

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9271 / October 24, 2011

SECURITIES EXCHANGE ACT OF 1934
Release No. 65609 / October 24, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14600

In the Matter of

**Pipeline Trading Systems LLC,
Fred J. Federspiel, and
Alfred R. Berkeley III,**

Respondents.

**ORDER INSTITUTING ADMINISTRATIVE
AND CEASE-AND-DESIST PROCEEDINGS
PURSUANT TO SECTION 8A OF THE
SECURITIES ACT OF 1933 AND SECTIONS
15(b) AND 21C OF THE SECURITIES
EXCHANGE ACT OF 1934, MAKING
FINDINGS, AND IMPOSING A CEASE-AND-
DESIST ORDER**

I.

The Securities and Exchange Commission (“Commission”) deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 (“Securities Act”) and Sections 15(b) and 21C of the Securities Exchange Act of 1934 (“Exchange Act”) against Pipeline Trading Systems LLC (“Pipeline Trading”), Fred J. Federspiel, and Alfred R. Berkeley III (collectively, “Respondents”).

II.

In anticipation of the institution of these proceedings, Respondents have each submitted an Offer of Settlement (the “Offers”) which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission’s jurisdiction over them and the subject matter of these proceedings, which are admitted, Respondents consent to the entry of this Order Instituting

Administrative and Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933 and Sections 15(b) and 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-and-Desist Order (“Order”), as set forth below.

III.

On the basis of this Order and Respondents’ Offers, the Commission finds that:

A. SUMMARY

1. Pipeline Trading (together with its parent, “Pipeline”) operated an alternative trading system (“ATS”), a private stock-trading platform commonly referred to as a “dark pool.” Pipeline held out its ATS as a “crossing network” that anonymously matched customers’ interests in trading large amounts of stock. However, Pipeline did not disclose to its customers that the overwhelming majority of the shares traded on its ATS were bought or sold by a wholly owned subsidiary of Pipeline.

2. The undisclosed subsidiary (the “Affiliate”) was entirely owned and funded by Pipeline, which created the Affiliate to provide liquidity to Pipeline’s customers.

3. Pipeline advertised that it had “no prop[rietary trading] desk gaming [customer] orders.” Its advertising and other public statements repeatedly claimed that the trading opportunities on the ATS were “natural,” that the ATS would not reveal the side (*i.e.*, whether an order was to buy or to sell) or price of a customer order before a trade was completed, that the ATS denied “arbitrageurs” and “high-frequency traders” information needed to “front run,”¹ that it provided a refuge from “predators,” and that it prevented “pre-trade information leakage.”

4. These claims were false and misleading in that the Affiliate was on the other side of the vast majority of trades executed on the ATS. The Affiliate sought to predict the side and price of Pipeline customers’ orders and then trade on the same side as those orders in other trading venues before filling them on the ATS.

5. While Pipeline on the advice of its counsel disclosed to most of its customers the possibility of unspecified Pipeline affiliates trading on the Pipeline ATS, it assured its customers that any affiliate trading on the ATS would receive no preferential treatment and would “have no access to order or trade data of other subscribers.” In fact, Pipeline occasionally revealed to the Affiliate, after the trades were consummated, order and trade data of other customers. Pipeline also provided the Affiliate with certain access and information that improved the Affiliate’s ability to trade advantageously, including certain electronic connectivity to the ATS, input into designing ATS rules for deterring predatory conduct, and information about ATS operations and Pipeline’s methods of policing for predatory behavior that were not known to other customers.

¹ Pipeline did not use the term “front run” to mean the illegal practice of a broker-dealer misusing specific customer order information to trade stock for its own account in advance of, and to the detriment of, its customer. References in this Order to “front running” or “trading in front” are not meant to refer to that practice.

6. From August 2004 to March 2010, Pipeline violated the Commission's Regulation ATS by omitting to disclose, in required filings with the Commission, the Affiliate as an entity involved in the operation of the alternative trading system.

7. By virtue of the conduct described herein, Pipeline Trading violated Section 17(a)(2) of the Securities Act and Rules 301(b)(2) and 301(b)(10) of Regulation ATS under the Exchange Act, and Federspiel and Berkeley caused Pipeline Trading to violate Section 17(a)(2) of the Securities Act and Rules 301(b)(2) and 301(b)(10) of Regulation ATS.

B. RESPONDENTS

8. **Pipeline Trading Systems LLC**, a Delaware limited liability company headquartered in New York, New York, is a registered broker-dealer. Since 2004, Pipeline Trading has operated a registered ATS pursuant to Regulation ATS under the Exchange Act.

9. **Fred J. Federspiel**, age 48 and a resident of Larchmont, New York, is Pipeline's founder and CEO. Prior to March 16, 2010, he was Pipeline's President. Federspiel is a registered representative and supervisory principal at Pipeline Trading.

10. **Alfred R. Berkeley III**, age 67 and a resident of Baltimore, Maryland, is Pipeline's chairman. From December 19, 2003 until March 16, 2010, he was Pipeline's CEO. Berkeley is a registered representative and supervisory principal at Pipeline Trading. Berkeley is a former Vice Chairman and President of the NASDAQ Stock Market.

