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UNITED STATES DISTRICT COURT
DISTRICT OF NEW JERSEY

SECURITIES AND EXCHANGE COMMISSION Plaintiff, v. JOSEPH W. LEIGHTON Defendant.	Civ. No. 05-2050 **COMPLAINT**

Plaintiff Securities and Exchange Commission (the "Commission") alleges as follows against the above-named defendant:

ADDRESSES OF PARTIES

1. The address of plaintiff Securities and Exchange Commission is 450 Fifth Street, N.W., Washington, D.C. The address of defendant Joseph W. Leighton is 128 Oxford Boulevard Garden City, NY 11530.

SUMMARY

2. This case arises from a fraudulent trading scheme carried out by defendant Leighton, the former leading institutional sales trader at Knight Securities, L.P. ("Knight" or the "Firm") and other former employees of Knight. From January 1999 through November 2000, Leighton engaged in a pattern of deceptive trading that defrauded Knight's institutional customers by filling (or "working") certain institutional orders in a manner that generated excessively high profits for the Firm in violation of Knight's duty to provide "best execution" for orders placed by its customers.

3. By engaging in this conduct, Leighton violated the antifraud provisions of the federal securities laws, specifically Section 17(a) of the Securities Act of 1933 (the "Securities Act") [15 U.S.C. § 77q(a)], Section 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act") [15 U.S.C. § 78j(b)], and Exchange Act Rule 10b-5 thereunder [17 C.F.R. § 240.10b-5].

4. Defendant Leighton may, unless restrained and enjoined, continue to engage in the acts, practices and courses of conduct of similar object and purport.

JURISDICTION

5. This Court has jurisdiction pursuant to Securities Act Sections 20 and 22 [15 U.S.C. §§ 77t and 77v] and Exchange Act Sections 21(d) and 27 [15 U.S.C. §§ 78u(d) and 78aa]. The defendant, directly or indirectly, used the means or instrumentalities of interstate commerce or the mails, or the facilities of a national securities exchange, in connection with the transactions, acts, practices, and courses of business described herein. Certain transactions, acts, practices and courses of business

occurred within this District, and venue is proper pursuant to Section 22 of the Securities Act and Section 27 of the Exchange Act.

DEFENDANT

6. Joseph W. Leighton, age 47, a resident of Garden City, N.Y., was an associated person with Knight between June of 1996 through November of 2000. Leighton worked as an institutional sales trader at Knight and was a Senior Vice President. At all relevant times, Leighton held a Series 7 general securities license as well as Series 24, 55 and 63 licenses.

KNIGHT

7. Knight, now known as Knight Equity Markets, L.P., is a registered broker-dealer headquartered in Jersey City, New Jersey. Knight is a subsidiary of Knight Trading Group, Inc., a Delaware corporation also headquartered in Jersey City, New Jersey. The common stock of Knight Trading Group, Inc. is registered with the Commission pursuant to Exchange Act Section 12(g) [15 U.S.C. § 78*l*] and trades on the Nasdaq National Market.

8. During the relevant time period, Knight was one of the largest Nasdaq market makers. As a Nasdaq market maker, Knight maintained a two-sided quotation in securities and provided liquidity and buys and sells on a principal basis by taking the counter-side of customers' orders.

FACTS

Knight and Its Institutional Sales Desk

9. During the relevant time period, institutional customers routed their orders to purchase or sell Nasdaq securities to Knight's Institutional Sales Desk for execution services.

10. Institutional sales traders employed by Knight were responsible for the relationship between Knight and its institutional customers. The institutional sales traders executed those institutional orders on Knight's behalf.

11. Defendant Leighton was employed by Knight as an institutional sales trader responsible for executing institutional orders. Leighton managed the vast majority of Knight's largest institutional accounts, handled approximately 50 percent of the trade volume on the institutional desk and generated the highest profits per share of any trader at Knight.

