Scavone did not appear in person and testify at the VDM Phase II hearing, and, pursuant to the parties' stipulation, no inference is drawn from his absence. Tr. 7705 (S-11).

[65] VDM left the specialist business, and its operations were acquired by Lehman Brothers on December 10, 2007, and operated as Lehman Brothers MarketMakers; as of September 25, 2008, after the collapse of Lehman Brothers, Barclays Capital acquired the market making business.

[66] The conduct alleged by the Division as to Scavone occurred during his association with VDM from the August 2001 merger to June 2003.

Compensation of a VDM specialist was not tied directly to the profitability of the panel in which he specialized. Resp. Ex. 755 at 2. Specialists, including Volpe and Scavone, were compensated as follows: a yearly salary of $150,000, a share of the firm's monthly profit and loss proportional to the specialist's ownership interest in the firm, NYSE seat rental payment, and a bonus. Tr. 7810-13 (S-18); Resp. Ex. 362 at VDMCR 006604. As a practical matter, the bonus amounts were determined by Bongiorno, Hayward, and Stern, using subjective criteria; they did not use a set formula to determine the amounts. Tr. 7811 (S-18), Tr. 8175-76; Resp. Ex. 362 at VDMCR 006604. Among several factors that they might consider was profitability of an individual specialist's panel. Tr. 7812-13; Resp. Ex. 362 at VDMCR 006604.

VDM settled charges arising out of the trading of Volpe, Scavone, and other VDM specialists, by, in addition to agreeing to various undertakings, paying $57,675,104 (consisting of civil penalties of $22,748,491 and disgorgement of $34,926,613). Van der Moolen Specialists USA, LLC, 82 SEC Docket 2113 (Mar. 30, 2004). VDM's Dutch parent paid 75% of these sums, and the individual owners, including Volpe and Scavone, paid the remaining 25% in proportion to their ownership interests. Tr. 7813-14 (S-18), 7998-8000. Volpe's ownership interest was 0.9363%. Resp. Ex. 783 at A-4. Thus, his share of the payments was $540,012. Whatever was available in his capital account was taken, and he wrote a check to VDM for the balance of $401,872. Tr. 7999-8000. Scavone's ownership interest was 0.6433%. Tr. 7708 (S-11); Resp. Ex. 783 at A-3. Thus, his share of the payments was $371,024. The $34,926,613 in disgorgement in the VDM settlement was calculated using all of the allegedly violative trades attributed to Volpe and Scavone in this proceeding. Tr. 7790 (S-13). Neither Volpe nor Scavone participated in VDM's decision to settle. Tr. 8055-56.

Stepping ahead of public orders had been pervasive at LOM, and was company policy at VDM. Tr. 8182-83, 8226-29; Volpe Tr. 688-90. Such trading was known by the legitimate-sounding term "DOT arbitrage." Volpe Tr. 1065, 1071-72. VDM management openly promoted it: a member of the Management Committee addressed the clerks and instructed them not to pair off DOTs. Volpe Tr. 560-62. At a specialists' morning meeting, Bongiorno stated that firm policy was not to pair off DOTs and that anyone who disagreed could work elsewhere. Tr. 8182-83, 8226-29. Bongiorno would yell at a clerk if he caught him pairing off DOTs, as would Hayward. Volpe Tr. 558, 699-700, 10227-28. Hayward even continued his practices after the NYSE investigation into improper trading was generally known. Volpe Tr. 1027-30, 1044-45, 1067. Certainly, the proclivities toward improper trading at VDM were not concealed and were, in fact, generally known, as indicated by the testimony of witnesses called both by the Division – Kathryn Handelman (Handelman), Robert Corcoran (Corcoran), Michael Studer (Studer), and Theodore Gatsonis (Gatsonis) – and by Volpe and Scavone – Jason Blatt (Blatt), Brian Schaeffer (Schaeffer), and Fagenson. Tr. 8129-32; Volpe Tr. 240, 302, 404, 414, 663-64, 691-700, 1032, 1039, 1062-63; Scavone Tr. 325.

Fagenson joined the Management Committee after his company was acquired by VDM. Volpe Tr. 1068. The Management Committee continued to operate almost the same way as before he got there; for example, he was left out of decisions on promoting clerks to specialists. Volpe Tr. 1068. He did, however, confront Bongiorno, both at meetings and on the trading floor, concerning his instructions that DOTs not be paired off. Tr. 8182-83; Volpe Tr. 1062-63.

Fagenson considered pairing off DOT orders "rule number one," and consistently told specialists this. Scavone Tr. 833.

Neither Volpe nor Scavone operated the DB keyboard. Tr. 7882; Volpe Tr. 388, 640-41, 666, 1042; Scavone Tr. 304. Thus, all of their trades were entered by clerks. While working as a specialist, Volpe referred to his clerk Robert Corcoran as his "electric link" on the DB. Tr. 7917-19; Resp. Ex. 782. Volpe and Scavone each acknowledged that he was responsible for the trades in his panel entered by his clerk. Tr. 8030; Scavone Tr. 763. A specialist was not, however, responsible for trades ordered by a relief specialist who was trading in his panel. Tr. 7851-52. Volpe's clerks from whom evidence was received were Division witnesses Handelman (Eli Lilly, early 2000, Volpe Tr. 162-371), Corcoran (Disney, early 2001 through 2002, Volpe Tr. 372-633), Studer (Pfizer, fall 2000 to spring 2001, Volpe Tr. 633-764) and Volpe witnesses Blatt (VDM clerk and specialist who clerked for Volpe at Einhorn, Tr. 8125-8244) and Schaeffer (Disney, January 2003 through the remainder of Volpe's tenure at VDM, Volpe Tr. 1023-51). Scavone's clerks from whom evidence was received were Division witness Gatsonis (Eli Lilly, April 2002 to January 2003, Scavone Tr. 278-505) and Scavone witness John Napoli (Napoli) (clerked for Scavone as front-line clerk at SMC and as relief clerk at VDM, Tr. 8059-71; Scavone Tr. 869-879).

VDM did not keep contemporaneous attendance records, so the dates that the Division used to attribute exceptions to them are based on after-the-fact estimates. Tr. 8162-63; Resp. Ex. 755 at 2. To respond to a Commission inquiry, VDM directed specialists to try to recall their attendance and panel assignments. Tr. 7927-28, 8163; Resp. Ex. 755 at 2.

Clerks whose evidence (transcripts of their testimony from Volpe or Scavone) was offered by the Division testified pursuant to non-prosecution agreements. Volpe Tr. 163, 374-75, 634; Scavone Tr. 283; Div. Ex. P VDM 8-9 at Gov't Ex. 3509-10. At an early stage of the NYSE investigation Corcoran, Studer, and Gatsonis (Handelman was no longer working at the NYSE) were called to give testimony under oath by the NYSE Division of Market Surveillance in the spring of 2003. Volpe Tr. 376, 635; Scavone Tr. 284. The three testified that there was no improper trading by VDM specialists. Volpe Tr. 375-76, 636; Scavone Tr. 285. They did so to protect their jobs at VDM.[67] Volpe Tr. 376, 578, 636, 714; Scavone Tr. 285. In Scavone's criminal trial Gatsonis affirmatively testified that he would lie under oath to protect his job. Scavone Tr. 406. The VDM clerks were represented at the NYSE testimony sessions by VDM's lawyers. Volpe Tr. 376, 712-13; Scavone Tr. 285. Subsequently, in 2004, they were interviewed by the NYSE Division of Enforcement and stated that the VDM specialists did trade improperly. Volpe Tr. 377, 636; Scavone 285. For those interviews they had their own lawyers, not VDM's. Volpe Tr. 377, 592; Scavone Tr. 412. Handelman also was interviewed then by the NYSE Division of Enforcement and was represented by her own lawyer. Volpe Tr. 263-64. Later, all

[67] Later, Gatsonis believed that he had been passed over for promotion to specialist because his response to the NYSE investigation was not considered satisfactory. Scavone Tr. 408-09, 876-79. Subsequently, a few months after he provided different information in his interview by prosecutors and 2005 grand jury testimony, he was promoted to specialist. Scavone Tr. 417-25, 879.

four were interviewed by agents of the U.S. Attorney's Office, stated that the specialists traded improperly, and were given non-prosecution agreements. Volpe Tr. 264, 341-42, 594-606, 758-63; Scavone Tr. 415-24; Div. Ex. P VDM 8-9 at Gov't Ex. 3509-10. Their testimony in the criminal trial was consistent with the statements they had given during their interviews. Indeed, Corcoran believed that if he testified that he did not know whether Volpe intentionally engaged in any improper trades, the government would tear up the non-prosecution agreement and prosecute him for perjury. Volpe Tr. 609-10. Handelman and Gatsonis recognized that the prosecutors, not the presiding judge, would determine whether their testimony was truthful for the purpose of their non-prosecution agreements. Volpe Tr. 343-44; Scavone Tr. 423. Thus, just as Volpe's and Scavone's testimony must be viewed in the light of their self-interest, the testimony of the clerks must be viewed in the light of their self-interest. An additional factor bearing on Corcoran's recollection of the events in question is his contemporaneous use of opiates and other controlled substances while at work and heavy drinking after work. Volpe Tr. 377-78, 552-53. His drug and alcohol abuse did not affect his work performance at the time, however. Tr. 7843-44, 7918; Volpe Tr. 553.