C. OTHER ENTITY

11. **Pipeline Financial Group, Inc.** ("Pipeline Financial"), a Delaware corporation headquartered in New York, New York, is a holding company that wholly owns Pipeline Trading and the Affiliate. Pipeline Financial was founded in 1999 as e-Xchange Advantage Corporation. Pipeline Financial and Pipeline Trading have offices in New York, Boston, Chicago, San Francisco, and London. Together they currently have approximately 85 employees.

D. FACTS

Market Background

12. An alternative trading system is a privately operated platform for trading securities.

13. Many customers use ATSS to avoid moving the price of a stock merely by placing an order to buy or sell it. Traditional trading venues, such as stock exchanges, typically post information about available orders. Exchanges reveal an order's size (the number of shares a trader wants to buy or sell) and price (the amount a buyer is willing to pay, called a "bid," and the amount a seller is willing to receive, called an "ask" or "offer"). Traditional trading venues also publish quotations from market makers of the prices at which they are willing to buy and sell stocks. The

highest published bid and lowest published offer generally available at any given time nationwide are referred to as the National Best Bid and Offer, or NBBO.

14. When information about a large order becomes known by other market participants, or “leaks out,” an opportunistic firm can trade in front of that order to the detriment of the firm that placed it. For example, if an institutional investor is seeking to buy (or sell) a large amount of stock, the opportunistic firm can immediately buy shares at the lowest prevailing offers (or sell shares short at the highest prevailing bids). Because the lowest offers (or highest bids) have been removed from the market, the best offers become higher (or the best bids become lower). The market price thus moved up (or down) in response to increased demand (or supply). Having bid the price up (or down), the opportunistic firm can make money by selling its shares at the new higher price (or buying shares at the new lower price), knowing that the demand (or supply) from the institutional investor’s order will continue to keep the price high (or low).

15. ATSs are designed to avoid such pre-trade market impact. ATSs often display little or no information about their customers’ orders and, accordingly, are referred to as “dark pools.” When a dark platform matches orders, the market impact described above may be avoided or minimized because customers’ trading interests are not publicized before a trade is executed.

16. Pipeline created its ATS as a type of dark pool that would allow customers to trade large amounts of stock, claiming that this would minimize market impact. According to a 2003 Pipeline internal business plan, “Institutions have always had a problem trading large blocks of shares. Whenever information about a large institutional order leaks out to the market, several market intermediaries step in front of such an order. This often results in an adverse movement in the market price for large trades.”

17. Emphasizing features of the ATS that were designed to prevent customers’ order information from leaking to the market, Pipeline’s marketing targeted institutional investors – mutual funds, pension funds, insurance companies, and other large asset managers, referred to in industry parlance as the traditional “buy side.” Typically, those firms buy or sell a security as a long term investment. Pipeline’s ATS was also known to be open to brokerage firms (referred to as the “sell-side”) and hedge funds.

18. Institutional investors are wary of so-called “predators” – typically broker-dealers and high frequency trading firms that seek to profit from short-term price fluctuations. Institutional investors are normally concerned that predators will use small orders to “sniff out,” or test for the presence of, a much larger institutional order. By risking only a small amount of capital on the smaller order, the predator can gain information that can be used to trade in piecemeal fashion in front of the institutional order for the predator’s own profit and to the detriment of the institutional investor.

19. Pipeline sought to prevent or deter this practice by imposing large minimum sizes for orders on its ATS. The large minimums would prevent block orders from being broken up into smaller, “leaky” trades, and at the same time force would-be predators to risk a large amount of capital to sniff out an institutional order. Pipeline’s minimum order size for each stock – 10,000,

25,000 or 100,000 shares, depending on the stock – was called the “LBQ,” for Large Block Quantity.

Pipeline Overview

20. Pipeline launched its ATS on September 9, 2004. Its customers entered into subscription agreements with Pipeline pursuant to which the customers agreed to pay a commission for each share bought or sold on the ATS.

21. Pipeline’s customers placed orders by using Pipeline’s Block Board, a proprietary graphical interface on customers’ computers. When a customer placed an order, the Block Board displayed the stock symbol in a small orange-colored box on all other customers’ computers. This “orange light” did not indicate the order’s side, price, or size. However, for the orange light to turn on, the price had to be reasonable and the order had to be at least as large as the applicable LBQ. Reasonably priced meant a customer’s bid or offer price was within a proprietarily calculated range known as the “BPR,” for Block Price Range.

22. If two customers entered “market” orders (*i.e.*, orders to buy or sell at the best prevailing market prices) on the ATS for the same stock and the orders were on opposite sides, a trade would take place. The price of the trade would be the mid-point of the NBBO at the time of the trade.

23. From the outset, Pipeline wanted to generate enough liquidity – that is, trading opportunity – to attract customers.

24. After considering other options, Pipeline created a firm to provide some of that liquidity. Several months before the ATS launch, Pipeline created the Affiliate as an ATS user. According to a June 2004 memo that Pipeline Financial’s Director of Research sent to Federspiel and Berkeley, the Affiliate was to “[k]eep the Block Board active” and “[p]rovide a baseline fill rate for early Pipeline adopters” by frequently placing orders and trading with Pipeline customers.

25. After consulting with a law firm experienced in securities law matters, Pipeline included a disclosure in most of its subscriber agreements that unspecified affiliates of Pipeline Financial or its investors could be trading on the ATS.

