SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 64489 / May 13, 2011

Admin. Proc. File No. 3-13979

In the Matter of the Application of

PHILIP L. SPARTIS
and
AMY J. ELIAS
c/o Jeffrey L. Liddle, Esq.
Liddle & Robinson, L.L.P
800 Third Avenue
New York, New York 10022

For Review of Disciplinary Action Taken by

NYSE Regulation, Inc.

OPINION OF THE COMMISSION

REGISTERED SECURITIES ASSOCIATION -- REVIEW OF DISCIPLINARY PROCEEDINGS

Failure to Comply with Public Communications Rules

Former registered representatives of national securities exchange member firm caused violations of exchange rule by transmitting materially misleading communications to customers. *Held*, exchange's findings of violations and sanctions imposed *sustained*.

APPEARANCES:

Jeffrey L. Liddle, David I. Greenberger, and *David. F. Feldstein* of Liddle & Robinson, L.L.P., for Philip L. Spartis and Amy J. Elias.

Susan Light, Allen Boyer, and *Aida Vernon*, for Financial Industry Regulatory Authority, Inc., on behalf of NYSE Regulation, Inc.

Appeal filed: July 27, 2010
Last brief received: December 1, 2010

I.

Philip L. Spartis and Amy J. Elias ("Applicants"), former registered representatives of Salomon Smith Barney, Inc. ("Smith Barney" or the "Firm"),[1] a member of the New York Stock Exchange, LLC (hereinafter referred to, together with its regulatory subsidiary, NYSE Regulation, Inc., as "NYSE" or the "Exchange"), appeal from NYSE disciplinary action.[2] The Exchange found that Applicants caused Smith Barney to violate NYSE Rule 472.30 by sending customers communications "that omitted material facts and/or w[ere] misleading."[3] The Exchange censured Applicants. We base our findings on an independent review of the record.

II.

A. Background

This case concerns certain marketing materials Applicants provided to their customers, between 1998 and 2001, in connection with the customers' exercise of employee stock options that had been granted to them by WorldCom, Inc., a national telecommunications company that had grown substantially during the years preceding the period at issue.[4] In 1998, the company's stock price began to rise rapidly from $30 per share in January to $75 by year-end, eventually peaking at $96.76 in June 1999. Smith Barney research reports, issued throughout the relevant period by Firm telecommunications analyst Jack Grubman, forecasted further increases in WorldCom's stock price – predicting, for example, in twelve consecutive 1999 reports, highs of

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[1] Smith Barney is now known as Citigroup Global Markets Inc. The Firm terminated Spartis's and Elias's employment on February 4, 2002.

[2] On July 26, 2007, the Commission approved proposed rule changes in connection with the consolidation of the member firm regulatory functions of the National Association of Securities Dealers, Inc. ("NASD") and NYSE Regulation. *See* Securities Exchange Act Rel. No. 56146 (July 26, 2007), 91 SEC Docket 517. Pursuant to this consolidation, certain member firm regulatory and enforcement functions and employees of NYSE Regulation were transferred to NASD, and the expanded NASD changed its name to the Financial Industry Regulatory Authority, Inc. ("FINRA"). *See* Exchange Act Rel. No. 56148 (July 26, 2007), 91 SEC Docket 522. NYSE Regulation, which initiated this proceeding, is now represented by FINRA.

[3] NYSE Rule 472.30 prohibits the use of "any communication which contains . . . any untrue statement or omission of a material fact or is otherwise misleading." Subsequent to the events herein, in May 2002, NYSE amended Rule 472, adding restrictions on the activities of research analysts. As a result, Rule 472.30 was renumbered, without substantive change, as NYSE Rule 472(i). Exchange Act Rel. No. 45908 (May 10, 2002), 77 SEC Docket 1945.