1. Volpe

Volpe testified that he did not realize at the time that Bongiorno, Hayward, Stern and McGagh were trading improperly. Tr. 8027-28. Likewise, he testified that he did not realize at the time that VDM clerks were trading ahead and interpositioning. Tr. 7842-47, 8030-31. Essentially, he testified that many specialists and clerks were trading ahead and interpositioning to make money for the firm, but that he was unaware of it at the time. Tr. 8033-35. This is not entirely consistent with the testimony of VDM specialist Blatt, called by Volpe, that, at a specialists' meeting, Volpe – and only Volpe – protested Bongiorno's instructions not to pair off DOTs. Tr. 8182-83, 8226-29. Also, as found above, the proclivities toward improper trading at VDM were not concealed and were, in fact, generally known. Volpe acknowledged that he did not train his clerks, as at Einhorn, rather, that VDM assigned him clerks trained by VDM management, including McGagh. Tr. 7748-49, 7840-41, 8025-26. Such clerks would be inclined to follow management's stated policies concerning trading DOTs.

At VDM, Volpe traded Eli Lilly and Company (Lilly) from January to February 2000. Tr. 7926-28. Handelman testified that she clerked for Volpe in Lilly from January to June 2000. Volpe Tr. 169. His recollection is accepted over hers. She continued in Lilly when that stock was taken over by Stern. Volpe Tr. 266-67. Thus the source of her recollection that Volpe traded Lilly through June 2000 is the fact that she herself was clerking in Lilly through June 2000. Volpe's testimony that he traded Lilly at VDM for two months or less is also bolstered by Blatt's testimony that he could not recall Volpe trading Lilly at all after the takeover by VDM. Tr. 8163-64. Volpe traded Pfizer Inc. (Pfizer) from about October 2000 to about January 2001. Tr. 7928. He traded The Walt Disney Company (Disney) from approximately June 2001 to November 2004. Tr. 7721-23.

Generally Volpe concentrated on the crowd, while the clerk concentrated on the DB. Volpe Tr. 640-41, The crowd usually numbered two to three or more in Lilly, Volpe Tr. 308, one to seven in Pfizer, Volpe Tr. 642, and one to ten in Disney. Tr. 7945; Volpe Tr. 388. When at his panel, Volpe stood in front of the post about two or three feet from the DB screen; at times his

attention was wholly focused on floor brokers in the crowd; at times he turned and looked at the DB screen or other screens that displayed market data. Tr. 7749-51; Volpe Tr. 227-28, 640-42.[68] He was not necessarily looking at the 8 price window while looking at the DB screen; the depth price window, for example, would have been useful to him while dealing with large crowd orders. Tr. 7751; Volpe Tr. 281. Although he monitored his positions constantly, he would not necessarily have noticed small changes arising from the relatively smaller trading ahead DOT transactions. Tr. 7750-52, 7772-76. Also, his position would have been the same before and after an interpositioning transaction. Volpe Tr. 288.

Volpe recognized that the alleged interpositioning and trading ahead conduct was improper and well-known to be a violation of the negative obligation. Tr. 7745-48. Volpe suggested that interpositioning and trading ahead transactions that occurred while he was actually at his panel were either errors or were the product of clerks trading on their own. Tr. 7839-45, 7951-53. He denied instructing clerks to trade ahead or interposition. Tr. 7770, 7837. Schaeffer,[69] who clerked for Volpe in Disney from approximately January 2003 to November 2004, testified that Volpe, unlike Hayward, never directed him to enter an improper trade. Volpe Tr. 1027, 1032, 1036, 1039-40, 1044-45, 1049-50. However, as found below, the NYSE investigation had become known to Volpe by March 2003, and even according to the Division's exception exhibits, Volpe's interpositioning and trading ahead exceptions decreased between December 2002 and January 2003 and decreased markedly, almost to zero, after March, 2003. Div. Exs. 198A, 198B. Blatt,[70] who became a specialist at VDM, clerked for Volpe at Einhorn in Lilly and other stocks, testified that Volpe never traded improperly when he clerked for him. Tr. 8125-27. Volpe always paired off DOTs at Einhorn, and as far as Blatt knew, did not change his trading style at VDM. Tr. 8128-29.

Volpe testified that when instructing a clerk to pair off orders on the book, he would turn to the book and use minimal verbiage, such as "5 cents, 4 cents, 3 cents," to tell the clerk the price, and the clerk would know that any DOT order available to trade at that price would trade at that price, and the principal account would be used to offset any small disparities. Tr. 7762. If dealing with the crowd when there was nothing in the book, he would say, for example, "I sold 5,000 to Bear Stearns in the crowd." Tr. 7764.

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[68] Corcoran's testimony concerning where Volpe stood is confusing and has been disregarded. Corcoran testified, "I stood in front of him," when asked where he stood when clerking for Volpe. Volpe Tr. 386. Then he was asked "How were you able to tell?" after he testified that Volpe paid attention to the flow of orders on the screen, and responded "Because he was in front of me." Volpe Tr. 387.

[69] Schaeffer started as a backup clerk in 1997 and was a VDM specialist at the time of Volpe's trial in 2006. Volpe Tr. at 1024-25.

[70] Blatt, who became a VDM specialist in November 1999, started as a backup clerk in 1992. Tr. 8125.

Witnesses called by the Division who clerked for Volpe at VDM before the NYSE investigation became known testified that he did instruct them to trade improperly. Handelman[71] clerked for Volpe in early 2000 in Lilly. Volpe Tr. 169. She was accustomed to trading improperly, having clerked for Stern and Bongiorno. Volpe Tr. 240, 266, 301-02. Until she started working for Volpe, she did not know whether he interpositioned or not. Volpe Tr. 314-15. So, she testified, to ascertain whether he would trade in this manner, she set up an improper trade on the DB and asked him whether he wanted to execute it; he asked her whether the other specialists did it, she responded that they did, and he did not respond. Volpe Tr. 232-33, 247, 315-16. She estimated that fewer than 5% of the trades (not volume) were improper. Volpe Tr. 241. Although she acknowledged executing some trades on her own, she estimated that Volpe ordered 98% of the improper trades. Volpe Tr. 246-47. She testified that when Volpe directed her to trade ahead and interposition he said "you" to indicate the principal account bought or sold. Volpe Tr. 241, 313. Volpe's testimony that he used "I" to indicate principal participation in trades with the crowd when there was nothing in the book is not inconsistent with this. Tr. 7764. Volpe testified that he did not recall using "you" to indicate dealer participation. Tr. 7764. Corcoran[72] clerked for Volpe from the beginning of 2001 to the end of 2002 in Disney. Volpe Tr. 385. He testified that Volpe directed him to interposition by specifying two trades, for example, "2,000 traded at 19.98, 2,000 traded at 20.03," while to pair off, Volpe would specify one trade, for example, "2,000 traded at 20." Volpe Tr. 402. Corcoran estimated that he executed such trades 50% of the time on his own, and 50% at the direction of Volpe. Volpe Tr. 401, 440. Such improper trades were company policy, and he did not inform Volpe when he executed them on his own. Volpe Tr. 404. Like Handelman, he estimated that the proportion of improper trades was less than 5%. Volpe Tr. 411-12. Studer[73] clerked for Volpe from fall 2000 to spring 2001 in Pfizer. Volpe Tr. 639. He testified that he never traded improperly on his own. Volpe Tr. 647. Studer testified that Volpe always traded orders according to the sequence in which they appeared on the DB, but that when buy and sell market orders appeared simultaneously coming out of a freeze, Volpe paired them off. Volpe Tr. 658-62. Corcoran and Studer agreed that Volpe never instructed them, "Don't pair off DOTs," or words to that effect, unlike some other specialists. Volpe Tr. 558-60, 685-86, 699-700

Volpe was known for taking large positions, which increased the possibility of profits and the risk of loss. Tr. 8166; Volpe Tr. 1031. Sometimes Volpe would be relieved from his trading by Bongiorno's SWAT team, which included McGagh, Hayward, and Stern in addition to Bongiorno; this occurred during breakout situations and when Bongiorno became concerned

[71] Handelman started as a backup clerk in 1994. Volpe Tr. 165-66. She eventually left VDM and the securities industry. Tr. 170.

[72] Corcoran started on the NYSE floor in 1993. Volpe Tr. 380. He left VDM in 2004. Volpe Tr. 384.

[73] Studer started on the NYSE floor in 1988. Volpe Tr. 637. He became a specialist at VDM in 2003, but was demoted to clerk after two and a half years because his trading was not profitable enough for the firm. Volpe Tr. 639-40. He was a VDM clerk at the time of Volpe's trial in 2006. Volpe Tr. 640.

about the size of Volpe's positions and desired to trade to lower the size of the positions.[74] Tr. 7824-25 (S-20), 7939, 7955-58, 8131-32; Resp. Exs. 751, 786. In these situations the SWAT team's trading included trading ahead and interpositioning. Tr. 7824-25 (S-20); Resp. Ex. 751. Volpe had many friends and relatives on the floor, and visited them when the SWAT team occupied his panel, as well as on other occasions. Tr. 7944-45, 8169-70.

While taking large positions intraday, Volpe attempted to be flat overnight, which accorded with VDM policy. Tr. 7938-39; Volpe Tr. 554.

Volpe was a floor official during the relevant period through 2002 and was a floor captain for VDM. Tr. 7907-09. These duties took him away from his panel anywhere from a few seconds to two hours at a time. Tr. 7909-10, 8132-33. During 2000, Volpe acted as a floor official in 190 incidents, in 2001, 679, and in the first six months of 2002, 680. Tr. 7826-29 (S-21); Resp. Ex. 750. Volpe's breaks included a one-hour break in the afternoon. Tr. 8168; Volpe Tr. 643-44. On the one-hour break, Volpe engaged in what he characterized as meditation and Bongiorno and others, a nap. Tr. 7962-63, 8168. Volpe noted some anomalies relating to his badge swipe records and the exception reports: exceptions shown before he swiped onto the trading floor. Tr. 7972-88.

Volpe learned of the NYSE investigation into improper trading in early 2003. Tr. 7737. He recalls a partners' meeting at which it was discussed in March 2003. Tr. 7737. This is consistent with Fagenson's testimony that he received a letter from the NYSE in January 2003 requesting extensive information about certain stocks that VDM traded, that he did not know the nature of the problem at that time, but that he spoke with the specialists and clerks who traded the stocks at issue, and that in the following months up to April 2003, he learned more specifics and conveyed the information to the specialists and clerks. Volpe Tr. 1064-67, 1071-74; Scavone Tr. 804-12.