12. In 1999 and 2000, Leighton generated approximately $135 million in profits for Knight.

13. Nearly all institutional orders Leighton received during 1999 through 2000 were handled on a "not held" basis. In "not held" institutional orders, the institutional customer grants the broker dealer the discretion to work the order. Because "not held" orders are worked on a discretionary basis, the orders did not -- by their terms -- require execution at any specific time or price.

14. Once Knight's sales traders received "not held" orders from their institutional customers, the sales traders communicated those orders to the traders in Knight's market-making group. Knight's market-makers then proceeded to either fill

those orders with stock in Knight's own inventory accounts or acquire a position in the market (through other market-makers or Electronic Communications Networks).

15. Although Knight's market-makers were responsible for establishing the Firm's positions in the stock to fill an institutional order, Knight's institutional sales traders, including Leighton, were responsible for the execution of institutional customer transactions and had discretion as to when -- and at what price -- to execute the stock to the customer.

16. Knight's institutional sales traders were also responsible for reporting institutional customer transactions to the Automated Confirmation Transaction Service ("ACT"). ACT is the automated system owned and operated by The Nasdaq Stock Market, Inc. which, among other things, transmits reports of transactions to the National Trade Reporting System for dissemination to the public and the industry.

17. NASD rules require that member firms, including Knight, accurately report transactions to ACT within 90 seconds of execution. If a member firm fails to report the transaction within 90 seconds, the firm must use certain codes, called "ACT trade modifiers," in order to identify late trade reports and executions.

18. Knight generally traded with its institutional customers on a "net basis." A firm trades "net" with an institution when a firm accumulates a position at one price and executes the offsetting trade with an institutional customer at another price, so that the firm's compensation for trades are embedded in the price that institutional customers paid for trades.

19. Knight's institutional customers believed that in almost all instances the net prices they paid for trades with Knight were based upon Knight's cost in acquiring (or selling) shares pursuant to their orders, plus a reasonable amount of compensation.

20. In working institutional "not held" orders, Knight and defendant Leighton owed their institutional customers a duty to provide "best execution" -- that is, to fill customer orders on the most favorable terms reasonably available under the circumstances, including the best reasonably available price.

21. Accordingly, Knight's institutional customers expected Leighton to work their orders to obtain "best execution" on their behalf. Knight's institutional customers, however, could not see the size of Knight's position in the stocks that were the subject of their orders, the timing of Knight's positioning in the stocks and Knight's cost basis, all of which limited the customers' ability to ascertain execution quality.

Knight and Leighton Fail to Provide Best Execution to Institutional Customers

22. Leighton and others at Knight took advantage of the discretionary nature of the institutional customers' "not-held" orders and their inability to view the timing, size and cost of Knight's positions by engaging in a pattern of trading that embedded fraudulently excessive profits into institutional "not held" orders.

23. As a consequence, and as described in more detail below, Leighton's profits per share during the relevant time period were at times far in excess of the custom and standard in the industry.

24. By working "not held" orders in a deceptive manner designed to yield Leighton and Knight excessive profits at the expense of Knight's institutional customers,

Leighton failed to provide “best execution” for orders placed by the Firm’s institutional customers.

The Best Execution Fraud

25. After receipt of an institutional order, but prior to executing the order, Leighton had Knight’s market makers acquire long or short positions in the market pursuant to the customer’s order. For example, if an institutional customer wanted to purchase a security, the market-making desk would acquire a long position in the stock in anticipation of filling the customer order.

26. In numerous instances where the market was moving in a favorable direction in relation to the value of Knight’s position in the stock, Leighton executed relatively small portions of the position to the customer, while retaining the rest of the position.

27. In these instances, Leighton would then delay execution of the customer’s order to take advantage of the favorable intra-day price movement in the stock price. Leighton would ultimately fill the customer’s order -- although at prices substantially greater than Knight’s own cost for the stock. Leighton would thereby maximize the Firm’s profit at the expense of Knight’s institutional customers.