26. Pipeline did not disclose the Affiliate’s role in providing liquidity on the ATS. As further set forth below, Pipeline made statements in its marketing materials and press releases that portrayed Pipeline as a leading platform to find “natural” counterparties. These statements were inconsistent with the Affiliate’s predominant role in transactions on the ATS.

27. Ten months after the ATS launch, Pipeline changed the Affiliate’s name from Exchange Advantage LLC to Aurora Technology Partners LLC (“Aurora”) in order to obscure the Affiliate’s connection to Pipeline. Pipeline chose Aurora’s name after the Director of Research wrote that it “should sound like a technology firm, consulting or software.” In July 2006, to further obscure the Affiliate’s connection to Pipeline, Pipeline transferred the Affiliate’s operations from Aurora to Milstream Strategy Group LLC, a new, wholly owned subsidiary of Pipeline Financial.

28. For most of the life of the ATS, Pipeline and the Affiliate were located in the same building, although on different floors.

29. The Affiliate traded only on an intra-day basis. That is, it exited all its stock positions before the close of trading every afternoon and never took a long-term interest in any security. The Affiliate simply focused on matching the other side of orders placed by Pipeline's customers.

30. From the launch until May 2006, Pipeline Financial's Director of Research, who principally designed the ATS, managed the Affiliate. During most of that time, the Director of Research personally conducted trades for the Affiliate.

31. For the first four months after the ATS launch, the Affiliate was party to transactions accounting for 97.5% of the shares traded on the ATS. In 2005, the Affiliate was party to 87% of the ATS trading volume. This pattern persisted with occasional variation. From the launch until December 31, 2009, the Affiliate participated in approximately 80% of the trading volume on the ATS. Therefore, Pipeline customers in substance overwhelmingly traded with the Affiliate, and not with each other.

32. Pipeline was aware that its customers generally expected to trade with other customers, not with an affiliate of Pipeline, and that the Affiliate participated in the overwhelming majority of the trading volume on the ATS. Pipeline also was aware that a full disclosure of the Affiliate's role could drive customers away.

Pre-positioning

33. To reduce the risks associated with buying and selling shares on the ATS and improve its financial performance, the Affiliate commonly sought to pre-position, or trade in front of Pipeline's customers' orders. When the Affiliate judged that a customer had placed an order on the ATS to purchase shares, the Affiliate would buy shares of the same stock in other market centers and then seek to sell the shares to that customer on the ATS. Conversely, when the Affiliate judged that a customer had placed an order on the ATS to sell shares, the Affiliate would sell shares of the same stock short in other market centers and then seek to cover these short shares by buying from that customer on the ATS.

34. Although the Block Board did not reveal whether an order was a buy or a sell, the Affiliate's traders sought to predict the side of customer orders in order to then trade on the same side as those orders in other trading venues before filling them on the ATS. By, among other things, looking to market conditions and recent trading history on the ATS and by placing test orders in Pipeline and in other dark pools, the Affiliate had some success in making these predictions.

35. Pipeline took certain actions that facilitated the Affiliate's pre-positioning in front of Pipeline customer orders. Pipeline provided the Affiliate a type of electronic connection to the ATS, one otherwise provided only to customers who were institutional investors. When a customer's order turned a stock symbol orange on the Block Board (or when the opposite happened, *i.e.*, an orange light went off and the stock reverted to "white"), Pipeline customers without that con-

nection could know that only from human observation of their computers' graphical interface. The Affiliate, however, received the information in a more easily processed form, as data sent over a FIX line. (FIX is a protocol for transmitting order information in the financial industry.) These FIX messages, which included the BPR every time a stock turned orange or white, allowed the Affiliate to construct a database that tracked the precise times during which each stock was orange and white, as well as certain price information. This database allowed the Affiliate more efficiently and accurately to assess the persistence, side, and approximate limit price of customer orders.

36. The Affiliate developed a practice of placing large numbers of orders only to cancel them immediately afterwards – “flashing,” in industry jargon. The Affiliate did this, among other reasons, to assess the interest of Pipeline's customers.

37. Federspiel encouraged the Affiliate to place orders in specific stocks or categories of stocks that Federspiel thought would interest Pipeline's customers. After the close of trading, Federspiel sometimes told the Affiliate's manager that the Affiliate had missed certain opportunities and asked why it had not traded particular stocks. Other times, Federspiel and other Pipeline employees telephoned the Affiliate during the trading day to ask the Affiliate to trade specific stocks.

Marketing the ATS

“Natural,” “Predator-proof” Crossing

38. Pipeline repeatedly described its ATS as a crossing network that protected institutional investors from the market impact associated with predatory trading. For example, in a 2005 statement shared with journalists and industry analysts, Berkeley emphasized that “Pipeline's new technology reduces market impact by denying day traders, predatory dealers and other speculators the information they need to front run institutional investors' orders.”

39. Pipeline represented to its customers that its trading system was designed to prevent users from uncovering customer order information for the purpose of trading in front of those orders. In user guides, marketing materials, and other public statements, Pipeline stated that:

- Pipeline was an “anonymous Alternative Trading System designed to help users cross blocks without revealing the direction of their trading interest to anyone prior to completion of a large trade.”
- “[B]ecause your order is hidden, you can leave it in Pipeline for hours without leaking any information or moving the market.”
- “[T]he Pipeline Block Board has become the preferred source of liquidity for a rapidly growing group of buy and sell side block traders intent upon moving large blocks without tipping their hands to predators and front runners.”
- Pipeline's ATS was “leak-proof” and “predator-proof.”