Bajaj testified on behalf of Volpe, performing the same analysis he performed on the computer data in Phase I and thus, that discussion and corresponding conclusions are incorporated by reference herein. Tr. 8250. Bajaj's analysis with respect to Volpe was tailored to Volpe's trading only and similar to that analysis done for the other Respondents for whom he testified in Phase II; such discussions are incorporated by reference herein. Tr. 8250; Resp. Ex. 788. Bajaj reached similar conclusions as well. Tr. 8250; Resp. Ex. 788.

The Division ascribes 12,655 interpositioning exceptions and 6,511 trading ahead exceptions to Volpe from January 2000 through June 2003. Div. Exs. 198-A, 198-B. Of the interpositioning exceptions, 98.95% were customer disadvantaged, 0.04% were customer

[74] Corcoran estimated that there were about fifty breakout situations while he was clerking for Volpe. Volpe Tr. 389. Nonetheless, he recalled the SWAT team taking over trading in Disney only about five times. Volpe Tr. 626. Volpe did not quantify the SWAT team's incursions, but described them as "quite often." Tr. 7939.

advantaged, and 1.01% were break-even; of the trading ahead exceptions, 62.65% were customer disadvantaged, 2.24% customer advantaged, and 35.11% break-even. Div. Exs. 198-A, 198-B.

Factors impacting on the reliability of the testimony of clerk witnesses were described above. However, the fact that Volpe's exceptions declined markedly after he became aware of the NYSE investigation corroborates the testimony of former clerks that he did, in fact, trade improperly prior to that time. Additionally, as with other Respondents, the lopsided proportion of customer disadvantaged exceptions to customer advantaged exceptions also bolsters the finding that he traded improperly.

Using the Division's exception figures as a starting point, after removing March and April 2003 exceptions, a substantial haircut would be necessary to take account of VDM's lack of attendance and assignment records, the SWAT team's trading in Volpe's panel, and Volpe's absences from his panel on floor captain and floor official duties. However, it is unnecessary to apply the haircut to ascertain gains Volpe received from the trading at issue. The sum that Volpe paid toward VDM's settlement, $540,012,[75] far exceeds the approximately $82,500 that the Division calculates as Volpe's gains.

2. Scavone

Scavone traded Lilly from August 2001 throughout the relevant period. Tr. 7708 (S-11). Scavone's clerks were Gatsonis,[76] during 2002, followed by Corcoran as of January 2003.[77] Tr. 7708-09 (S-11); Scavone Tr. 458, 755. Napoli was Scavone's full-time front-line clerk at SMC until it was taken over by VDM in August 2001. Tr. 8061. At VDM he filled in as a relief clerk almost daily when Scavone's clerk was on breaks.[78] Tr. 8064-65, 8068.

Generally Scavone concentrated on the crowd, while the clerk concentrated on the DB. Scavone Tr. 386. The crowd in Lilly numbered one to three in 2002. Scavone Tr. 308, 334.

[75] Approximately 60% of VDM's settlement amount, which included all of Volpe's exceptions, was disgorgement. According to the Division's calculations, Volpe received gains of about 7% of the profits generated by the questioned trades. In funding VDM's settlement with the Commission, Volpe paid far more than the Division calculated that he benefited from the trading at issue. This results primarily from the fact that VDM disgorged the entire amount of its profits from the violative trades identified in Van der Moolen Specialists USA, LLC, infra, while the profits ascribed to the individual traders were derived as a small percentage of those same profits.

[76] Gatsonis started as a backup clerk in February 1998, progressed to front-line clerk, and became a specialist in August 2005; he was a VDM specialist at the time of Scavone's trial in 2006. Scavone Tr. 279-81.

[77] There is no evidence in the record from Corcoran regarding Scavone's trading.

[78] Napoli started at SMC in 1995; he continued as a clerk until he left VDM in 2006. Tr. 8059-60.

When at his panel, Scavone stood in front of the post about two or three feet from the DB screen; at times his attention was wholly focused on floor brokers in the crowd; at times he turned and looked at the DB screen or other screens that displayed market data. Scavone Tr. 305, 332-34, 386-88, 426-27, 433-34, 438, 756-58. Even if he were seen looking at the DB screen, it would not be possible to tell which window that was currently displayed had his attention. Scavone Tr. 438-39. Concerning monitoring his position, specialists cared about the value of their positions at the end of the day, not intraday. Scavone Tr. 498-99. They liked to end as flat as possible at the end of the day. Scavone Tr. 456-57.

Scavone recognized that the alleged interpositioning and trading ahead conduct was improper and well-known to be a violation of the negative obligation. Scavone Tr. 756, 762, 765-67. At the time of the NYSE investigation, Scavone expressed disbelief and frustration when advised that interpositioning and trading ahead transactions had occurred at his panel. Scavone Tr. 807, 812, 817. Napoli testified that Scavone never instructed him to trade ahead or interposition at SMC or at VDM. Tr. 8062-65.

Gatsonis testified that Scavone instructed him to trade improperly. Scavone Tr. 284, 336-37. Generally, Gatsonis testified, Scavone executed the improper trades when they appeared simultaneously or in sequence, that is trading first with the order that arrived first and second with the order that arrived second. Scavone Tr. 339-43. At the time, Gatsonis did not consider that improper, but sometimes Scavone traded with orders out of time sequence, which Gatsonis attempted, unsuccessfully, to challenge. Scavone Tr. 343-45. Scavone also paired off DOTS regularly. Scavone Tr. 335-36. In fact, Gatsonis estimated that Scavone traded properly 95% to 98% of the time. Scavone Tr. 376. Gatsonis testified that Scavone never explicitly instructed him "let's cheat the DOTs," or words to that effect, but rather instructed Gatsonis with conventional phrases, such as "you sold, you bought" to indicate that the principal account sold or bought. Scavone Tr. 479-81.

Scavone was relieved by the SWAT team, as was every other VDM specialist, on occasion; this occurred during breakout situations.[79] Tr. 7824-25 (S-20), 7933-34, 8131-32; Resp. Exs. 751, 786. In these situations the SWAT team's trading included trading ahead and interpositioning. Tr. 7824-25 (S-20); Resp. Ex. 751. Scavone was a floor captain for VDM. Tr. 7909-10, 8132-33; Scavone Tr. 754. When he was called upon, these duties took him away from his panel anywhere from five minutes to two hours. Tr. 8133. Scavone took two breaks a day of ten to twenty-five minutes and would remain at his panel during busy parts of the day, at the opening, from 9:30 to 10:30 a.m., and close, from 3:00 to 4:00 p.m. Scavone Tr. 347-48. Scavone had many friends and relatives on the floor and visited with them from time to time. Scavone Tr. 426-27. When present on the floor, Scavone was at his panel 70% to 90% of the trading day, Gatsonis estimated. Scavone Tr. 348.

Scavone learned of the NYSE investigation into improper trading in early 2003. Scavone Tr. 762-63. He recalls receiving a letter requiring him to appear and testify before the NYSE

[79] Gatsonis testified that breakout situations in Lilly occurred at least six times a year. Scavone Tr. 290.

Division of Market Surveillance in March 2003. Scavone Tr. 762-63. This is consistent with Fagenson's testimony that he received a letter from the NYSE in January 2003 requesting extensive information about certain stocks that VDM traded, that he did not know the nature of the problem at that time, but that he spoke with the specialists and clerks who traded the stocks at issue, and that in the following months up to April 2003, he learned more specifics and conveyed the information to the specialists and clerks. Scavone Tr. 804-12; Volpe Tr. 1064-67, 1071-74. Scavone's exceptions declined markedly after he became aware of the NYSE investigation. Div. Ex. 197A, 197B.

Bajaj testified on behalf of Scavone, performing the same analysis he performed on the computer data in Phase I and thus, that discussion and corresponding conclusions are incorporated by reference herein. Bajaj's analysis with respect to Scavone was tailored to Scavone's trading only and similar to that analysis done for the other Respondents for whom he testified in Phase II; such discussions are incorporated by reference herein. Tr. 8249; Resp. Ex. 789. Bajaj reached similar conclusions as well. Tr. 8249; Resp. Ex. 789.

The Division ascribes 3,616 interpositioning exceptions and 5,485 trading ahead exceptions to Scavone from August 2001 through June 2003. Div. Exs. 197-A, 197-B. Of the interpositioning exceptions, 97.54% were customer disadvantaged, 0.14% were customer advantaged, and 2.32% were break-even, and of the trading ahead exceptions 80.44% were customer disadvantaged, 3.81% were customer advantaged, 15.75% were break-even. Div. Exs. 197-A, 197-B.

Factors impacting on the reliability of the testimony of Gatsonis were described above, including his testimony that he would lie under oath to protect his job when he was still employed at VDM. While Napoli, who testified that Scavone did not trade improperly was Scavone's full-time clerk at SMC, he clerked for brief periods for Scavone as a relief clerk during the relevant period at VDM. However, the fact that Scavone's exceptions declined markedly after he became aware of the NYSE investigation corroborates the testimony of Gatsonis that he did, in fact, trade improperly prior to that time. Additionally, as with other Respondents, the lopsided proportion of customer disadvantaged exceptions to customer advantaged exceptions also bolsters the finding that he traded improperly.

Using the Division's exception figures as a starting point, a substantial haircut would be necessary to take account of VDM's lack of attendance and assignment records, a certain amount of trading by the SWAT team in Scavone's panel, and Scavone's absences from his panel on floor captain duties. However, it is unnecessary to apply the haircut to ascertain gains received from the trading at issue. The sum that Scavone paid toward VDM's settlement, $371,024,[80] far exceeds the approximately $28,500 that the Division calculates as Scavone's gains.