28. In numerous instances where the market was moving in an unfavorable direction in relation to the position that Knight had established to fill the customer order, Leighton reduced Knight’s position by executing its remaining positions in the order to the customer at prices at which Knight still generated a profit.

29. In numerous instances in which the market moved so unfavorably that the position Knight acquired to fill the order had declined in value, Leighton and others at

Knight improperly used trade modifiers to report the transaction to ACT. Leighton and others at Knight then manually entered a fabricated execution time for the transaction that indicated that the execution occurred earlier in the day -- a time when the trade would have been profitable to Knight.

30. In this manner, the misuse of ACT modifiers permitted Leighton and others at Knight to improperly input trades into Knight's trading system at prices that were different from the inside market at the time the trades were reported.

31. By effectively eliminating Knight's risk on these institutional "not held" orders -- but still reaping enormous profits by delaying execution until they were most profitable to Knight -- Leighton and others at Knight defrauded the Firm's institutional customers and violated the duty of "best execution" they owed them.

32. By working institutional "not held" orders in the manner described above, defendant Leighton and others at Knight deprived the Firm's institutional customers of "best execution" in connection with, at the very least, hundreds of institutional orders. Leighton's handling of the following three institutional orders illustrates the manner in which he defrauded Knight's institutional customers by improperly working both buy and sell orders to deny institutional customers "best execution."

Applied Micro Circuits Corporation - April 4, 2000 Buy Transaction

33. On April 4, 2000, Knight pocketed a profit of over $1.1 million -- or an average of $3.94 per share -- over a period of less than 90 minutes by executing a market not-held order on behalf of an institutional customer to purchase 290,000 shares of Applied Micro Circuits Corporation (AMCC:NASDAQ) that involved effectively no risk to Knight.

34. At approximately 12:49 p.m., Leighton received the first part of the market not-held order from the institutional customer with instructions to buy 250,000 shares of AMCC, which was later increased to an order to buy 500,000 shares, however Leighton only filled 290,000 of the 500,000 share order to buy AMCC. At the time Leighton received the first part of the order, Knight was short 1,239 shares of AMCC in its proprietary account.

35. Knight's market maker began purchasing shares of AMCC almost immediately upon receipt of the institutional order. Over the next 18 minutes, Knight acquired a long position of approximately 147,000 shares at an average cost of approximately $91.00 per share.

36. Rather than promptly selling the 147,000 shares to the institutional customer at Knight's own cost basis of $91.00 plus a reasonable amount of compensation, Leighton sold them to the institutional customer over a period of time at an approximate average price of $93.00 per share -- yielding Knight an average profit of approximately $2.00 per share.

37. Throughout the day, Knight continued to hold a significant position in the stock in anticipation of filling the institutional customer's order. However, instead of passing those shares on to the institutional customer to fill its order at or around the price Knight had acquired the shares, Leighton continued to sell portions of its AMCC position to the institutional customer at prices significantly higher than Knight's own costs.

38. In fact, at one point in working the order, Leighton sold shares to the institutional customer at a profit of over $8.00 per share. Leighton finally executed the last part of the order at 14:10:59. Knight's average profit per share for the institutional

customer's order was approximately $3.94 per share -- for a total of over $1.1 million in profit on a transaction for which Knight bore effectively no risk of loss.

39. While handling the AMCC order, Leighton was at times reporting executions improperly through the misuse of ACT modifiers. For example, at one point during the life of the order, the market moved against Knight's position. Leighton was able to profit even as the share price went down by attaching ACT modifiers to give the customer the impression that the executions took place at an earlier time when the market price more closely correlated to the prices the customer actually received.

ViroPharma, Inc. - January 18, 2000 Sell Transaction

40. On January 18, 2000, Knight pocketed a profit of over $350,000 -- or an average of $4.81 per share -- by executing a market not-held order on behalf of an institutional customer to sell 72,700 shares of ViroPharma Inc. (VPHM:NASDAQ) that involved effectively no risk to Knight.