- “[W]ith Pipeline, pre-trade leakage of critical information is eliminated. Pipeline gives block traders the ability to attract giant contras while frustrating the prying eyes of predators.”
- According to Federspiel, “Traders [using Pipeline] experience the simplicity and speed of anonymously executing large blocks without moving the market. Relieved from predators and front runners, traders can quickly and quietly unearth block liquidity – generating more fills with less slippage.”
- Pipeline was “a refuge from predators and front runners.”
- According to Berkeley, Pipeline “acts as a confidential channel, specifically to bring natural buyers and sellers together . . . without disseminating their intentions.”
- According to Federspiel, the Pipeline ATS reduced “the predatory practices that can occur in traditional trading venues . . . to the point of extinction.”
- “Pipeline’s unique pay-to-play model prevents pre-trade information leakage.”
- According to Berkeley, “Pipeline minimizes market impact by keeping . . . the details of the trader’s intentions secret” and “is optimized to meet the block trader’s need to operate invisibly in the market . . . free from backing away and front running.”

40. In a December 3, 2004 email, Federspiel instructed Pipeline’s sales force as follows:

If a potential user is concerned that people would use the system to try to guess that someone else might be on the same side, we could say this: the scenario you laid out might make some kind of theoretical sense, but in practice, no one is behaving that way.

41. Pipeline also consistently marketed the ATS as providing “natural” liquidity. While there is no standard definition of “natural” liquidity, the term is generally understood to exclude a trading opportunity generated by a dealer or by the trading venue itself specifically for the purpose of filling a given customer’s order. Nevertheless, in 2004 and 2005, at times when the Affiliate accounted for 90% or more of the ATS trading volume, Federspiel wrote in emails to customers:

- “If you find yourself too busy to watch the Block Board, you can simply place orders and collect the in-line execution reports, finding natural liquidity without influencing the market.”
- “We want to be your preferred destination to find natural liquidity, and more importantly, to actually trade with it.”
- “Many of you have told us you want to use Pipeline for large naturals in less liquid names.”

42. In 2007, when the Affiliate accounted for approximately 80% of the ATS trading volume, Federspiel wrote in emails to customers:

- On March 12, 2007, “traders were even more successful in their active search for natural contra liquidity. We are excited to build toward a future where traders have even more control over their search for naturals.”
- “On Tuesday, July 3[, 2007], Pipeline will help you find giant natural trades through the 1PM close of the retail-sized markets.”

43. A number of Pipeline press releases misleadingly implied that rising trading volume on the ATS was attributable to increasing numbers of “natural” trades executed on the system. In fact, that increased volume was due to the Affiliate’s trading. In particular:

- On March 22, 2006, Pipeline issued a press release written by Federspiel announcing that Pipeline had “executed a record 26,639,000 shares on March 21, 2006.” The press release continued: “‘More and more block traders are adding Pipeline to their trade management strategies,’ said Fred Federspiel, President and Founder. ‘Traders are finding natural liquidity in mega-block size for stocks that otherwise trade in bits and pieces. The result is a real savings.’” But the volume record had nothing to do with “natural” liquidity: on March 21, 2006, the volume of customer-to-customer trades had actually gone *down* as compared with the preceding day. The reported volume jump was due entirely to a spike in the volume of trades between customers and the Affiliate.
- On April 6, 2006, Pipeline issued a press release written or approved by Federspiel announcing a volume record for April 5, 2006 that was largely attributable to a spike in the Affiliate’s purchase and sale of shares on the ATS. The press release quoted Federspiel: “Traders are finding that Pipeline is an impact-free tool to generate large block naturals.”
- On June 5, 2007, Pipeline issued a press release authored or approved by Federspiel with the headline “Block Traders Flock to Pipeline for Large Natural Liquidity / The Block Market™ Sustains Record Growth.” The press release announced volume records for May 2007, and quoted Federspiel saying: “Our continuous growth in volume is a result of our rapidly growing customer base – now totaling over 500 firms – and technology integration efforts, which make it easier for many . . . users to leverage Pipeline to generate giant natural trades.” The press release also quoted Federspiel saying: “More and more block traders understand that Pipeline provides the best chance to find large natural liquidity.” The volume records reported in the press release, however, were not a result of natural liquidity: they were entirely due to increases in the volume of trades involving the Affiliate.
- Additional volume records were reported in a similarly misleading fashion in Pipeline press releases dated July 9, 2007, and February 5, 2008.

44. In an advertisement that Federspiel approved for inclusion in an April 2007 industry magazine and that referred to Pipeline as a “crossing network,” Federspiel said that “The Block Market™ from Pipeline offers unsurpassed ability to find and trade with natural liquidity” and that Pipeline’s approach “maximizes a trader’s probability of capturing natural liquidity.”

“No prop desk”

45. Some operators of ATSS own proprietary trading desks that trade securities on their ATSS with the operators’ own money. Pipeline’s customers believed that Pipeline was not such an ATS. Pipeline specifically instructed its sales force to tell customers that there was “no prop desk at Pipeline attempting to game your block orders.”