[80] Approximately 60% of VDM's settlement amount, which included all of Scavone's exceptions, was disgorgement. According to the Division's calculations, Scavone received gains of about 5% of the profits generated by the questioned trades. As with Volpe, in funding VDM's settlement with the Commission, Scavone paid far more than the Division calculated that he benefited from the trading at issue.

G. Bear Wagner

Frank A. Delaney, IV, was associated with Bear Wagner Specialists LLC (Bear Wagner).[81] He became a specialist in 1989 and joined a predecessor of Bear Wagner in 2000. Tr. 3823-25, 3872-78. He became a partner in Bear Wagner in June 2000. Tr. 3841. John Mulheren, Jr. (Mulheren), was the CEO of Bear Wagner; below him in the chain of command were Jay Mahoney (Mahoney) and Peter Murphy, who ran the floor, and below them were Delaney and two other super captains. Tr. 3879-80. Delaney's career ended on April 12, 2005, when he was indicted based on the conduct at issue in this proceeding,[82] and he has not worked since, except for trading his own account. Tr. 3930-31. He has been personally and financially devastated. Tr. 3938.

Delaney's compensation, including bonus and share of profit, was over $2 million each year in 2002 and 2003. Tr. 3841-42. In 2002, his compensation was salary of $250,000, partnership distribution of $950,000, and bonus of $1.9 million (paid in March 2003). Div. Ex. BW-1 at 190-91. In 2001, his salary was $250,000 and the rest of the compensation was about $4 million; likewise, the bonus was actually paid in the following year, 2002. Div. Ex. BW-1 at 191. Profitability was one of many factors taken into account for specialists' bonuses, but not at a fixed percentage, as every specialist's situation was different. Resp. Ex. 232 at 38-41. Mulheren, who determined specialists' bonuses, tried to pay out as little as possible.[83] Ex. 232 at 38-42.

Bear Wagner settled charges arising out of the trading of Delaney and other Bear Wagner specialists by, in addition to agreeing to various undertakings, paying $16,259,446 (consisting of disgorgement of $10,724,903 and a civil money penalty of $5,534,543). Bear Wagner Specialists LLC, 82 SEC Docket 2052 (Mar. 30, 2004). Delaney contributed, unwillingly, to these sums; he does not know the amount of his contribution, which was taken out of his capital account. Tr. 3870-71. He did not agree to the settlement. Tr. 3870. The $10,724,903 in disgorgement in the Bear Wagner settlement was calculated using all of the allegedly violative trades attributed to Delaney in this proceeding. Tr. 4613 (S-5).

Delaney never used the DB keyboard and did not know how to operate it. Tr. 3840-41, 3877, 3909. Thus, all of his trades were entered by clerks. Delaney guardedly conceded that a specialist was responsible for trades entered by clerks, absent errors or misunderstandings. Tr.

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[81] Bear Wagner was acquired by JPMorgan following the collapse of Bear Stearns. Currently, JPMorgan has agreed to sell the business to Barclays Capital, which will merge its operation with its own NYSE market-making business. See *Bear Wagner is Sold*, WALL ST. J., Mar. 10, 2009, at C4.

[82] Subsequently, on review of the evidence in the case and information pertaining to Delaney subsequent to the filing of the indictment, the Government concluded that further prosecution of Delaney would not be in the interests of justice, and an order of Nolle Prosequi was entered on November 21, 2006. United States v. Delaney, No. 1:05-cr-00394-HB (S.D.N.Y. Nov. 21, 2006).

[83] Mulheren was a tough and intimidating executive. Tr. 4566.

3834, 3934-35. Errors did occur. Tr. 3990, 8361. Delaney's clerks from whom evidence was received were Division witnesses Jennifer Trentacosta Maher (Maher) (January to May 2002, Tr. 3939-4013) and David Carroll (Carroll) (May to December 2002, Tr. 4335-4412) and Delaney witness Brent Mekosh (Mekosh) (June to November 2001, Tr. 8349-99). Additionally, Jason Dowd (Dowd), a former clerk of another Bear Wagner specialist, Kevin Fee, who was called by then-Respondent Fee, testified tangentially as to Delaney. Tr. 4471-73.

Division witnesses Maher and Carroll testified pursuant to non-prosecution agreements with the U.S. Attorney's Office. Tr. 3940-41, 4338. In January 2003 each was interviewed by Bear Wagner management, which was conducting an internal investigation. Tr. 3942-43, 4354-59. Maher told them that she had not seen any improper trading, and testified consistently before the NYSE later in 2003. Tr. 3943-45, 3976-80. At the hearing, she characterized her 2003 statement and testimony as untruthful, stating that she was afraid of losing her job at the time. Tr. 3943-45, 3977. In July 2004, however, she left the NYSE and the securities industry. Tr. 3941-42. Then, in 2005, she went to a proffer session with the U.S. Attorney's Office, stated that in fact she had seen interpositioning and trading ahead, and was given a non-prosecution agreement. Tr. 3945-46, 3970-71. This was the first time she had her own defense lawyer. Tr. 3981. When she testified before the NYSE, she was represented by Bear Wagner's lawyer. Tr. 3985. She testified at the hearing that she finally told the truth then because she no longer feared for her job. Tr. 3981-82. When interviewed by Bear Wagner management in January 2003, Carroll was shown screenshots of improper transactions in Merrill Lynch; he said that Delaney had instructed him to trade that way. Tr. 4358-60. Management advised him that Delaney had no recollection of that and, shortly thereafter, removed him from the floor and assigned him to work in "upstairs trading."[84] Tr. 4337-38, 4358, 4360, 4363-64. Later in 2003 he testified before the NYSE consistently with the statements he gave Bear Wagner management. Tr. 4409. He gave a consistent statement to the U.S. Attorney's Office, was given a non-prosecution agreement, and testified before the grand jury. Tr. 4409-10. Both Maher and Carroll acknowledged that they could be prosecuted if they did not testify consistently with what they had told the U.S. Attorney's Office. Tr. 3983, 4410.

Delaney witness Mekosh was interviewed by Bear Wagner management and the NYSE and on each occasion stated that Delaney did not trade ahead of DOT orders. Tr. 8367-70, 8377. Eventually he was interviewed by the U.S. Attorney's Office and showed MARS reports and screenshots which he was told represented Delaney's trades; he said the trades were improper. Tr. 8367-70. Mekosh testified that any statement he made to the U.S. Attorney's Office that Delaney's trading was improper was based on the documentation he was shown and, outside of the MARS reports and screenshots he was shown, he had no basis to state that Delaney traded improperly. Tr. 8371-78, 8383. Contrary to the Division's argument, there is no evidence in the

[84] Unlike Maher and Mekosh, whom Delaney had recommended highly, Carroll did not become a specialist after leaving Delaney's panel. Tr. 3921-23, 4395-97. Carroll was disappointed. Tr. 3924, 4398. Delaney suggests that Carroll's testimony was biased because he blamed Delaney for his failure to become a specialist. Carroll, however, blamed the investigation, not Delaney. Tr. 4398-99. Additionally, Carroll's statements and testimony are consistent with concerns that he expressed to Delaney in 2002 while he was still clerking for him. Tr. 4352-53, 4412, 4471-72.

record that he told the U.S. Attorney's Office that he had any doubts about Delaney's trading when he was clerking for him or otherwise outside of the documents he was shown. Tr. 8375-99.

During the relevant period Delaney traded Bank One Corp. (Bank One) from approximately November 2000 to May 2001 and Merrill Lynch & Co. Inc. (Merrill Lynch) from approximately June 2001 to June 2003. Tr. 3825-27. At the same time that he traded Merrill Lynch, he traded ACS and had two trading assistants, one for each stock, each with his own DB. Tr. 3880-81.

Generally Delaney concentrated on the crowd, while the clerk concentrated on the DB. Usually there was a crowd in Merrill Lynch, and sometimes in ACS, too. Tr. 3839, 3886-87. The crowds in Merrill Lynch were especially large in the months following September 11, 2001. Tr. 8353-54, 8358. At times, trading was so busy that Delaney called for a second specialist; he ran the crowd or crowds while the second specialist ran the DB. Tr. 3887-91, 8354, 8359. When at his panel, Delaney stood in front of the post about two or three feet from the post and the DB screen; at times his attention was wholly focused on floor brokers in the crowd; at times he turned and looked at the DB screen or other screens that displayed market data. Tr. 3835-40, 3843, 3908, 3947, 3994, 4346. Delaney did not look at the DB all the time, and when he did, he looked at the orders displayed in the 8 price window on the left of the screen, not the Smart Report template where the clerk reported executions, on the right. Tr. 3908-10, 3917, 8355. Delaney had available a video display of Bear Wagner's "Position Management" database, which enabled him to track the inventory in the firm's principal account, in over 300 stocks, and all the use of its capital for every individual stock, what each panel was doing individually, and the overall P&L of the firm. Tr. 3836, 3838. He did not notice small changes in his positions in his own stock, Merrill Lynch, such as 200 to 1,500 shares, as his trading strategy involved taking positions of 15,000 to a million shares. Tr. 3884, 3911.

Delaney recognized that the alleged interpositioning and trading ahead conduct was improper. Tr. 3827-33. He suggested that interpositioning and trading ahead transactions that occurred while he was at his panel were either errors or the result of miscommunications. He denied trading ahead or interpositioning or instructing clerks to do so. Tr. 3833, 3867, 3912, 3927, 3932. Mekosh[85] clerked for Delaney from June to November 2001. Tr. 8352. To his knowledge, Delaney did not intentionally trade ahead of DOT orders; it was Delaney's practice to pair off pairable DOT orders coming out of a freeze. Tr. 8364. If Delaney instructed him to trade for the principal account, and he knew there were DOT orders entitled to execution, he would inform Delaney. Tr. 8366.