41. At approximately 9:10 a.m., on January 18, 2000, Leighton received a market not-held order from an institutional customer to sell 72,700 shares of VPHM. Knight's proprietary position in VPHM at the time it received the order was long about 300 shares. Within minutes of the opening, Knight built a short position of 102,380 shares at an average sell cost of almost $80.00 per share. Leighton's first execution with its institutional customer was a purchase from the customer of 41,000 shares.

42. Even though Leighton -- with the customer's sell order in hand -- sold VPHM stock for almost $80.00 per share, the Firm covered its short position by purchasing stock from the institutional customer at $75.00 per share.

43. In approximately 25 minutes, Leighton made three purchases from the institutional customer, all at the same execution price of $75.00. Knight's average profit per share for the entire order was $4.81.

44. Leighton directed others at Knight to misuse modifiers throughout the VPHM order -- which again camouflaged the disparity between Knight's execution price and the current market price -- making it difficult for the customer to assess the quality of execution they were receiving from Knight.

E-Tek Dynamics, Inc. - March 16, 2000 Sell Transaction

45. On March 16, 2000, Knight pocketed a profit of over $971,000 -- or an average of $7.00 per share -- by executing a market not-held order on behalf of an institutional customer to sell 138,800 shares of E-Tek Dynamics (ETEK:NASDAQ) that involved effectively no risk to Knight.

46. At approximately 9:20 a.m., Leighton received a market not-held order from an institutional customer to sell 138,800 shares of ETEK. At the time of the order, Knight's proprietary account was long 20,000 shares of ETEK. Knight quickly reduced its position from long 20,000 shares to flat within the first 5 minutes of trading as it sold ETEK aggressively.

47. Knight then sold approximately 75,000 shares of ETEK at an average sell cost of $239.51 per share, to establish a short position of about 55,000 shares -- within about 50 minutes after receiving the order. Over the next two hours, Knight continued to sell to the market while incrementally purchasing shares from the institutional customer.

48. Even though Leighton -- with the customer's sell order in hand -- sold ETEK for an average sell cost of approximately $239.51 per share, Knight covered its

initial short position by purchasing the stock from the institutional customer at prices that ranged from $229.00 per share to $239.00 per share.

49. At one point in the ETEK order, Leighton was purchasing stock from its customer at a profit to Knight of $19.72 per share. Leighton executed the last part of the order at 11:44:00 a.m., more than two hours after receiving the order to sell.

50. Knight's average profit for the sell order was approximately $7.00 per share -- an excessively high profit for handling an order that involved effectively no risk to Knight.

51. Leighton misused modifiers on a number of occasions throughout the ETEK order -- reporting execution times improperly and hindering the customer's ability to monitor the quality of the execution they received.

Additional Examples of the Failure to Provide Best Execution

52. While the transactions described above typified Leighton's fraudulent trading practices during 1999-2000, they were just three orders among a number of examples in which Knight's customers were defrauded.

53. Other orders in which Leighton fraudulently failed to provide "best execution" to Knight's institutional customers in order to generate excessive profits included: (1) a 250,000 share order of Coronet Metals, Inc. (CRFH:NASDAQ) executed by Knight on March 8, 2000 in which Knight took in an average profit per share of $2.92 and realized a total profit of $730,000.00; (2) a 25,000 share order of Adaptive Broadband Corp (ADAP:NASDAQ) in which Knight's average profit per share was $9.63 and realized a total profit of $240,750.00; and (3) a 200,000 share order of Digex,

Inc (DIGX:NASDAQ) executed by Knight on April 4, 2000 in which Knight pocketed an average profit per share of $6.22 and realized a total profit of $1,244,000.00.

54. In each instance, the institutional customers had no expectation that Leighton was taking such unreasonably excessive profits and profits per share out of their institutional orders.