“Denying statistical arbitrageurs the information they need to front run”

46. In press releases and other marketing materials issued in 2008 and 2009, Pipeline stated that its ATS provided protection against “statistical arbitrageurs” and “high-frequency trading operations.” For example, a press release dated June 10, 2008 (authored or approved by Federspiel), and certain user guides claimed that Pipeline “optimize[s] the execution of giant orders while denying statistical arbitrageurs the information they need to front run.” Press releases dated July 31, 2008, December 2, 2008, February 26, 2009, and March 2, 2009 (all authored or approved by Federspiel), contended that Pipeline “optimize[s] the execution of giant orders while denying statistical arbitrageurs the information they’d need to take advantage of institutional orders It was built from the ground up to deliver impact-free block liquidity in the face of increasingly sophisticated predators.” On August 17, 2009, Pipeline issued a press release in which Federspiel said: “Our mission is to help buy-side desks get all the liquidity they need while minimizing losses to high-frequency trading operations.” At all relevant times, however, the Affiliate sought to predict the side and price of Pipeline customers’ orders and then trade on the same side as those orders in other trading venues before filling them on the ATS.

47. Berkeley edited, reviewed and/or approved the June 10, 2008, July 31, 2008, and February 26, 2009 press releases.

48. In a July 2009 interview with an industry magazine, Berkeley stated that “High-frequency traders are the natural enemy of . . . the large institutional investor” and that “most market centers are doing things that disadvantage the . . . institutional investor, because they’re doing things to advantage the high-frequency trader.”

49. Berkeley also stated in the July 2009 interview that “we have some of the smartest guys in the country figuring out how to make it hard to see customer orders.” He also stated that high-frequency trading firms were not his “audience,” but were “very relevant for our customers because those high-frequency firms are front-running institutions.” He further stated that Pipeline was practically the only ATS operator committed to serving “the traditional buyside” (institutional investors) because “almost everyone else is addicted to the volume that comes from high-frequency trading.” At the time, however, the Affiliate was a high-frequency firm that sought to predict the side and price of Pipeline customers’ orders and then typically traded on the same side as those orders in other trading venues before filling them on the ATS.

“Policing” the system

50. Pipeline instructed its sales force to represent that Pipeline policed the ATS to limit “gaming” behavior. On April 24, 2006, Federspiel suggested that the sales force tell its customers that Pipeline monitors “whether there’s any systematic way to gain knowledge of, and take advantage of, Pipeline orders. . . . The results show zero – that . . . there is no profitable way to game the system.”

51. On January 25, 2008, Federspiel wrote to the sales staff:

Today we suspended access indefinitely for [a user].

As you know we monitor activity, looking for firms with unusual activity patterns on the system. Because obtaining any actionable information in Pipeline is so difficult (LBQs make it virtually impossible to come up with a profitable gaming strategy), most parties who try give up. But we still actively police the system and in this case determined that the [suspended user] was not acting in the interests of the Pipeline community. We end up needing to do this about twice a year.

52. Pipeline trained its sales staff to tell customers that Pipeline conducts “human policing” for “indications of behavior which is not beneficial to the entire community.” However, Pipeline’s sales force did not disclose the Affiliate’s role on the ATS or its trading behavior.

Conflicts of Interest

53. Early in the life of the ATS, the Affiliate lost money on its trading, with Pipeline viewing the losses as a marketing cost. In May 2006, Federspiel replaced the Director of Research with the Affiliate’s head trader (“Head Trader”) as the Affiliate’s manager. Federspiel believed that the Head Trader could reduce the Affiliate’s losses.

54. Pipeline’s senior management recognized that there could be “a direct conflict of interest” between the Affiliate and a customer whose order it was seeking to fill. In any given trade, the better the price the customer received, the worse the price the Affiliate received, and vice versa.

55. Pipeline implemented an incentive system designed to address that conflict. Around May 2006, Federspiel, Berkeley, the Director of Research, Pipeline Financial’s CFO (“CFO”), and the Head Trader agreed on a bonus system for the Affiliate’s traders to motivate them to trade profitably while at the same time reducing their incentive to trade to the detriment of Pipeline’s customers. Under the system, each trader received payments based on the sum of three quantities: (1) the profits and losses from the employee’s trading (incentivizing traders to generate profits and avoid losses for Pipeline); (2) a quantity known as the Execution Quality Rebate, or EQR (incentivizing traders to provide executions to Pipeline’s customers at prices that were not unfavorable to the customers); and (3) \$0.007 for each share that the trader executed on the ATS (incentivizing traders to execute a high volume of trades opposite customers on the ATS).

56. EQR was calculated by subtracting, for each trade on the ATS, (a) the price at which the Affiliate actually filled a customer's order from (b) the stock's average price on the market, weighted by volume (known as volume-weighted average price, or VWAP) in the 10 minutes immediately before and after when the trade took place on the ATS. This so-called 20-minute VWAP was intended to serve as a measure of good execution quality for Pipeline's customers.

57. Accordingly, Pipeline compensated the Affiliate's traders both for trading profitably and for filling customer orders at prices that, from the customer's standpoint, were favorable as compared to market prices in the 20 minutes surrounding the trade – a compensation methodology designed to mitigate the conflict of interest between the Affiliate and the customers on the opposite side of the Affiliate's trades.

