

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

Summary

1. From at least March 2000 to May 2002 (the "relevant period"), certain customers of Goldman Clearing who used the firm's direct market access, automated trading system unlawfully sold securities short in advance of follow-on and secondary offerings in their prime broker accounts by, among other means, falsely marking their orders to sell "long." The customers' pattern of illegal sales went undetected by Goldman Clearing, which relied exclusively on the representations made by its customers concerning their positions in securities at the time of sale. Goldman Clearing's exclusive reliance on its customers' representations was unreasonable. The customers' pattern of trading and other information in Goldman Clearing's possession reflected that the customers were selling the offered securities short. Had Goldman Clearing instituted and maintained procedures reasonably designed to detect any significant disparity between its customers' pattern of trading and the manner in which they marked their orders to sell, it could have discovered that its trading and clearance records revealed the pattern of unlawful trades effected by its customers. Goldman Clearing also could have discovered that it was improperly lending the customers borrowed and proprietary securities to make deliveries on their purported long sales and closing their short positions with securities that they purchased in follow-on and secondary offerings. Accordingly, Goldman Clearing did not have a reasonable basis to believe its customers' representations that they were "long" the securities they were selling and, therefore, violated the Commission's short sale rules and was a cause of its customers' violations of the rules, as described below.

Respondent

2. Goldman Clearing is a limited partnership based in Jersey City, New Jersey and has been registered with the Commission as a broker-dealer since 1948. Goldman Clearing was formerly known as Spear, Leeds & Kellogg L.P. ("Spear"). In October 2000, The Goldman Sachs Group, Inc. acquired control of Spear by purchasing SLK LLC, Spear's general partner. On January 14, 2005, the Spear name was changed to Goldman Clearing. Goldman Clearing provides customers with, among other things, direct market access, automated trading and prime broker and stock loan and stock borrow services.

The Selling Customers' Trading Strategy

3. From at least March 2000 to May 2002, certain customers of Goldman Clearing employed a trading strategy that involved selling securities short, including securities listed on the New York Stock Exchange, in advance of follow-on and secondary offerings and covering their short sales with securities that they bought in the offerings (the "Selling Customers").¹ By selling in advance of the offerings, the Selling Customers sought to take advantage of anticipated declines in the market prices of the securities in the days prior to the offerings. Typically, the purchase prices for the offered securities were fixed at, or at a discount to, the closing prices for the stock on the dates before the offerings commenced. The Selling Customers profited when they sold the securities short at prices that were higher than the offering prices set by the market and that they subsequently paid to purchase the covering stock in the offerings. By engaging in this trading strategy, the Selling Customers frequently covered short sales that they made within five days of the pricing of the offerings in contravention of Rule 105 of Regulation M. The Selling Customers also frequently effected their short sales on "minus ticks" (i.e., at prices below the prices at which the securities were last sold) and "zero-minus ticks" (i.e., at the same prices at which the securities were last sold, but lower than the prices of the next preceding sales executed at different prices) in contravention of Section 10(a) of the Exchange Act and Rule 10a-1(a) thereunder.

4. The Selling Customers carried out their trading strategy in prime broker accounts that they maintained at Goldman Clearing as follows. Although they were selling the offered securities short, the Selling Customers repeatedly effected their sales as long transactions by submitting their orders for execution through Goldman Clearing's direct market access, automated trading platform, the REDI System© ("REDI"). Using REDI, the Selling Customers prepared their own orders to sell on computer terminals and falsely marked them "long." The orders were routed through REDI directly to the New York Stock Exchange and other markets for execution. After being informed by REDI that their sales had been executed, the Selling Customers frequently covered their sales by purchasing securities in follow-on and secondary offerings in transactions executed away from Goldman Clearing and had the offered securities delivered into their prime broker accounts (the "cover stock"). The cover stock was delivered into the Selling Customers' accounts though the Institutional Delivery System.