Witnesses called by the Division who clerked for Delaney testified that he did instruct them to trade improperly. Maher[86] clerked for Delaney from January to May 2002. Tr. 3941.

[85] Mekosh started as a backup clerk in 1996, became a front-line clerk in 1998, and was a specialist with Bear Wagner from November 2001 to February 2006. Tr. 8349-53.

[86] Maher started as a backup clerk in 1996, became a front-line clerk in 1999, and was a specialist from May 2002 to July 2004, when she left Bear Wagner and the securities industry. Tr. 3939-42.

She testified that he instructed her to trade ahead of pairable DOT orders daily. Tr. 3951-62. She understood that he was looking at the DB screen and knew the orders were pairable when he made comments such as "screw the DOTs." Tr. 3957-59. All the specialists with whom she worked said "screw the DOTs." Tr. 4000. At one time, before the NYSE investigation, specialists routinely traded with pairable DOT orders according to the time sequence in which they appeared on the DB. Tr. 3975, 3987, 3990, 4006-07. Delaney also paired off DOTs. Tr. 3963-64. When he intended to trade ahead for the principal account he would instruct her "you" bought or sold. Tr. 3964-65, 3994, 3999-4000, 4004-06. On one occasion when she argued with him over an improper trade, he responded that he was not concerned about the NYSE Division of Market Surveillance. Tr. 3960-61. However, she also testified that she did not consider trading ahead of DOT orders in time sequence to be improper until she became aware of the NYSE investigation. Tr. 4006-08. She explained this apparent inconsistency by testifying that Delaney also traded ahead out of time sequence and that other specialists did not. Tr. 4008.

David Carroll[87] clerked for Delaney from May to December 2002. Tr. 4337. He testified that Delaney instructed him to trade ahead of pairable orders; he assumed that Delaney knew they were pairable. Tr. 4341-50, 4365-84; Div. Ex. 130-H. When Delaney intended to trade ahead of DOT orders, he would instruct him "you" bought or sold. Tr. 4349. There were rumors during the summer or fall of 2002 of an investigation into trading ahead of DOT orders. Tr. 4350-51. Then, sometime in the fall, Bear Wagner manager Jay Mahoney called a meeting of the clerks and told them that they must pair off pairable DOT orders and should report anyone who tells them to do otherwise to management. Tr. 4351-52. Shortly thereafter, Carroll approached Delaney and told him that everyone was talking about trading ahead of DOT orders, that they had been doing it and had to stop doing it. Tr. 4352. Delaney's response was that Carroll should not worry, Delaney had been doing it for years. Tr. 4352-53. Carroll discussed his concerns about Delaney's trading with other clerks, including Dowd. Tr. 4361-63, 4471-72.

When Delaney told his clerk that "you" bought or sold, "you" could indicate the book as well as principal participation. Tr. 3906, 4004-05, 8365-66. The clerk would understand through instinct, experience, and context whether he meant the principal account or DOT orders (or both) each time he said "you." Tr. 3934, 3964-65, 3999-4000, 4005-06.

The volume of orders was so great that it was not possible for Delaney to cross every trade. Tr. 8360-61. Delaney did not cross orders that were small or if a trade between two like orders was obvious; he would merely say a number of shares trades at a price or say "pair them off." Tr. 3963-64, 4349. Delaney usually crossed DOT orders that could be paired off if there was a crowd present. Tr. 3964, 4349. He did not cross them when there was no crowd present. Tr. 4348; Div. Ex. BW-1 at 58.

As a super captain, Delaney was in charge of the firm's trading on the floor and would troubleshoot when a specialist was going to commit a large amount of capital, in a breakout

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[87] Carroll started as a backup clerk in 1996 and became a front-line clerk in 1997. Tr. 4336-37. At the time of the hearing he was working for Bear Wagner's parent, Bear Stearns. Tr. 4338.

situation, when a stock became volatile, or when a specialist was losing a great deal of money. Tr. 3883, 3913-14; Div. Ex. BW-1 at 92-93. When such a situation arose, which was not uncommon, he would be paged and go to the post that was experiencing the problem. Tr. 3883, 3913-15. This responsibility had priority over trading his own panel. Tr. 3883. At such times, a relief specialist or the specialist at the adjacent panel would take over Delaney's panel. Tr. 3915, 8364; Div. Ex. BW-1 at 93. There were no records kept of these occurrences. Tr. 3899, 3917-18. Also, quite often, other specialists would come to him and ask for advice. Tr. 3916. He also took breaks three or four times a day for personal reasons or to discuss issues with other captains; a break might last up to an hour when he was trying to walk off back pain. Tr. 3917-18. All told, Delaney estimated he was away from his post 25% of the time. Div. Ex. BW-1 at 92-93. Maher estimated that he was at his panel 90% of the time normally, and 75% to 80% on days when a breakout situation occurred. Tr. 3948-49. However, she conceded that was just an estimate; it could have been 50%. Tr. 3999.

Delaney first learned of the NYSE investigation into improper trading in November 2002 when Mahoney advised him and other captains and super captains that the NYSE's then-CEO Dick Grasso (Grasso) had met with the heads of specialist firms and advised that there was improper trading of DOT orders and that this was to stop. Tr. 3853-63. In January 2003, Mulheren came to his home and informed him that there was a problem with improper trading of Merrill Lynch. Tr. 3858-59, 3928. Delaney testified, somewhat equivocally, that he did not have an understanding as to the nature of the improper trading of DOT orders until warned by Mulheren in January. Tr. 3854-63. He also testified that shortly after the November 2002 meeting with Mahoney he asked Carroll and another trading assistant, Gregory Shields, whether there was any problem with trading DOT orders but did not discuss the issue with any other specialists. Tr. 3862-63. The claimed lack of curiosity about the nature of the DOT problem is not completely consistent with Delaney's position as a super captain, whose duties included helping less experienced or overwhelmed specialists trade. Delaney testified that, three days a week, he and the other super captains had a morning meeting with the firm specialists at which topics for discussion included "any kind of compliance issues that were relevant at the time." Tr. 3896. The claim that he did not discuss with other specialists a compliance issue that Grasso and Bear Wagner management considered important is not entirely consistent with that testimony. It is found that Delaney became aware in November 2002 that Grasso and the NYSE were concerned about specialists' stepping ahead of DOT orders. Delaney's interpositioning and trading ahead exceptions declined substantially after November 2002. Tr. 3865-67; Div. Exs. 231-A, 231-B.

The Division ascribes 2,081 interpositioning exceptions and 2,484 trading ahead exceptions to Delaney from November 2000 through June 2003. Div. Exs. 231-A, 231-B. Of the interpositioning exceptions, 90.82% were customer disadvantaged, 0.62% were customer advantaged, and 8.55% were break-even, and of the trading ahead exceptions, 56.04% were customer disadvantaged, 4.43% were customer advantaged, and 39.53% were break-even. Div. Exs. 231-A, 231-B.

Mark Ready, Ph.D. (Ready) testified for Delaney. He was accepted as an expert in finance, including the specialist function at the NYSE. Tr. 8413-15. Ready is a professor at the

University of Wisconsin, having previously served as Chief Economist for the Commission. Tr. 8405-06; Resp. Ex. 246, Ex.1.

Ready testified that almost half of the charged trading ahead exceptions could have been explained as oral consummation preceding the disadvantaged order's DBTime. Tr. 8442; Resp. Ex. 247, Exs. E, F. He further testified that Delaney lost more money with the exceptions than otherwise. Tr. 8448; Resp. Ex. 247, Ex. H. However, Ready's calculations failed to account for filtering, ensuring each exception disadvantages only one customer order, and failed to remove orders ineligible to be exceptions thus generating artificially low conclusions. Tr. 8418, 8452-55, 8458-60.

Factors impacting on the reliability of the testimony of Maher and Carroll were described above.[88] However, the fact that Delaney's exceptions declined markedly after he became aware of the NYSE investigation corroborates the testimony of Maher and Carroll that he did, in fact, trade improperly prior to that time. Additionally, as with other Respondents, the lopsided proportion of customer disadvantaged exceptions to customer advantaged exceptions also bolsters the finding that he traded improperly.

Using the Division's exception figures as a starting point, a 25% haircut will be applied to take account of Delaney's absences from his panel on super captain duties and for other reasons as found above. The 25% figure is consistent with Delaney's own estimate of his absence from his panel.

The amount of his firm's profits from Delaney's trading at issue during the period from November 2000 to June 2003 as identified by the Division is $551,179 - $168,715 from interpositioning and $382,464 from trading ahead. Div. Ex. 224-A. Applying the 2.05% haircut to compensate for timestamp anomalies reduces the firm's trading ahead profits to $374,624 - $12,869 in 2000, $151,259 in 2001, $208,540 in 2002, and $1,956 in 2003.

Using the Division's reasoning, set forth in Div. Ex. 202, the amount of bonus payments Delaney received for July 1999 through December 2000, 2001, 2002, and 2003, as a result of his trading at issue is $70,706. To estimate his gains related to that trading, the Division calculates it as the amount that it assumes Delaney's bonus was increased as a result of his violative trading by calculating the percentage relationship of the bonus to his trading profits. For example, in 2001, Delaney's bonus of $2,662,229 was approximately 14% of his trading profits of $18,998,261. Div. Ex. 202. Therefore, using the Division's reasoning, Delaney's gains of approximately 14% profit from his trading at issue, which totaled $250,307 in 2001, were $35,043. Div. Ex. 202. For July 1999 through December 2000, the corresponding numbers are 20.23% of $13,624 in firm profits from his trading at issue, or $2,756; for 2002, 11.37% of $277,433, or $31,544; and for

[88] Carroll's statements, however, have been consistent from the first time he was interviewed by Bear Wagner management to his testimony in this proceeding, and his version of events is corroborated by the testimony of Dowd that Carroll had expressed concern to him about Delaney's trading during the time at issue.