58. Under the supervision of the Head Trader, the Affiliate's trading gradually became less unprofitable. For the years 2004 through 2006, the Affiliate lost approximately \$19.7 million on its trading. In 2007, the Affiliate had almost no net trading losses. By early 2008, Federspiel, Berkeley, and the CFO discussed the Affiliate as potentially an "asset rather than a potential liability" and that its financial results should be a "core part of the Company." The Affiliate's trading profits in 2008, 2009, and 2010 were \$18.4 million, \$9.3 million, and \$4.5 million, respectively.

59. Over the life of the Affiliate through 2010, the expenses associated with operating the Affiliate, including compensation, exceeded the gains from trading.

Execution Quality

60. Pre-trade market impact is commonly measured by comparing the price at which a customer's order was executed with market prices at the time the customer placed its order. This measurement is known as "implementation shortfall" or an "arrival price" comparison. Institutional investors generally want to minimize shortfalls – that is, they want to trade at prices close to the arrival price.

61. The Affiliate's participation in a trade generally was associated with greater departures from the arrival price in comparison to when two customers traded, even if the Affiliate's pre-positioning did not cause all of the pre-trade price movement.

62. Beginning in 2006, Pipeline began using a different price benchmark as its dominant measure of execution quality on the ATS: VWAP in the twenty minutes surrounding the execution time, which was the same benchmark used to calculate bonuses for the Affiliate's traders. Thus, Pipeline deemed an execution "good" from a buying customer's standpoint if the customer's order was filled at or lower than 20-minute VWAP. For a selling customer, an execution was deemed "good" if it took place at or higher than 20-minute VWAP.

63. The EQR system gave the Affiliate and its traders an incentive to create those good executions on the ATS relative to 20-minute VWAP. However, this metric is not the sole measure of trade execution, and did not measure price movements occurring before or after the 20-minute window. Prices in trades with the Affiliate were less favorable when measured by reference to the price of the stock at the time the customer placed its order than when measured by reference to 20-minute VWAP surrounding the time of execution of the Affiliate's trade with the customer.

64. Pipeline occasionally disciplined customers by limiting or terminating their access to the ATS. Pipeline did this when it determined that a customer was taking advantage of other customers. Pipeline had no fixed rules or criteria for making disciplinary decisions. In general, Pipeline exercised discretionary judgment based on the 20-minute VWAP measurement.

65. Pipeline never disciplined the Affiliate by limiting or terminating its access to the ATS.

“All Pipeline subscribers are treated equally”

66. Pipeline repeatedly told its customers that all ATS subscribers, including Pipeline affiliates, are treated equally.

67. On June 1, 2009, and with Federspiel’s knowledge, Pipeline emailed a letter from its compliance officer to each of its customers that read in part:

While affiliates of Pipeline Trading Systems LLC may submit orders for themselves or on behalf of others to the Pipeline ATS, they do not receive any preferential treatment in accessing the system. Specifically, our policy is that affiliates (i) have no access to order or trade data of other subscribers; (ii) receive the same information about orange, yellow and black lights as non-affiliates; and (iii) are subject to the same price-time prioritization rules as non-affiliates. In other words, all Pipeline subscribers are treated equally.

68. Approximately one week later and with Federspiel’s knowledge, Pipeline emailed its customers a disclosure that read in part (emphasis in original):

Subscribers to Pipeline may be affiliated with Pipeline’s parent, Pipeline Financial Group, Inc., and, as such, trade equity and/or option securities via Pipeline. Pipeline affiliates do not receive any advantage whatsoever in their trading on the Pipeline ATS. Our policy is that affiliates (i) are subject to the same price-time prioritization rules as non-affiliates; (ii) receive the same information about orange and black lights as non-affiliates; and (iii) have no access to order or trade data of other subscribers.

69. In April 2010, Pipeline sent its customers a disclosure that read in part:

Subscribers to Pipeline include affiliates that effect transactions for their own proprietary account. Such affiliates do not receive any advantage in their trading on the Pipeline ATS. Our policy is that affiliates (i) are subject to the same price-display-time prioritization rules as non-affiliates; (ii) receive the same information about orange and yellow lights as non-affiliates; and (iii) have no access to order or trade data of other subscribers.

70. Despite these representations, Pipeline provided the Affiliate with certain advantages.

71. First, the Affiliate, unlike other customers, knew that Pipeline assessed execution quality on the ATS largely using the 20-minute VWAP. The Affiliate therefore could participate in trades with implementation shortfall and still provide customers with good execution quality, as measured by Pipeline, so long as the price movement occurred at least 10 minutes before the Affiliate executed a trade with another Pipeline customer. In aggregate, trades between customers and the Affiliate were associated with greater implementation shortfall than trades between two customers – although factors other than the Affiliate’s trading activity may have caused much of the shortfall.

72. Second, Pipeline provided the Affiliate with a FIX connection to the Block Board. This connectivity conferred an advantage by making it much easier to track history and activity on the Block Board. Pipeline denied a request for such a connection from at least one customer out of concern that the customer, a broker-dealer and market maker, would use the advantage to “game” the ATS and trade to the detriment of Pipeline customers.

73. Third, the Affiliate received the boundaries of the BPR each time a stock went from orange to white or from white to orange even after Pipeline, at a certain point in 2010, stopped providing that data to virtually all other users. This information assisted the Affiliate in determining the side and approximate price of customer orders.