[4] In November 1997, WorldCom merged with MCI, Inc., another national telecommunications company, more than doubling its size.

up to $130 per share.[5] Such increases, however, never materialized, as WorldCom's stock price began a steady decline at the end of 1999, closing by December 31, 2001, at $14 per share. In July 2002, WorldCom filed for bankruptcy protection, following settlement of civil fraud charges that it misled investors, from 1999 to 2002, by overstating its income.[6]

During the period at issue, Spartis and Elias served, respectively, as director of, and financial consultant in, Smith Barney's Atlanta-based Corporate Client Group (the "ACC Group"), a specialized retail unit of brokers that provided employee stock option services to the Firm's corporate clients. Under a January 1998 agreement between WorldCom and Smith Barney, WorldCom employees were required, with limited exception, to use Smith Barney's services whenever they elected to exercise their company stock options.[7]

Granted under various stock option plans, an option gave a holder the right to purchase a certain number of shares of WorldCom stock at a fixed price, commonly known as the "grant" or "strike" price. A holder could then exercise the option and thereby purchase company stock anytime on or after a vesting date, but before expiration (typically ten years from the grant date). By the early part of the period at issue, as a result of an increase in WorldCom's stock price relative to the grant price of their options, many WorldCom employees were able to exercise their options and immediately sell the stock at a substantial profit.

B. Servicing of WorldCom's Stock Option Plans

Smith Barney relied on the ACC Group's financial consultants to assist WorldCom's employees in the exercise of their stock options and also to sell additional brokerage services to employees in connection with the management of their assets. As head of the ACC Group, Spartis was responsible for maintaining the Firm's relationship with WorldCom and further

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[5] In 2003, Grubman consented to a permanent injunction and $15 million in sanctions, in connection with his coverage, as an analyst, of the telecommunications sector from 1999 to 2001. *See SEC v. Grubman*, 03 Civ. 2938 (WHP) (S.D.N.Y. Oct. 31, 2003)*; Jack Benjamin Grubman*, Exchange Act Rel. No 48725 (Oct. 31, 2003), 81 SEC Docket 2013 (barring Grubman from associating with a broker, dealer, or investment adviser).

[6] *SEC v. WorldCom, Inc.*, 273 F. Supp. 2d 431, 431 (S.D.N.Y. 2003); *see also WorldCom, Inc., Sec. Litig.*, 346 F. Supp. 2d 628, 637-47 (S.D.N.Y. 2004) (discussing WorldCom's collapse and criminal indictments of several executive officers). Following its emergence from bankruptcy, in April 2004, WorldCom changed its name to MCI, Inc.

[7] According to Applicants, in late 1997, Spartis "won for [Smith Barney] the exclusive right to administer" WorldCom's employee stock option plans.

expanding the group's options business.[8] Elias joined the group in early 1999 as a sales assistant, becoming a financial consultant shortly thereafter.[9]

Throughout the period at issue, Applicants fielded phone inquiries from WorldCom employees regarding their options and often continued, thereafter, providing other brokerage services to those employees. As compensation for the options business, the Firm earned a per-employee fee from WorldCom, while Applicants earned a commission of five cents per share on the sale of the customers' stock. "[M]ore importantly," Elias testified, the financial consultants sought to build on the relationships created from the options business by "offer[ing] the other services that we had, our retirement planning, our financial planning, our Smith Barney asset management." According to Elias, "the goal [with] any of the plans' optionees . . . w[as] obviously to eventually have them become a client, . . . gather assets and build out portfolios for them."[10]

1. The Exercise-and-Hold Strategy

Shortly after an employee contacted them with an interest in an options exercise, Applicants sent the employee a packet of introductory materials discussing, in general terms, the various exercise strategies available to them.[11] These introductory materials also provided generalized risk information, noting, for example, that a customer should "hold stock if [y]ou believe the stock will increase in value and you are willing to assume market risk"[12] and "sell stock . . . if [y]ou believe the stock price is about to decline [and] are unwilling to assume market risk."

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[8] Although he lacked formal supervisory authority, he was the ACC Group's most senior broker, generally overseeing the activities of the junior brokers and sales assistants. The ACC Group was commonly referred to, by personnel, as the "Spartis Group," or the "WorldCom Group," after its largest client.

[9] In addition to Spartis and Elias, NYSE brought proceedings against another member of the ACC Group, based on similar misconduct, which resulted in settlement.