¹ During the relevant period, Rule 3b-3 under the Exchange Act defined a short sale as "any sale of a security which the seller does not own or any sale which is consummated by the delivery of a security borrowed by, or for the account of, the seller." In July 2004, the Commission amended the short sale rules by adopting Regulation SHO and Rule 200(a) of the new regulation replaced Rule 3b-3. See Short Sales, Securities Exchange Act Release No. 50103 (Jul. 28, 2004). However, the definition of a short sale generally did not change. Regulation SHO became effective in January 2005.

Goldman Clearing did not Have a Reasonable Basis to Believe its Customers' Representations That They Were "Long" the Securities They Were Selling

5. During the relevant period, Section 10(a) of the Exchange Act and Rule 10a-1(d) thereunder, provided that a broker could mark an order to sell a security registered, or admitted to unlisted trading privileges, on a national securities exchange "long" only if: (a) the security to be delivered after sale was carried in the account in which the sale was to be effected or (b) the broker had been informed that the seller owned the security ordered to be sold and, as soon as possible and without undue inconvenience or expense, would deliver the security owned to the account for which the sale was to be effected. In addition, Section 10(a) of the Exchange Act and Rule 10a-2 thereunder, prohibited brokers from lending, or arranging for the loan of, any security registered on a national securities exchange for delivery to the broker for the purchaser after sale if the broker or dealer knew or had reasonable grounds to believe that the sale was effected pursuant to an order marked "long" unless the broker knew, or had been informed by the seller, that: (a) the security sold had been forwarded to the seller's account, or (b) the seller owned the security sold and that it was then impracticable to deliver the security and that it would be delivered to the seller's account as soon as possible without undue inconvenience or expense. Accordingly, broker-dealers, including Goldman Clearing, had to have a reasonable basis to believe their customers' representations that they were "long" the securities they were selling.²

6. From at least March 2000 to May 2002, Goldman Clearing relied exclusively on the representations made by its customers whether they were selling securities "long" or "short" when they did not have the securities in their accounts at the time of sale. In particular, Goldman Clearing relied on agreements that it entered into with each of its customers that provided that a designation of a sell order as "long" was a representation that the customer owned the securities being sold. Consequently, when the Selling Customers marked their orders to sell "long," Goldman Clearing presumed that the Selling Customers owned the securities. It did not take further steps following execution to detect whether the Selling Customers' representations might be false, as discussed below.

² Upon the adoption of Regulation SHO, Rule 10a-1(d) and Rule 10a-2 were removed and replaced by provisions in the new regulation. Rule 10a-1(d) was replaced by Rule 200(g)(1) of Regulation SHO which permits a broker to mark an order to sell "long" only if the security being sold is owned by the seller and "either . . . (i) the security to be delivered is in the physical possession or control of the broker . . . ; or (ii) it is reasonably expected that the security will be in the physical possession or control of the broker . . . no later than the settlement of the transaction." 17 CFR 242.200(g)(1). Rule 203(a) of Regulation SHO, which replaced Rule 10a-2, states in section (1) that "[i]f a broker or dealer knows or has reasonable grounds to believe that the sale of an equity security was or will be effected pursuant to an order marked 'long,' such broker or dealer shall not lend or arrange for the loan of any security for delivery to the purchaser's broker after the sale, or fail to deliver a security on the date delivery is due." 17 CFR 242.203(a)(1). Section (2) of that rule states, however, that a broker or dealer may lend or arrange for the loan of a security to make delivery on a long sale "[i]f the broker or dealer knows, or has been reasonably informed by the seller, that the seller owns the security, and that the seller would deliver the security to the broker or dealer prior to the scheduled settlement of the transaction, but the seller failed to do so." 17 CFR 242.203(a)(2)(ii). Under Rules 200(g)(1) and 203(a), brokers remain obligated to have reasonable grounds to believe their customers' representations that they are "long" the securities that they are selling.