Use of ACT Modifiers to Circumvent Retail Limit Order Protection

55. In addition to misusing ACT modifiers in furtherance of the "best execution" scheme outlined above, Leighton and other sales traders at Knight misused the modifiers to improperly fill more lucrative "not held" institutional orders before certain retail customer limit orders.

56. The NASD prohibits NASD members (like Knight) from trading for their own account at prices that would satisfy a customer's limit order unless the member first executes the customer's limit order. This entitles the customer to priority over the Firm in obtaining the most favorable price in circumstances that would satisfy the limit order.

57. Consequently, Leighton and other sales traders at Knight were often obligated to fill unprofitable (or minimally profitable) limit orders that were resting on Knight's books before they filled profitable institutional "not held" orders.

58. By misusing ACT trade modifiers and changing the execution times of customer trades, Leighton and others at Knight avoided limit order protection protocols and filled more profitable institutional "not held" orders before certain resting limit orders.

FIRST CLAIM FOR RELIEF

(Securities Fraud)

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

59. Paragraphs 1 through 58 are realleged and incorporated by reference.

60. As described above, Leighton, acting knowingly or recklessly, directly or indirectly, in connection with the purchase or sale of a security, by use of means or instrumentalities of interstate commerce, of the mails, or the facilities of a national securities exchange:

a. employed devices, schemes or artifices to defraud;

b. made untrue statements of material fact or omitted to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; or

c. engaged in acts, practices, or courses of business which operated or would operate as a fraud or deceit upon other persons.

61. By engaging in the foregoing conduct, Leighton violated Section 10(b) of the Exchange Act [15 U.S.C. § 78j(b)] and Rule 10b-5 thereunder [17 C.F.R. § 240.10b-5].

SECOND CLAIM FOR RELIEF

(Securities Fraud)

Violations of Securities Act Section 17(a)

62. Paragraphs 1 through 61 are realleged and incorporated by reference.

63. As described above, defendant Leighton, acting knowingly or recklessly, in the offer or sale of securities, by use of means or instruments of transportation or communication in interstate commerce or by use of the mails, directly or indirectly:

a. employed devices, schemes or artifices to defraud;

b. obtained money or property by means of untrue statements of a material fact or omitted to state material facts necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; or

c. engaged in transactions, practices, or courses of business that operated or would operate as a fraud or deceit upon the purchaser.

64. By engaging in the foregoing conduct, Leighton violated Section 17(a) of the Securities Act [15 U.S.C. § 77q(a)].

PRAYER FOR RELIEF

WHEREFORE, plaintiff respectfully requests that this Court enter a Final Judgment:

(i) permanently enjoining, pursuant to Securities Act Section 20(b) [15 U.S.C. § 77t(b)] and Exchange Act Section 21(d)(1) [15 U.S.C. § 78u(d)(1)], defendant Leighton from violating, directly or indirectly, Section 17(a) of the Securities Act [15 U.S.C. § 77q(a)], Section 10(b) of the Exchange Act [15 U.S.C. § 78j(b)], and Exchange Act Rule 10b-5 [17 C.F.R. § 240.10b-5];

(ii) ordering defendant Leighton to pay civil penalties pursuant to Securities Act Section 20(d) [15 U.S.C. § 77t(d)] and Exchange Act Section 21(d)(3) [15 U.S.C. § 78u(d)(3)];

(iii) ordering defendant Leighton to disgorge, with prejudgment interest, the amount by which he was unjustly enriched as a result of his participation in the conduct described above;

(iv) granting such other relief as the Court deems just or appropriate; and

(v) retaining jurisdiction of this action in accordance with the principles of equity and the Federal Rules of Civil Procedure in order to implement and carry out the terms of all orders and decrees or to entertain any suitable application or motion for additional relief within the jurisdiction of this Court.

Respectfully submitted,

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