[10] Spartis testified similarly, noting the importance of maintaining the relationship and acknowledging that his annual bonus was based, in part, on the total assets he managed.

[11] These materials were commonly referred to as the "A" pack and contained several pamphlets, including the "Seven Strategies for Maximizing your Employee Stock Options."

[12] The Firm's introductory packet further stated: "Holding the stock after exercise increases your market risk. Prior to exercise, your options carry the potential gain of the market without the risk of losing your investment, since you have made none."

The two main options strategies that Applicants discussed with employees were:

- the "exercise-and-sell strategy," whereby an employee purchased stock at the grant price and then immediately sold the resulting shares, receiving in cash the net proceeds of the stock sale, minus taxes and fees; and

- the "exercise-and-hold strategy," whereby an employee purchased stock at the grant price and held onto it for a period of time (generally, at least a year), paying the purchase price of the stock, taxes, and fees with cash or by use of a margin loan, obtained through Smith Barney.[13]

Applicants promoted the exercise-and-hold strategy over the exercise-and-sell strategy, stressing its tax benefits: if the employee exercised the options and held the stock for at least a year, any resulting profit from its subsequent sale would be taxed at a more favorable long-term capital gains rate, compared with the less favorable ordinary income tax rate, which applied if the employee exercised their options and sold the shares immediately.[14] In his hearing testimony, Spartis explained that "[w]hen these optionees were exercising [and selling their stock] they were booking tremendous gains but they're treated as ordinary income."

Choosing the exercise-and-hold strategy, nonetheless, could be costly – depending on the number of options exercised – requiring many customers to borrow funds to finance the exercise.[15] As a result, Applicants recommended margin loans (up to 50% of the market value of the stock) that would cover the purchase price of the stock, applicable taxes, and fees. Promoting the use of margin, the Firm's introductory packet noted: "Cash may seem like the quickest and easiest way to fund an exercise, but this is not necessarily true. The amount of money necessary to pay for an option exercise . . . can be quite high. It may be necessary to liquidate assets if you plan to use cash to fund your exercise." WorldCom employees who

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[13] Other strategies were available, but less frequently employed. One alternative was the "exercise and sell-to-cover" strategy, whereby the customer purchased the stock and sold enough of it to cover the purchase price of the stock, taxes, and fees, and retained the remaining shares. This strategy, like the exercise-and-sell strategy, required no margin loan. The spreadsheet-based document at issue, as discussed in Section II.B.2 below, compared only the two main strategies and did not discuss the other alternative approaches.

[14] The federal long-term capital gains rate, at the time, was 20% compared with the ordinary income tax rate that could be as high as 39.6%, depending on the employee's taxable income. *See* Taxpayer Relief Act of 1997, Pub. L. No. 105-34, § 311, 111 Stat. 831 (1997) (reducing the maximum capital gains rate on net capital gains from 28% to 20%).

[15] For instance, during a taped phone conversation, a customer confirmed with Elias that "the total cost to [him] of an ex and hold is . . . $1.274 [million] plus the taxes."

financed an options transaction with margin debt were generally charged a variable interest rate of six to eight percent.[16]

Elias explained the rationale for using margin under the exercise-and-hold strategy, during a taped phone conversation with a customer, as "basically . . . betting that the stock is going to grow at a rate better than the 8% or whatever you're paying." When the customer asked Elias's opinion of the exercise-and-hold strategy, Elias described it as "one of the smartest things you can do," explaining that "[w]hen the stock pulls back like this" – *i.e.,* drops with the expectation of rising again – "it's kind of like the silver lining in the cloud as far as option exercises. If you can afford to do it or you feel comfortable using margin it makes all the sense in the world especially if you believe in the growth of [WorldCom] which we do."

The exercise-and-hold strategy, however, carried risks – primarily that the share price of WorldCom stock could decline or not appreciate sufficiently to cover the costs associated with holding the stock, including the interest on the margin loan. The Firm's introductory packet explained: "As with any securities-based loan, there is always a level of risk [to using margin]. If the value of the securities should decline, you may be required to deposit cash or additional securities, or sell a portion of your securities to pay off the loan."