7. During the relevant period, Goldman Clearing's own records contained information about consummated transactions that reflected that the Selling Customers were engaged in a pattern of selling securities short and that they were misrepresenting their "short" sales as "long" sales. Specifically, Goldman Clearing's records contained information that reflected the Selling Customers were repeatedly failing to deliver to Goldman Clearing the securities that they purported to sell long, and that the Selling Customers were purchasing securities in follow-on and secondary offerings away from Goldman Clearing and delivering those securities into their prime broker accounts to cover their sales. In addition, Goldman Clearing's records contained information reflecting it was improperly lending the Selling Customers securities to make deliveries on their purported long sales and closing their short positions with the cover stock that they purchased in the offerings.

8. In its capacity as prime broker, Goldman Clearing received certain confirmations from the brokers from whom the Selling Customers purchased the cover stock indicating that the cover stock were offered securities (the "Confirmations"). The Confirmations indicated that the cover stock were syndicate securities and that the transactions in which the Selling Customers had purchased the cover stock had extended settlement dates typical for transactions involving securities offered in follow-on and secondary offerings. The Confirmations also indicated that the purchases made by the Selling Customers were subject to the closing of the offerings and that the Selling Customers had received prospectuses.

9. Goldman Clearing used the information contained in the Confirmations to post the purchase transactions effected by the Selling Customers to its trading records, including its Clearance Activity and Daily Margin Reports. The Clearance Activity Report reflected the Selling Customers' daily positions in securities. On the days it received the Confirmations, Goldman Clearing's Clearance Activity Report showed that the Selling Customers held short positions in the offered securities because they had sold the securities into the market within the five business days preceding the offerings and did not have the securities in their accounts at the time of sale. Goldman Clearing's Daily Margin Report also reflected the Selling Customers' short positions in the offered securities. Goldman Clearing closed the short positions the Selling Customers' held in the offered securities by posting the cover stock the Confirmations indicated they purchased to its Clearance Activity and Daily Margin Reports.

10. Because the Selling Customers covered their unlawful short sales by purchasing securities in the offerings, Goldman Clearing never had possession of the cover stock on the days that it had to settle such sales transactions (the "settlement dates"). Goldman Clearing only received the cover stock when the offerings settled and the offerings typically settled at least a day after the settlement dates for the sales. Rather than fail the sales made by the Selling Customers, however, Goldman Clearing delivered borrowed and proprietary securities to the brokers for the purchasers to settle the transactions. As a consequence, on the settlement dates, Goldman Clearing's Daily Stock Record, which showed the firms' daily positions in securities, contained information that reflected the short sales made by the Selling Customers. Specifically, the Daily Stock Record showed the Selling Customers held short positions in the offered securities that were offset by long positions in the offered securities in Goldman Clearing's stock borrow and proprietary accounts. Goldman Clearing closed the Selling Customers' short

positions on its Daily Stock Record after it paid the brokers who executed the purchase transactions in full for the cover stock and it received the cover stock from them.

11. Thus, for more than two years, Goldman Clearing's records contained information that reflected the Selling Customers were falsely marking their REDI orders to sell "long." As reflected in Goldman Clearing's records, the Selling Customers never delivered the securities that they purported to sell long to Goldman Clearing. Rather, they frequently covered their sales by purchasing securities in follow-on and repeat offerings after they effected their sales transactions. In addition, Goldman Clearing always settled the Selling Customers' sales with borrowed and proprietary securities and closed their short positions in the offered securities only after it paid for and received the cover stock purchased by the Selling Customers. The Selling Customers' pattern of trading was therefore consistent with selling securities short and not long as they represented on their orders to sell.

12. In light of the foregoing facts, Goldman Clearing's exclusive reliance on the Selling Customers' representations was unreasonable. The Selling Customers' pattern of trading and other information in Goldman Clearing's possession reflected that the Selling Customers were selling the offered securities short. Had Goldman Clearing instituted and maintained procedures reasonably designed to detect any significant disparity between its customers' pattern of trading and the manner in which they marked their orders to sell, it could have discovered that its trading and clearance records contained information reflecting that the Selling Customers were, in fact, falsely marking their REDI orders to sell "long" and selling securities short in violation of Rule 105 of Regulation M and Section 10(a) of the Exchange Act and Rule 10a-1(a) thereunder. In addition, Goldman Clearing could have discovered that it was improperly lending the Selling Customers borrowed and proprietary securities to make deliveries on their purported long sales and closing their short positions with offered securities.