74. Fourth, Pipeline solicited and received input from the Affiliate on Pipeline’s determination of LBQ for each stock traded on the ATS. Pipeline’s marketing materials repeatedly represented that the LBQ, which Pipeline advertised as a key “predator proofing” device, was determined by the stock’s trading volume in accordance with criteria advertised by Pipeline – namely, 100,000-share minimums for stocks trading more than 5,000,000 shares per day, 25,000-share minimums for stocks trading less than 5,000,000 and more than 500,000 shares per day, and 10,000-share minimums for stocks trading 500,000 shares per day or less. As a result of the Affiliate’s input, however, LBQ size sometimes departed from these criteria.

75. Customers were not invited to provide the same degree of input as the Affiliate. On January 6, 2006, the Director of Research asked Federspiel “What do you think should be the communication strategy [*i.e.*, to customers] on LBQ changes?” Federspiel replied, “I don’t want to draw too much attention to LBQ changes.”

76. In general, the larger the LBQ, the greater the dollar amount of the minimum order size, and therefore the riskier it was for the Affiliate or any other trader to “pre-position” to its own advantage and potentially to the detriment of the customer on the other side of the trade. Federspiel supervised the setting of LBQ sizes and knew that in many cases the LBQs were lower than they would have been if Pipeline had determined the LBQs solely based on the stock’s trading volume. In many cases, the decision to maintain a lower LBQ for a given stock (e.g., 25,000 shares rather than 100,000 shares) was influenced by the objectives of reducing the Affiliate’s risk of losing money on trades with customers and enabling the Affiliate to trade more actively with customers, thereby increasing the overall volume of trades on the ATS and commissions earned by Pipeline.

77. Fifth, Pipeline provided the Affiliate with information regarding other ATS features designed to “predator proof” the ATS. For example, soon after launch, Pipeline began randomizing

the amount of time during which a stock would stay orange before reverting to white once an order had been cancelled or filled. Pipeline randomly selected this orange-to-white interval between approximately one minute and two minutes. According to Pipeline, this feature was intended to make information revealed by the Block Board “fuzzier,” and therefore deter predators.

78. Pipeline told its customers about this randomized feature, but it did not tell customers the specific minimum and maximum intervals. However, Pipeline provided the Affiliate the exact range. In addition, Pipeline solicited and received the Affiliate’s input on the range.

79. Sixth, Pipeline provided the Affiliate with information on the ATS and its Block Board that was not provided to other customers. For instance, on November 22, 2006, Pipeline provided the Affiliate with documentation for the Block Board’s software that included detailed specifications for certain features that could be used to assess more accurately the existence and price of a potential matching order. Pipeline did not share the documentation, which bore a stamp indicating it was “for internal distribution only,” with customers.

Commission Filings

80. In its filings with the Commission pursuant to Regulation ATS, Pipeline made a series of material misstatements and omissions.

81. Regulation ATS required Pipeline to disclose on Form ATS “any entity . . . that will be involved in the operation of the alternative trading system.” The Affiliate was such an entity. It was created specifically to provide liquidity on the ATS, where it completely dominated the trading volume, and the compensation of its staff was tied to the execution quality that Pipeline’s customers received.

82. However, Pipeline’s Form ATS filings, which were reviewed by Federspiel and Berkeley, did not disclose the Affiliate until March 2010, at which point Pipeline described the Affiliate as “an affiliate of Pipeline Trading Systems” that “effects transactions on the Pipeline ATS, providing liquidity on the ATS.”

83. Moreover, some of Pipeline’s Form ATS filings attached user guides and other marketing materials containing the false or misleading information referred to above, including descriptions of the basic nature of the ATS, the selection of LBQ size, and Pipeline’s guarantee of anonymity.

Inadequate Safeguards for Customers’ Confidential Trading Information

84. The Commission’s Regulation ATS requires an ATS to “establish adequate safeguards and procedures to protect subscribers’ confidential trading information,” and specifies that such safeguards and procedures must include “limiting access to the confidential trading information of subscribers to those employees of the alternative trading system who are operating the system or responsible for” compliance functions. The regulation also requires an ATS to have “adequate oversight procedures to ensure” compliance with the safeguards and procedures for protecting confidential trading information.

85. Pipeline failed to comply with these requirements. Although he was not seeking to take advantage of customers, Pipeline Financial's Director of Research, with the knowledge of Federspiel and Berkeley, accessed or received confidential customer information in the period, from the launch of the ATS in 2004 through the spring of 2006, when he also served as the manager in charge of the Affiliate and as a trader at the Affiliate. This information, which the Director of Research generally received only after the consummation of trades, included customers' identities and the side, size, and price of their orders in the very stocks that he and others at the Affiliate were trading.

86. As a member of Pipeline's senior management, the Director of Research had access to information on Pipeline's sales efforts. On at least two occasions, in September 2005 and February 2006, the Director of Research told traders at the Affiliate the names of new or prospective Pipeline customers.

87. From time to time, representatives of Pipeline failed to strictly maintain the confidentiality of other information concerning customers. On at least several occasions, for example, Federspiel provided the Affiliate information about orders on the ATS, such as that recent orders in certain stocks had come from "a dealer," or a customer who was "aggressive" or "passive," or a "consistent" or "selective" customer. Similarly, after he left the Affiliate, the Director of Research occasionally told the Affiliate traders after the close of trading the side and approximate size of orders in a particular stock, or the type of account placing the orders. On one occasion, the head of Pipeline's help desk called the Head Trader with the side and precise size of a customer's interest in a stock.