In contrast, the exercise-and-sell strategy lacked market risk, as any gains amassed from the grant date of the options were locked in upon exercise and immediate sale of the stock. Unlike an exercise-and-hold transaction, customers who elected to "exercise and sell" were not required to open a Firm account and could effect the transaction, without using the ACC Group, by a voice response system, a customer service representative, or, eventually, the Internet.

2. The Exercise-and-Hold vs. Exercise-and-Sell Analysis

In 1998, Spartis created a spreadsheet-based document called the *Exercise & Hold vs. Exercise & Sell Analysis* (the "Options Analysis"), to better illustrate the benefits of the exercise-and-hold strategy. Spartis recounted in his on-the-record testimony that he was increasingly fielding questions "from people on what strategy would be the best for them" and "after attempting to model this on a calculator for employees as we spoke on the phone I thought it was more efficient to develop a chart that would . . . explore[] the various alternatives using the various exercise methods." Spartis, with the help of an intern, designed a template for the

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[16] Applicants provided WorldCom employees with a "preferred margin rate," by waiving their commission on the margin loan. Spartis indicated that, despite losing the transactional commission, Applicants received a small credit, year-end, on the total margin balance of their accounts.

document that could be customized and sent to customers, reflecting their specific circumstances and highlighting the potential returns under the two strategies.[17]

Generally five pages in length, the Options Analysis began with a cover page, stating that it was "intended to illustrate the benefit of exercising your options now while the stock is relatively low and then holding on to the shares for period of at least 1 year in order to take advantage of the considerably lower capital gains taxes." In calculating the employee's potential returns under the two strategies, the document stated that, "[o]f course, the most important factor . . . is that the future market value . . . at which you will sell at is higher than the current market value" and that "money is borrowed using margin for the initial cover amount to minimize the use of cash." A standard disclaimer followed at the bottom of the page, noting that the document "may not necessarily present every material fact" and that the Firm "makes no representations as to [its] completeness or accuracy."

The most prominent feature of the Options Analysis was a graph, comparing the net gains for the employee (based on the employee's available options) under the two strategies in an appreciating market for WorldCom stock. The graph showed two upwardly-trending lines at increasing future price points of WorldCom stock: one line showed the net gains under the exercise-and-hold strategy and the other line showed the net gains under the exercise-and-sell strategy. The two lines began on the x-axis, at the then-current trading price of WorldCom stock, and, as the two lines progressed rightward, they intersected at a "crossover point" – generally five to ten percentage points above the stock's current market value – where the exercise-and-hold strategy became a more profitable strategy than the exercise-and-sell strategy.

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[17] An early version of the document already existed when Spartis asked an intern to prepare an Options Analysis for a customer in early 1999. The intern testified that he improved on the template, with Spartis's approval, by making it "more legible" and adding a graph.

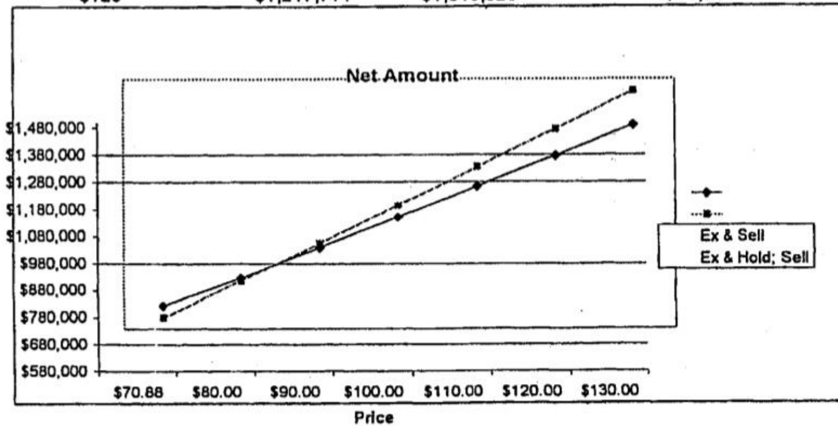
For example, the following is an Options Analysis generated for an employee on October 6, 1999, when WorldCom's share price was $70.88.