2003, 16.42% of $1,973, or $324. Applying a 25% haircut to the total of $69,667, it is found that Delaney's proven gains from the trading at issue were $52,250.

III. CONCLUSIONS OF LAW

The OIP charges that Respondents, through their interpositioning and trading ahead, violated the antifraud provisions of the Securities and Exchange Acts, NYSE Rules pertaining to the "negative obligation" and other trading issues, and Exchange Act Section 11(b) and Rule 11b-1, pertaining to the NYSE's and Commission's regulation of specialists. In this section it is concluded that each Respondent violated NYSE Rules 92, 104, and 401. It is further concluded that all other violations charged in the OIP are unproven.[89]

A. Antifraud Provisions

Respondents are charged with violating antifraud provisions of the Securities and Exchange Acts – Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 – which prohibit essentially the same type of conduct. United States v. Naftalin, 441 U.S. 768, 773 n.4 & 778 (1979); SEC v. Pimco Advisors Fund Mgmt. LLC, 341 F. Supp. 2d 454, 469 (S.D.N.Y. 2004). The Division argues that the record shows that Respondents violated these provisions. However, despite the Division's eloquence, the antifraud charges must be dismissed, in light of United States v. Finnerty, 533 F.3d 143 (2d Cir. 2008). See also United States v. Hayward, 284 Fed. Appx. 857 (2d Cir. 2008).[90]

B. Exchange Act Section 11(b) and Rule 11b-1 thereunder; NYSE Rules

The concept of securities industry self-regulation, with Commission oversight, is well-known.[91] In the case of regulation of specialists, the Commission is authorized by Exchange Act Section 11(b) to provide direct regulation, if it chooses, but it has chosen, by Exchange Act Rule 11b-1 to defer regulation in the first instance, to the NYSE – Rule 11b-1(a) as to formulation of NYSE Rules, and Rule 11b-1(b) as to enforcement of the negative obligation of NYSE Rule 104.[92] Exchange Act Section 11(b) provides, "When not in contravention of [Commission rules

[89] In light of the conclusions herein, all motions for summary disposition are denied as moot.

[90] Even if the defendant knew he had violated a NYSE rule and tried to cover it up, violation of an NYSE rule does not establish securities fraud, even in the civil context. Finnerty, 533 F.3d at 151; accord, Hayward, 284 Fed. Appx. at 857.

[91] The legislative history of the 1975 amendments to the securities statutes, P.L. 94-29, discusses such self-regulation as it applies to specialists, indicating that Congress intended that exchanges have the primary responsibility for the formulation and enforcement of the regulation of specialists. See S. REP. NO. 94-75, at 14-15, 22-23, 34-35, 100, 133-34 (1975), reprinted in 1975 U.S.C.C.A.N. 179, 192-94, 200-02, 212-13, 278-79, 310-11.

[92] The regulatory regime for specialists embodied in Rule 11b-1 and exchange rules, under which the exchanges have maximum self-regulatory responsibility under Commission oversight, was the

and regulations], the rules of a national securities exchange may permit . . . (2) a member to be registered as a specialist [who] may be permitted to act as a broker and dealer." Rule 11b-1(a) requires an exchange to require "as a condition of a specialist's registration, that a specialist engage in a course of dealings for his own account to assist in the maintenance, so far as practicable, of a fair and orderly market" and to have "[p]rovisions restricting [a specialist's] dealings so far as practicable to those reasonably necessary to permit him to maintain a fair and orderly market." The NYSE requirements pursuant to Exchange Act Section 11(b) and Rule 11b-1(a) that are at issue in this proceeding are NYSE Rules 92, 104, and 123B. The OIP also charges that Respondents violated NYSE Rule 401, a generic rule requiring "good business practice" of all NYSE members. These NYSE Rules are set forth in Div. Ex. 5A (selections from NYSE Constitution and Rules, Sept. 1999 ed.), Div. Ex. 5B (selections from NYSE Constitution and Rules, Aug. 2003 ed.); and Resp. Exs. 612, 617, and 619.

NYSE Rule 104 sets forth the so-called "negative obligation" forbidding a specialist from trading for his account "unless such dealings are reasonably necessary to . . . maintain a fair and orderly market." NYSE Rule 92 forbids proprietary trades when a specialist has an agency order that could be executed at the same price. This proscription is the same both before and after the 2001 amendment of NYSE Rule 92.[93] The provisions of NYSE Rule 123B concern DOT orders

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product of negotiations between the Commission and the NYSE and American Stock Exchange (Amex), in consideration of the recommendations of the Special Study (REPORT OF THE SPECIAL STUDY OF SECURITIES MARKETS OF THE SECURITIES AND EXCHANGE COMMISSION, PT. 2, 88th Cong., 167-71 (1963)). Regulation of Specialists, 29 Fed. Reg. 15862, 15863 (Nov. 26, 1964); Securities Specialists, Notice of Proposed Rule Making (NPRM), 29 Fed. Reg. 13777, 13779 & n.2 (Oct. 6, 1964); JOEL SELIGMAN, THE TRANSFORMATION OF WALL STREET: A HISTORY OF THE SECURITIES AND EXCHANGE COMMISSION AND MODERN CORPORATE FINANCE, 340-43 & n.140 (3d ed. 2003); *Securities Industry Study, Part 4: Hearings Before the Subcomm. on Securities of the Senate Comm. on Banking, Housing and Urban Affairs*, 92d Cong. 1-21, 47-49, 121-22 (1972); STAFF OF SUBCOMM. ON SECURITIES OF THE SENATE COMM. ON BANKING, HOUSING AND URBAN AFFAIRS, 93D CONG., SECURITIES INDUSTRY STUDY REPORT 201-04 (Comm. Print 1972). The Commission could exercise its residual power of direct regulation pursuant to Section 11(b), Regulation of Specialists, 29 Fed. Reg. at 15863; NPRM, 29 Fed. Reg. at 13779 & n.2, but has not done so. (The Commission adopted some technical, non-substantive changes – changing "stock" to "securities" and eliminating duplicative language – in 1981. Regulation of Specialists, 46 Fed. Reg. 15134 (Mar. 4, 1981)).

[93] The earlier version of NYSE Rule 92(a) forbids such trades while a specialist "personally holds or has knowledge that his member organization holds an unexecuted" market order or unexecuted limit order that could be executed at the same or better price. Div. Ex. 5A. The later version forbids such trades "if the person responsible for the entry of such order has knowledge of any particular unexecuted customer's order . . . which could be executed at the same price." Div. Ex. 5B. The Supplementary Material provides, at .10, "A member . . . shall be presumed to have knowledge of a particular customer order . . ." and, at .30, "a member organization's member on the Floor . . . may not execute a proprietary order at the same . . . or . . . better price, as an unexecuted customer order that he or she is representing." Div. Ex. 5B.

and, inter alia, require specialists to cross DOT orders. These NYSE Rules do not specify any particular level of intent that is an element of violating them. Respondents argue that proof of violation of NYSE Rule 92 requires "scienter" but use "scienter" interchangeably with "intentionally."

The Division requests sanctions pursuant to, inter alia, Sections 15(b) and 21B of the Exchange Act. The Commission must find willful violations of the securities laws or the Commission's Rules to impose sanctions under Sections 15(b) and 21B of the Exchange Act. A finding of willfulness does not require an intent to violate, but merely an intent to do the act which constitutes a violation. See Wonsover v. SEC, 205 F.3d 408, 413-15 (D.C. Cir. 2000); Steadman v. SEC, 603 F.2d 1126, 1135 (5th Cir. 1979); Arthur Lipper Corp. v. SEC, 547 F.2d 171, 180 (2d Cir. 1976); Tager v. SEC, 344 F.2d 5, 8 (2d Cir. 1965).

The Division argues that Respondents violated NYSE Rules 92, 104, 123B, and 401 and through those violations, Exchange Act Section 11(b) and Rule 11b-1, as well. Based on the facts found above, each Respondent violated NYSE Rules 92 and 104. By violating those Rules, each violated the "good business practice" prescription of NYSE Rule 401. While the evidence of record does not show that any individual exception, or each and every exception, alleged as a violation against each Respondent was itself a violation, the computer evidence together with the evidence of the clerks shows that each Respondent engaged in trading ahead and interpositioning in violation of those NYSE Rules. As found above, the record of evidence as to each Respondent shows that each one's acts that constituted his violations were clearly intentional. Thus, each violated these three NYSE Rules willfully. On the basis of the evidence of record, however, it cannot be concluded that Respondents failed to cross DOT orders, in violation of NYSE Rule 123B, in furtherance of their other Rule violations. Indeed, the record contains evidence of the use of oral crossing instructions to communicate violative executions.