E. VIOLATIONS

88. As a result of the conduct described above, Pipeline Trading "willfully"² violated:

a. Section 17(a)(2) of the Securities Act, which prohibits, directly or indirectly, in the offer or sale of securities, obtaining money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading.

b. Rule 301(b)(2) of Regulation ATS, which requires an ATS to file an amendment on Form ATS at least 20 days prior to implementing a material change to the operation of the ATS, 30 days after the end of a quarter when information contained in an initial operation report filed on Form ATS becomes inaccurate, and promptly upon discovering that an initial operation report filed on Form ATS or an amendment on Form ATS was inaccurate when filed; and

c. Rule 301(b)(10) of Regulation ATS, which requires an ATS to establish adequate safeguards and procedures to protect subscribers' confidential trading information and to

² As explained in footnote 3 below, "willfully" means only that the actor intentionally committed the act which constitutes the violation. There is no requirement that he also be aware that he is violating the securities laws.

adopt and implement adequate oversight procedures to ensure that the safeguards and procedures for protecting subscribers' confidential trading information are followed.

89. As a result of the conduct described above, Federspiel and Berkeley caused Pipeline Trading to violate Section 17(a)(2) of the Securities Act and Rule 301(b)(10) of Regulation ATS, and, pursuant to Sections 15(b)(6) and 21B(a)(3) of the Exchange Act, are liable for civil penalties for their "willful"³ acts or omissions that were a cause of Pipeline Trading's violations of Rule 301(b)(2) of Regulation ATS.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondents' Offers.

Accordingly, pursuant to Section 8A of the Securities Act and Sections 15(b) and 21C of the Exchange Act, it is hereby ORDERED that:

A. Respondent Pipeline Trading cease and desist from committing or causing any violations and any future violations of Section 17(a)(2) of the Securities Act and Regulation ATS promulgated under the Exchange Act.

B. Respondent Federspiel cease and desist from committing or causing any violations and any future violations of Section 17(a)(2) of the Securities Act and Regulation ATS promulgated under the Exchange Act.

C. Respondent Berkeley cease and desist from committing or causing any violations and any future violations of Section 17(a)(2) of the Securities Act and Regulation ATS promulgated under the Exchange Act.

D. Respondent Pipeline Trading shall, within 10 days of the entry of this Order, pay a civil money penalty in the amount of \$1,000,000 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717. Such payment shall be: (A) made by wire transfer, United States postal money order, certified check, bank cashier's check

³ Sections 15(b)(6)(A) and 21B(a)(3) of the Exchange Act authorize the Commission to impose sanctions, including civil penalties, against any associated person of a broker-dealer for, among other things, willfully causing to be made in any report required to be filed with the Commission statements which were, at the time and in the light of the circumstances under which they were made, false or misleading with respect to any material fact, or omissions of any material facts in any such report which were required to be stated therein. A Form ATS is a report required to be filed with the Commission within the meaning of Sections 15(b)(4)(A) and 21B(a)(3). 17 CFR § 242.301(b)(2)(vi). As used in the governing provisions of law, "willfully" means only that the actor "intentionally committed the act which constitutes the violation." *Tager v. SEC*, 344 F.2d 5, 8 (2d Cir. 1965); *see also Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000). "There is no requirement that the actor also be aware that he is violating one of the Rules or Acts," 344 F.2d at 8, and, accordingly, this use of the word "willful" does not reflect a finding that the Respondents acted with the intention to violate the law or knowledge that they were doing so.

or bank money order; (B) made payable to the Securities and Exchange Commission; (C) hand-delivered or mailed to the Securities and Exchange Commission, Office of Financial Management, Accounts Receivable, 100 F St., NE, Stop 6042, Washington, DC 20549; and (D) submitted under cover letter that identifies Pipeline Trading as a Respondent in these proceedings, the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to George S. Canellos, New York Regional Office, Securities and Exchange Commission, 3 World Financial Center, New York, NY 10281.

E. Respondent Federspiel shall, within 10 days of the entry of this Order, pay a civil money penalty in the amount of \$100,000 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717. Such payment shall be: (A) made by wire transfer, United States postal money order, certified check, bank cashier's check or bank money order; (B) made payable to the Securities and Exchange Commission; (C) hand-delivered or mailed to the Securities and Exchange Commission, Office of Financial Management, Accounts Receivable, 100 F St., NE, Stop 6042, Washington, DC 20549; and (D) submitted under cover letter that identifies Federspiel as a Respondent in these proceedings, the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to George S. Canellos, New York Regional Office, Securities and Exchange Commission, 3 World Financial Center, New York, NY 10281.

F. Respondent Berkeley shall, within 10 days of the entry of this Order, pay a civil money penalty in the amount of \$100,000 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717. Such payment shall be: (A) made by wire transfer, United States postal money order, certified check, bank cashier's check or bank money order; (B) made payable to the Securities and Exchange Commission; (C) hand-delivered or mailed to the Securities and Exchange Commission, Office of Financial Management, Accounts Receivable, 100 F St., NE, Stop 6042, Washington, DC 20549; and (D) submitted under cover letter that identifies Berkeley as a Respondent in these proceedings, the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to George S. Canellos, New York Regional Office, Securities and Exchange Commission, 3 World Financial Center, New York, NY 10281.

By the Commission.

Elizabeth M. Murphy
Secretary