MCI WorldCom Stock Options

Exercise Hold vs. Exercise Sell Analysis

Summary

FMV	Net Amount: Ex & Sell	Net Amount: Ex & Hold; Sell	Difference
$71	$663,547	$619,765	-$43,782
$80	$766,484	$756,096	-$10,388
$90	$879,291	$895,904	$16,613
$100	$992,099	$1,035,712	$43,613
$110	$1,104,906	$1,175,520	$70,613
$120	$1,217,714	$1,315,328	$97,614



The data represented here is believed to be accurate. Due to the projections of future results, please consult your tax advisor for further explanation.

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According to this graph, the exercise-and-hold strategy, despite the associated costs, became more profitable for this employee when WorldCom's stock price exceeded roughly $85 per share.

Following the graph, Applicants attached an "assumptions page" that reflected the employee-specific data used to create the graph, including: the number of WorldCom options available to the employee and the grant prices of each; the available interest rate on the margin loan; the applicable taxes (state and federal) that would be assessed; and the price points used in

the graph with the expected "gain" for the employee at each price point, based on the grant prices of the employee's options.[18]

The record contains several Options Analyses that Applicants sent to WorldCom employees, from March 29, 1999, to April 17, 2000. In his hearing testimony, Spartis admitted distributing, or causing the distribution of, "somewhere near 100" Options Analyses to his customers during the period at issue. Elias testified that she could not recall the exact number of Options Analyses she had sent out, but she admitted instructing the interns/sales assistants to transmit them to her customers, during the period at issue, on her behalf.

3. Omissions in the Options Analysis

The Exchange alleged that the Options Analysis omitted material facts or was misleading by "fail[ing] to depict any downside risk of holding the shares on margin," including "the velocity or magnitude of potential losses if the stock's price were to decline," and "by omitting the negative result if either the broker or the customer turned out to be wrong about the direction of WorldCom stock."

The Options Analysis failed to illustrate the effect on a customer's return in the event the market for WorldCom stock failed to appreciate or declined. The graph, as its focal point, showed that, if the stock price reached the uppermost price point, the employee would earn significantly higher returns, under the exercise-and-hold strategy, than if the employee followed an exercise-and-sell strategy. The Options Analysis did not provide a corresponding downward-sloping graph, reflecting a decreasing market in WorldCom stock. While the cover page contained some explanation of the assumptions used to calculate the customer's gain under the strategies – *e.g.*, that it assumed that future price of the stock "would be higher than the current market value" and that margin would be used to "minimize the use of cash" – nowhere in the Options Analysis was there a discussion of risk, including the risk associated with the customers' use of margin if WorldCom's stock price decreased, as ultimately occurred.

Applicants acknowledged in their testimony that the Options Analysis did not generally include any downward price analysis or discuss the risks involved. They maintained that, because a customer would do an exercise-and-hold transaction only if he or she thought the price of the stock would rise, it was pointless to provide the customer with an Options Analysis based on a declining market. Elias acknowledged that the customers were "true believers" in WorldCom. She testified that, while Applicants were capable of creating a downside depiction, "it would have been ridiculous to even waste the paper to print it out on. If the client thought the stock was going down, they wouldn't even want to look at it." Spartis testified similarly, asserting that the customers were sophisticated investors, "all aware that the stock could go

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[18] The calculations underlying the graph were featured in several spreadsheets that were also attached, showing the associated costs.

down," and that the risks associated with holding stock were disclosed in the Firm's introductory packet and discussed during their "conversations" with customers.[19]

With respect to the price projections used in the Options Analysis, Applicants testified that they were not their own projections of WorldCom's stock price, but were based either on the customer's estimation or, more often, on the forecasts of Smith Barney's research analysts. As Spartis explained, because he was not an analyst, he "used the Firm's research and price targets," reported primarily by Firm analyst Jack Grubman, during the period at issue.[20]