Respondents have not, however, through their misconduct violated Exchange Act Section 11(b) or Rule 11b-1. Section 11(b) authorizes the Commission and national securities exchanges to regulate specialists in the public interest, to maintain fair and orderly markets, and to promote other lofty goals. However, as relevant here, Section 11(b) does not place any requirements directly on specialists, and thus cannot be violated by specialists.[94]

[94] Section 11(b) does place directly on specialists requirements that are not relevant to the issues in this proceeding:

> It shall be unlawful for a specialist or an official of the exchange to disclose information in regard to orders placed with such specialist which is not available to all members of the exchange, to any person other than an official of the exchange, a representative of the Commission, or a specialist who may be acting for such specialist: *Provided, however,* That the Commission, by rule, may require disclosure to all members of the exchange of all orders placed with specialists, under such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors. It shall also be unlawful for a specialist permitted to act as a broker and dealer to

Likewise, Exchange Act Rule 11b-1 (authorized pursuant to Exchange Act Sections 11(a), 11(b), and 23(a)) places requirements on exchanges in carrying out their regulation of specialists. It does not place any requirements directly on specialists and thus cannot be violated by specialists.[95] There is no litigated case that provides the interpretation of the plain language of Section 11(b) and Rule 11b-1 that the Division urges in arguing that Respondents' misconduct violated those provisions. As the Division points out, several settlements, including settlements in this proceeding, referenced at note 1, found that specialists violated Exchange Act Section 11(b) and Rule 11b-1.[96] However, it goes without saying, as the Commission has many times stressed, that settlements are not precedent. See Richard J. Puccio, 52 S.E.C. 1041, 1045 (1996) (citing David A. Gingras, 50 S.E.C. 1286, 1294 (1992), and cases cited therein); Robert F. Lynch, 46 S.E.C. 5, 10 n.17 (1975) (citing Samuel H. Sloan, 45 S.E.C. 734, 739 n.24 (1975); Haight & Co. Inc., 44 S.E.C. 481, 512-13 (1971), aff'd without opinion, (D.C. Cir. 1971); Security Planners Assocs., Inc., 44 S.E.C. 738, 743-44 (1971)); see also Michigan Dep't of Natural Res. v. FERC, 96 F.3d 1482, 1490 (D.C. Cir. 1996) and cases cited therein (settlements are not precedent). Like all such Commission settlement orders, the settlements in this proceeding contain a disclaimer to this effect, at note 1 of the settlement orders: "The findings herein are made pursuant to [Respondent's] Offer of Settlement and are not binding on any other person or entity in this or any other proceeding."

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effect on the exchange as broker any transaction except upon a market or limited price order.

[95] As noted above, the text of Rule 11b-1 was the product of negotiations between the Commission and the NYSE and Amex. The Commission's earliest, February 11, 1964, proposed draft furnished to the NYSE and Amex placed requirements, including the negative obligation, directly on specialists. The NYSE vehemently objected to this, and the offending language was replaced in the rule as proposed and adopted with language placing the responsibility on the exchanges for imposing requirements on specialists. *Securities Industry Study, Part 4: Hearings Before the Subcomm. on Securities of the Senate Comm. on Banking, Housing and Urban Affairs*, 92d Cong., 1-21, 47-49, 121-22 (1972); STAFF OF SUBCOMM. ON SECURITIES OF THE SENATE COMM. ON BANKING, HOUSING AND URBAN AFFAIRS, 93D CONG., SECURITIES INDUSTRY STUDY REPORT 201-04 (Comm. Print 1972).

[96] The earliest uncontested case that suggested that Section 11(b) could be violated by specialists was Re, Re & Sagarese, Exchange Act Release No. 6551 (May 4, 1961) (Order), 41 S.E.C. 230 (1962) (Findings and Opinion of the Commission). The respondents in that case had taken advantage of their position as specialists to rig the markets for securities in which they were effecting massive illegal distributions on the Amex, violating the antifraud, manipulation, and registration provisions of the securities laws. The Re case was symptomatic of the breakdown of self-regulation at the Amex that appeared in the 1950s and was followed by a house cleaning supervised by the Commission. JOEL SELIGMAN, THE TRANSFORMATION OF WALL STREET: A HISTORY OF THE SECURITIES AND EXCHANGE COMMISSION AND MODERN CORPORATE FINANCE, 285-89, 305-09 (3d ed. 2003).

IV. SANCTIONS

The Division seeks sanctions under Securities Act Section 8A and Exchange Act Section 21C, which authorize the Commission to impose a cease-and-desist order and order disgorgement against any person who "is violating, has violated, or is about to violate any provision of this title, or any rule or regulation thereunder"; Exchange Act Section 21B, which, as relevant here, in Section 21B(a)(1), authorizes civil money penalties against a Respondent who "has willfully violated any provision of the Securities [or Exchange Acts] or the rules or regulations thereunder"; and Exchange Act Sections 15(b)(4)(D) and 15(b)(6)(A)(i), which authorize so-called remedial relief, such as censure and suspension or bar from association with a broker or dealer against a Respondent who "has willfully violated any provision of the Securities [or Exchange Acts or] the rules or regulations under any of such statutes." Additionally, the Division argues that such remedial relief can be applied pursuant to Exchange Act Rule 11b-1.

For the reasons discussed below, each Respondent will be barred from association with a broker or dealer and the Division will be ordered to request the Commission to impose discipline pursuant to Exchange Act Rule 11b-1(b) on the six Respondents who have not been so disciplined.

A. Sanction Considerations

In determining sanctions, the Commission considers such factors as:

> the egregiousness of the defendant's actions, the isolated or recurrent nature of the infraction, the degree of scienter involved, the sincerity of the defendant's assurances against future violations, the defendant's recognition of the wrongful nature of his conduct, and the likelihood that the defendant's occupation will present opportunities for future violations.

Steadman v. SEC, 603 F.2d at 1140 (quoting SEC v. Blatt, 583 F.2d 1325, 1334 n.29 (5th Cir. 1978)). The Commission also considers the age of the violation and the degree of harm to investors and the marketplace resulting from the violation. Marshall E. Melton, 56 S.E.C. 695, 698 (2003). Additionally, the Commission considers the extent to which the sanction will have a deterrent effect. Schield Mgmt. Co., 87 SEC Docket 848, 862 & n.46 (Jan. 31, 2006). The Commission also considers the public-at-large, the welfare of investors as a class, and standards of conduct in the securities business generally. See Christopher A. Lowry, 55 S.E.C. 1133, 1145 (2002), aff'd, 340 F.3d 501 (8th Cir. 2003); Arthur Lipper Corp., 46 S.E.C. 78, 100 (1975). The amount of a sanction depends on the facts of each case and the value of the sanction in preventing a recurrence. See Berko v. SEC, 316 F.2d 137, 141 (2d Cir. 1963); see also Leo Glassman, 46 S.E.C. 209, 211-12 (1975).

In determining whether a cease-and-desist order is appropriate, the Commission considers the Steadman factors quoted above, as well as the recency of the violation, the degree of harm to investors, and the combination of sanctions against the respondent. See KPMG Peat Marwick LLP, 54 S.E.C. 1135, 1192 (2001). See also WHX Corp. v. SEC, 362 F.3d 854, 859-860 (D.C. Cir. 2004). Whether there is a reasonable likelihood of such violations in the future must be

considered. KPMG, 54 S.E.C. at 1185. Such a showing is "significantly less than that required for an injunction." Id., 54 S.E.C. at 1185-91.

B. Sanctions

1. Securities Act Section 8A and Exchange Act Sections 15(b), 21B, and 21C

Sanctions pursuant to Securities Act Section 8A or Exchange Act Section 21C are not available because no Respondent "is violating, has violated, or is about to violate any provision of [the Securities or Exchange Acts], or any rule or regulation thereunder." A NYSE Rule[97] is not a Commission "rule or regulation" under the Securities or Exchange Acts. The Exchange Act makes clear the distinction of "rules of an exchange" from such Commission rules. Unlike Securities Act Section 8A and Exchange Act Sections 15(b)(4), 15(b)(6), 21B, and 21C, some provisions reference "rules of an exchange" in addition to Commission rules and regulations. For example, Exchange Act Section 6(b)(6), which requires that the rules of an exchange provide discipline "for violation of the provisions of this title, the rules or regulations thereunder, or the rules of the exchange" and Exchange Act Section 6(d)(1)(B), which requires that a determination by the exchange to impose a disciplinary sanction be supported by a statement that includes "the specific provision of this title, the rules or regulations thereunder, or the rules of the exchange" violated. Likewise, Exchange Act Section 19(g)(1) requires a self-regulatory organization to comply with "the provisions of this title, the rules and regulations thereunder, and its own rules" and to enforce compliance with such provisions by its members and persons associated with its members. The Commission also recognizes the distinction. For example, Exchange Act Rule 19d-1(c)(1)(i), which distinguishes between "(A) The rules of such [self-regulatory] organization;" and "(B) The provisions of the Act or rules thereunder." Accordingly, it is concluded that action under Securities Act Section 8A and Exchange Act Section 21C is limited to those who violate the federal securities statutes and Commission rules thereunder.

Assuming, arguendo, that cease-and-desist orders were authorized for violations of NYSE Rules, they would not be appropriate for the Respondents in this proceeding because the likelihood of future violation is close to zero for each Respondent. Respondents Luckow and Parolisi have been permanently barred from the NYSE and from any association with an NYSE member. Thus, it is impossible for them to act in any capacity on the NYSE floor, let alone violate NYSE Rules pertaining to specialists. As to the other six Respondents (five of whom were fired by their then-employers), in light of the change in the nature of the specialist function, the surveillance techniques instituted by the NYSE, and, with the decline in employment on the NYSE floor, the unlikelihood of their regaining employment on the NYSE floor, as a practical matter, the likelihood of their future violation of NYSE Rules is nil. Assuming, arguendo, that disgorgement were authorized, the gains from violative conduct as to each Respondent as found in the Findings of Fact section are Donald R. Foley, II, - $331,232, Scott G. Hunt - $123,996, Frank A. Delaney, IV, - $52,250, James V. Parolisi - $29,634, Robert W. Luckow - $23,152, Robert A. Johnson, Jr., - $11,557, Richard P. Volpe - none, and Robert A. Scavone, Jr., - none.

[97] "Rules of an exchange" are defined in Exchange Act Section 3(a)(27).

For the reasons discussed above, sanctions for violations of NYSE rules are not available under Exchange Act Section 21B (civil money penalties against a Respondent who "has willfully violated any provision of the Securities [or Exchange Acts] or the rules or regulations thereunder") and Exchange Act Sections 15(b)(4)(D) and 15(b)(6)(A)(i) (remedial relief, such as censure and suspension or bar from association with a broker or dealer against a Respondent who "has willfully violated any provision of the Securities [or Exchange Acts or] the rules or regulations under any of such statutes").