Violations

13. As a result of the conduct described above, Goldman Clearing willfully³ violated Section 10(a) of the Exchange Act and Rule 10a-1(d) thereunder, which, during the relevant period, prohibited a broker or dealer, directly or indirectly, by use of the means and instrumentalities of interstate commerce, and of the mails, and of any facility of any national securities exchange, from marking any order to sell a security registered on, or admitted to unlisted trading privileges on, a national securities exchange "long" unless (1) the security to be delivered after sale was carried in the account for which the sale was to be effected, or (2) such broker or dealer was informed that the seller owned the security ordered to be sold and, as soon as was possible without undue inconvenience or expense, would deliver the security owned to the account for which the sale was to be effected.

14. As a result of the conduct described above, Goldman Clearing willfully violated Section 10(a) of the Exchange Act and Rule 10a-2 thereunder, which, during the relevant period, prohibited a broker or dealer, directly or indirectly, by use of the means and instrumentalities of

³ "Willfully," as used in the Order, means intentionally committing the act that constitutes the violation. See Wonsover v. SEC, 205 F.3d 408, 414 (D.C. Cir. 2000); Tager v. SEC, 344 F.2d 5, 8 (2d Cir. 1965). There is no requirement that the actor also be aware that it is violating one of the Rules or Acts.

interstate commerce, and of the mails, and of any facility of any national securities exchange, from lending, or arranging for the loan of any security registered, or admitted to unlisted trading privileges, on a national securities exchange for delivery to the broker for the purchaser after sale, or from failing to deliver a security on the date delivery was due if such broker or dealer knew or had reasonable grounds to believe that the sale was effected, or would be effected, pursuant to any order marked “long” unless such broker or dealer knew or had been informed by the seller, (1) that the security sold had been forwarded to the account for which the sale was effected, or (2) that the seller owned the security sold, that it was then impracticable to deliver to such account the security owned and that he would deliver such security to such account as soon as it was possible without undue inconvenience or expense.

15. As a result of the conduct described above, Goldman Clearing was a cause of the Selling Customers’ violations of Section 10(a) of the Exchange Act and Rule 10a-1(a) thereunder, which prohibit any person for his own account, directly or indirectly, by use of the means and instrumentalities of interstate commerce, and of the mails, and of any facility of any national securities exchange, from effecting on a national securities exchange a short sale of any security (1) below the price at which the last sale thereof, regular way, was effected on such exchange, or (2) at such price when such price was below the next preceding different price at which a sale of such security, regular way, was effected on such exchange.

Remedial Efforts by Goldman Clearing

16. In determining to accept the Offer, the Commission considered remedial acts undertaken by Goldman Clearing.

IV.

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

Accordingly, pursuant to Sections 15(b)(4) and 21C of the Exchange Act, it is hereby ORDERED that:

- A. Respondent Goldman Clearing is hereby censured;
- B. Respondent Goldman Clearing cease and desist from committing or causing any violations and any future violations of Section 10(a) of the Exchange Act and Rule 10a-1(a) thereunder, and Rules 200(g) and 203(a) of Regulation SHO under the Exchange Act (formerly Rules 10a-1(d) and 10a-2); and
- C. Respondent Goldman Clearing shall, within thirty (30) days of the entry of this Order, pay a civil money penalty in the amount of \$1 million to the United States Treasury. Such payment shall be: (1) made by United States postal money order, certified check, bank cashier’s check or bank money order; (2) made payable to the Securities and Exchange Commission; (3) hand-delivered or mailed to the Office of Financial Management, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, VA 22312;

and (4) submitted under cover letter that identifies Goldman Clearing as a respondent in these proceedings and the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Teresa J. Verges, Assistant Regional Director, Securities and Exchange Commission, Southeast Regional Office, 801 Brickell Avenue, Suite 1800, Miami, Florida 33131.

By the Commission.

Nancy M. Morris
Secretary