4. Management's Role

Applicants testified that they believed the Options Analysis they used with customers was approved for distribution by their branch supervisors. Spartis testified that, in late 1998 or early 1999, he showed a template of the document to Michael Grace, the Atlanta Branch Manager and Applicants' supervisor during the period at issue. According to Spartis, Grace "approved" the use of the template after adding "disclaimers" and "two minor modifications."[21] Applicants also pointed to evidence, including notations in the ACC Group's database, indicating that several "supervisory designees," who were responsible for reviewing the Atlanta Branch's outgoing facsimile and mail correspondence, had reviewed some of the Options Analyses sent to customers during the period at issue.[22]

Grace's testimony, however, conflicted with Applicants' recollection. According to Grace, Spartis showed him a "rough draft" of the Options Analysis and, in response, Grace instructed Spartis to send the document to the Firm's compliance department in New York for review because it was "complicated correspondence" with numerous "moving parts" and it would be sent to more than one customer. Grace testified that Spartis responded that he would continue working on the document and return to him with a revised version, but Spartis never

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[19] Although Spartis testified that two Options Analyses (of more than one hundred that Applicants transmitted) illustrated a decreasing market in WorldCom stock, his testimony is not corroborated by the record – including the testimony of the customers who purportedly received them and that of other financial consultants in the ACC Group. *See infra* note 24.

[20] *See supra* note 5 and accompanying text. For example, the $130 stock price projected by Grubman throughout 1999 was reflected as the highest price point on several customers' Options Analyses in the record.

[21] The document was already in use when Elias joined the ACC Group in 1999.

[22] The ACC Group's intern, however, testified that "well over the majority" of time the documents were sent via e-mail. For much of the period at issue, the ACC Group's e-mail system was largely unmonitored by the Firm, until June 2001, when it began requiring the group to use the firmwide system.

did so. Grace stated that he only became aware that the document was being used in late 2000, when he received a customer complaint that attached the Options Analysis the customer had received.[23]

5. Customer Testimony

Several customers testified at the hearing that the Options Analysis they received presented an unbalanced picture of the two strategies and did not effectively explain the downside risks involved. Travis Brown, a customer of both Applicants, began discussing options strategies with Spartis in summer 1999 because he was leaving WorldCom and soon faced an accelerated vesting period for the exercise of his options. Brown testified that Applicants "gave extensive advice" "as to how to exercise" his options during "phone conversations and in written materials" and that Applicants told him that "the smart thing to do was to exercise and hold all of the options available to me on margin." According to Brown, the Options Analyses that Applicants sent to him during his discussions helped convince him that the exercise-and-hold strategy was the "smart way to proceed." Brown viewed the document's graph, in particular, as reflecting "that the opportunity was on the right side of the crossover point, and the downside risk was on the left side of the crossover point, which as you can see the right side far outweighs the left side in th[e] depiction."

When Brown decided to exercise his options and hold the resulting WorldCom shares, he funded the transaction with a $2.8 million margin loan. He testified that, although he had a "general understanding" of margin at the time, he did not understand, either from his discussions with Applicants or from the Options Analysis, the "accelerating" effect his margin loan would have on his losses if WorldCom's stock price declined. In late 2000, when the stock price plummeted, he sold off much of his account to cover margin calls, before eventually transferring his account to another broker-dealer.

Elizabeth Rich, an employee of WorldCom for over twenty years, initially contacted Applicants based on the recommendation of a co-worker. Rich testified that her decision on August 5, 1999, to exercise her options and hold WorldCom stock was based on "the [Options] analysis that Mr. Spartis sent me and the conversations that I had with him . . . reassuring me that [Applicants] knew how to handle my account and handle this type of transaction and my money." Rich, recounting her decision, testified, "I looked at the [Options] Analysis. I discussed it with my husband. We did not see any downside in the analysis. And that's what our

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[23] In October 2003, Grace consented to a censure and three-month suspension with the Exchange for failing, among other things, to supervise reasonably the ACC Group's activities. The Firm, in the same proceeding, consented to a censure and $1 million fine for failing to ensure effective supervision.