2. Exchange Act Rule 11b-1 – Enforcement of the Negative Obligation

Rule 11b-1(b) sets forth the Commission's role in sanctioning a specialist who deviates from NYSE requirements pertaining to the negative obligation referenced in Exchange Act Rule 11b-1(a):

> If after appropriate notice and opportunity for hearing the Commission finds that . . . a specialist in specified securities has, for any account in which he, his member organization, or any participant therein has any beneficial interest, direct or indirect, effected transactions in such securities which were not part of a course of dealings reasonably necessary to permit such specialist to maintain a fair and orderly market . . . in the securities in which he is registered and were not effected in a manner consistent with the rules adopted by [his] exchange pursuant to paragraph (a)(2)(iii) of this section, the Commission may by order direct such exchange to cancel, or to suspend for such period as the Commission may determine, such specialist's registration in one or more of the securities in which such specialist is registered: *Provided, however,* If such exchange has itself suspended or cancelled such specialist's registration in one or more of the securities in which such specialist is registered, no further sanction shall be imposed pursuant to this paragraph (b) except in a case where the Commission finds substantial or continued misconduct by a specialist . . . .[98]

a. Cancellation of Registration

Respondents Luckow and Parolisi have been subjected to NYSE sanctions that exceed cancellation of the registration in the securities in which they had been registered. Their sanctions resulted from a refusal to provide testimony before the NYSE concerning the events at issue in this proceeding. Each received a censure and a permanent bar from membership, allied

[98] As noted above, the text of Rule 11b-1 was the product of negotiations between the Commission and the NYSE and Amex. This convoluted indirect procedure for Commission enforcement was at the insistence of the NYSE, which wanted no Commission involvement with its regulation of specialists. JOEL SELIGMAN, THE TRANSFORMATION OF WALL STREET: A HISTORY OF THE SECURITIES AND EXCHANGE COMMISSION AND MODERN CORPORATE FINANCE, 342 & n.140 (3d ed. 2003). Indeed, the negative obligation is the only area where the Commission has any authority at all in enforcing NYSE Rules pertaining to specialists.

membership, approved person status, and from employment or association in any capacity with any member or member organization. Even absent a specific cancellation of the registration of the securities in which he had been registered, it would not be possible for a former specialist subject to these bars to maintain the registration of the security in which he had been registered.

The evidence of record does not show that the NYSE has cancelled or suspended the registration of any of the other six Respondents. While Exchange Act Rule 11b-1 provides that the Commission may order the NYSE to do so, the NYSE is not a party to this proceeding. To amend the OIP to add the NYSE as a party is beyond the powers that the Commission has delegated to the administrative law judge. Since the Commission has not delegated its authority to authorize OIPs to administrative law judges, they do not have authority to initiate new charges or to expand the scope of matters set down for hearing beyond the framework of the original OIP. See J. Stephen Stout, 52 S.E.C. 1162 n.2 (1996) (citing Comment (d) to 17 C.F.R. § 201.200). Since it is beyond the power of the undersigned to order the NYSE to take action against the six Respondents, the undersigned will order the Division to take appropriate action leading to NYSE discipline of the six Respondents.

b. Further Sanction

According to the procedure prescribed in Rule 11b-1(b), the Commission may order the NYSE to cancel a specialist's registration for violation of the negative obligation, but "no further sanction shall be imposed pursuant to [Rule 11b-1(b)]" except for "substantial or continued misconduct."[99]

Rule 11b-1 contains no indication of what "further sanction" the Commission might impose for "substantial or continued misconduct." In adopting Rule 11b-1 the Commission described this portion of the Rule as establishing a procedure that "permits the Commission to institute proceedings, under certain circumstances, to require an exchange to cancel or suspend a specialist's registration" in his stock for violation of the negative obligation; no mention is made of the phrase "except in a case where the Commission finds substantial or continued misconduct by a specialist." Regulation of Specialists, 29 Fed. Reg. 15863; NPRM, 29 Fed. Reg. at 13777. Nor has there been any litigated case that explicates its meaning. However, it is concluded that Respondents' misconduct, ranging upward from eighteen months, in the case of Luckow, to more than four years, was "continued." Concerning the "further sanction," the Division argues that remedial relief like that available under Exchange Act Section 15(b) is available under Exchange

[99] The convoluted wording of Rule 11b-1(b) is susceptible of the interpretation that the Commission cannot impose a further sanction for substantial and continued misconduct until after the exchange has cancelled or suspended the specialist's registration. Such an interpretation, urged by Respondents, defies common sense as requiring the Commission to await NYSE action before initiating enforcement action against the more egregious violators. In light of the remedial purpose of the Exchange Act and Rules thereunder, the language of Rule 11b-1 should be construed "not technically and restrictively, but flexibly to effectuate its remedial purposes." SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 195 (1963).

Act Rule 11b-1. This argument is accepted. At the time Rule 11b-1 was adopted, such remedial relief was the sanction available in Commission administrative proceedings under the Exchange Act.[100] The Commission could have, but did not, specify a different type of sanction in Rule 11b-1.

Respondents' violations of the negative obligation embodied in NYSE Rule 104 were egregious. Not only was the negative obligation a key concept in circumscribing the role of NYSE specialists, but the violations of NYSE Rule 104 were aggravated by the nature of Respondents' misconduct: trading to the disadvantage of their customers' orders to profit their firms' accounts, in violation of NYSE Rule 92. The violations are neither recent nor distant in time. Consistent with a vigorous defense of the charges against him, no Respondent admitted wrongdoing or made assurances against future violations. Each Respondent's infraction was recurrent over a lengthy period ranging from eighteen months to more than four years.[101] The violations were willful. Each Respondent caused, at a minimum, many hundreds of thousands of dollars of harm to the marketplace. Additionally, the fact that the violations occurred at the NYSE, long regarded as the nation's premier trading venue, means that the welfare of investors nationwide was affected and reflects negatively on standards of conduct in the securities industry generally, necessitating a strong deterrent. While Respondents prided themselves on straight dealing with floor brokers, an element of dishonesty crept into their dealing with DOT orders, and the securities industry is "a field where opportunities for dishonesty recur constantly." Ahmed M. Soliman, 52 S.E.C. 227, 231 (1995). While no Respondent is likely to obtain future employment on the floor of the NYSE, each, by virtue of his age, education, and experience, could re-enter the securities industry and, absent a bar, return to association with a broker or dealer. See Thomas J. Donovan, 86 SEC Docket 2652, 2663 (Dec. 5, 2005).

[100] Cease-and-desist orders and civil money penalties pursuant to Securities Act Section 8A and Exchange Act Sections 21C and 21B could not have been contemplated by the Commission when it adopted Rule 11b-1 in 1964 (or in 1981, the last time it amended Rule 11b-1) as these sanctions did not become available until October 15, 1990, with the passage of the Securities Enforcement Remedies and Penny Stock Reform Act of 1990, 101 P.L. 429, 104 Stat. 931 (1990).

[101] While many Respondents' violative conduct began before April 12, 2000, outside the five-year statute of limitations applicable to the sanction of a bar from association with a broker or dealer, acts outside the statute of limitations may be considered to establish a Respondent's motive, intent, or knowledge in committing violations that are within the statute of limitations. Sharon M. Graham, 53 S.E.C. 1072, 1089 n.47 (1998) (citing Fed. R. Evid. 404(b) and Local Lodge No. 1424 v. NLRB, 362 U.S. 411 (1960)), aff'd, 222 F.3d 994 (D.C. Cir. 2000); Terry T. Steen, 53 S.E.C. 618, 623-24 (1998) (citing H.P. Lambert Co. v. Sec'y of the Treasury, 354 F.2d 819, 822 (1st Cir. 1965)). Further, such acts may be considered in determining the appropriate sanction if violations are proven. Steen, 53 S.E.C. at 623-25.

V. RECORD CERTIFICATION

Pursuant to Rule 351(b) of the Commission's Rules of Practice, 17 C.F.R. § 201.351(b), it is certified that the record includes the items set forth in the revised record index issued by the Secretary of the Commission on July 8, 2009.

VI. ORDER

Based on the findings and conclusions set forth above:

IT IS ORDERED that, pursuant to Section 11(b) of the Securities Exchange Act of 1934 and Rule 11b-1 thereunder, the Division of Enforcement request that the Commission order the NYSE to impose discipline pursuant to Exchange Act Rule 11b-1 on Donald R. Foley, II, Scott G. Hunt, Frank A. Delaney, IV, Robert A. Johnson, Jr., Richard P. Volpe, and Robert A. Scavone, Jr., unless the NYSE has done so on its own accord.

IT IS FURTHER ORDERED that, pursuant to Section 11(b) of the Securities Exchange Act of 1934 and Rule 11b-1 thereunder, Donald R. Foley, II, Scott G. Hunt, Frank A. Delaney, IV, James V. Parolisi, Robert W. Luckow, Robert A. Johnson, Jr., Richard P. Volpe, and Robert A. Scavone, Jr., are BARRED FROM ASSOCIATION WITH ANY BROKER OR DEALER.

IT IS FURTHER ORDERED that the allegations that Respondents violated Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder are dismissed.

This Initial Decision shall become effective in accordance with and subject to the provisions of Rule 360 of the Commission's Rules of Practice, 17 C.F.R. § 201.360. Pursuant to that Rule, a party may file a petition for review of this Initial Decision within twenty-one days after service of the Initial Decision. A party may also file a motion to correct a manifest error of fact within ten days of the Initial Decision, pursuant to Rule 111 of the Commission's Rules of Practice, 17 C.F.R. § 201.111. If a motion to correct a manifest error of fact is filed by a party, then that party shall have twenty-one days to file a petition for review from the date of the undersigned's order resolving such motion to correct a manifest error of fact. The Initial Decision will not become final until the Commission enters an order of finality. The Commission will enter an order of finality unless a party files a petition for review or a motion to correct a manifest error of fact or the Commission determines on its own initiative to review the Initial Decision as to a party. If any of these events occur, the Initial Decision shall not become final as to that party.

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Carol Fox Foelak
Administrative Law Judge