decision was based on."[24] In September 27, 2000, after experiencing heavy losses in her account and several margin calls due to concentrated positions of WorldCom stock, Rich was among the first customers to complain to the Firm about the exercise-and-hold strategy that Applicants had recommended to her. At the time, she complained: "At no point in the last thirteen months was there ever a single discussion about how to handle [this] account . . . if the market or the stock trended downward."[25]

D. NYSE's Proceedings

On August 14, 2009, an NYSE Hearing Panel found that Applicants caused an NYSE Rule 472.30 violation by sending Option Analyses to customers that omitted material facts or were otherwise misleading.[26] The Panel found "the omission of any downward price analysis" in the Options Analysis materially misled customers because it "assum[ed] that the price of WorldCom stock would only go up[,] present[ing] an unduly optimistic picture of the potential gains that would result from exercising WorldCom options on margin and holding the resulting shares for at least one year." According to the Panel, "[b]ecause the use of margin ensured that

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[24] The record contains an undated Options Analysis for Rich, illustrating a declining market for WorldCom stock (showing a drop in price from $53.88 to $24); however, there is no evidence Rich ever received it. Rich had no recollection of ever reviewing a downside Options Analysis. Elias, whose name appeared on the document, testified that she did not have one prepared that reflected a declining price – which was consistent with her other testimony that it would have been "ridiculous" to do so. When showed the graph at the hearing, Rich testified that she would have wanted to have received it "at the same time as I got the other analysis because then I could have seen exactly what would happen in either direction and make my decision from there as to whether or not I wanted to exercise and hold stock options." Although Spartis testified that a downside Options Analysis was also prepared for Brown, no such document is in the record nor does Brown's testimony support the claim. A fellow financial consultant of Applicants testified that he never saw a downward-trending Analysis used in the office.

[25] Another customer of Applicants who had followed the exercise-and-hold strategy testified that, if she had known about the potential magnitude of losses to be incurred if the stock price declined, she "never would have used margin" to fund her options transaction. The customer owed $489,000 in margin debt when she decided to transfer her account to another brokerage firm.

[26] The proceedings below lasted six years, having been instituted in 2003. The length of NYSE's proceedings appears to have been a result of scheduling conflicts, numerous issues involved, and a voluminous record, comprising 30 volumes that includes over 5,500 pages of hearing transcript and 200 exhibits. The Panel dismissed three of NYSE's charges against Applicants – that they made unsuitable recommendations, sent unapproved communications, and (with respect to Spartis alone) operated an unapproved and unsupervised e-mail system.

customers would incur accelerated losses including interest payments and margin calls should the stock price decline, . . . the Analysis could not present an accurate and balanced comparison of the exercise strategies absent a discussion of those risks." The Panel, nonetheless, did not find that Applicants acted with scienter, "credit[ing their] contention that they were not attempting to circumvent [NYSE] rules . . . in sending customers [the Options Analysis]." The Panel censured Applicants, suspended Spartis for five months as the "architect" of the Options Analysis, and suspended Elias for three months.

On June 10, 2010, the NYSE Board of Directors affirmed the Panel's findings of liability[27] but modified its sanctions by vacating the suspensions. The Board sustained the censures the Panel had imposed.

III.

NYSE Rule 472.30 prohibits, in relevant part, the use of "any communication which contains . . . any untrue statement or omission of a material fact or is otherwise misleading." An omitted fact is material if there is a substantial likelihood that a reasonable investor would have considered the omitted fact important to his or her investment decision, and disclosure of the omitted fact would have "significantly altered the 'total mix' of information available."[28]

We agree with the Exchange that Applicants caused the Firm's violation of Rule 472.30 by transmitting the Options Analysis to their customers. As the Exchange found, the Options Analysis materially misled customers by "present[ing] an unduly optimistic picture of the potential gains" that would result under the exercise-and-hold strategy and by failing to include any downside risk analysis. Rather than presenting "in a balanced way the risks and rewards of" two options strategies available to their customers, the Options Analysis improperly focused exclusively on the advantages of the exercise-and-hold strategy.[29] The document's upwardly

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[27] The Board, while adopting the Panel's liability findings, expressly disagreed with the Panel's analysis on one point of law – where it relied on case law under the antifraud statutes of the securities laws to reject Applicants' claim that NYSE Rule 472.30 required proof of customer reliance. The Board held that "there is simply no requirement [under Rule 472.30] that [NYSE] Enforcement prove customer reliance."

[28] *Basic, Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988) (quoting *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976)).

[29] *Jay Michael Fertman*, 51 S.E.C. 943, 950 (1994) (finding that salesman caused firm's distribution of misleading sales literature in violation of NASD rules); *see also Pac. On-Line Trading & Sec., Inc.*, 56 S.E.C. 1111, 1119 (2003) (finding that firm's advertisement violated NASD's public communications rule because it "highlighted the purported benefits of . . . [a] securities trading [program] but failed to provide essential risk disclosures regarding such trading").

(continued...)

trending graph, in particular, was visually misleading to customers, conveying the false impression that the exercise-and-hold strategy held only upside potential.[30] A corresponding downwardly trending graph would have significantly altered the total mix of information available to customers.[31]

We are further troubled by the omission of information from the Options Analysis regarding the potential adverse consequences of financing these transactions on margin. As we have previously emphasized, "[t]ransactions effected on margin . . . entail substantial risks."[32] When the price of the stock purchased on margin depreciates sufficiently, as occurred here, customers may be forced to sell securities from their accounts at a loss to cover margin calls, in addition to paying interest on the margin debt they used to fund the transaction.[33] Customers

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(...continued)

In addition to NYSE Rule 472, Firm policies required that communications with the public "not contain any statements which are untrue or omit a material fact or are otherwise false or misleading" and present "a balance between describing the risks and the potential rewards of any investment."

[30] *See, e.g., Valicenti Advisory Servs., Inc.*, 53 S.E.C. 1033, 1039 (1998) (finding advertising "[c]hart and [b]ar [g]raph" that adviser distributed to his customers "presented a false portrayal of [his firm's] past performance and a misleading comparison . . . with the performance of other money managers"), *aff'd*, 198 F.3d 62 (2d Cir. 1999).

[31] Customer testimony supports this conclusion. For example, Rich testified that a decreasing stock depiction would have shown "exactly what would happen in either direction [enabling me to] make my decision from there as to whether or not I wanted to exercise and hold stock options."

[32] *Eugene J. Erdos*, 47 S.E.C. 985, 986 n.5 (1983), *aff'd*, 742 F.2d 507 (9th Cir. 1984).

[33] *See, e.g., Laurie Jones Canady*, 54 S.E.C. 65, 80 n.27 (1999) ("'Trading on margin increases the risk of loss to a customer for two reasons. First, the customer is at risk to lose more than the amount invested if the value of the security depreciates sufficiently, giving rise to a margin call in the account. Second, the client is required to pay interest on the margin loan, adding to the investor's cost of maintaining the account and increasing the amount by which his investment must appreciate before the customer realizes a net gain.'" (quoting *Stephen Thorleif Rangen*, 52 S.E.C. 1304, 1307-08 (1997)), *petition denied*, 230 F.3d 362 (D.C. Cir. 2000).

testified that information about the risks associated with margin was material to them.[34] To this point, it is important to recognize that customers, known to Applicants as WorldCom "true believers," were extremely enthusiastic about WorldCom's prospects, in part, because of the highly upbeat assessments by Smith Barney's own research analyst.

Applicants do not deny transmitting the Options Analysis to their customers, but they nevertheless contend that they should not be held liable because it was "reviewed and approved by" their supervisors. Applicants claim that "the Branch's supervisory personnel were either satisfied that the content of the Analysis was 'reasonable' and did not contain misrepresentations or omissions, or failed to use their ample resources to fulfill" their supervisory responsibilities. "Either way," according to Applicants, they "had a reasonable basis to assume that the Options Analysis conformed . . . with the requirements of [NYSE] Rule 472.30 . . . and could be distributed to clients."

We disagree. While the record contains some evidence that certain supervisory designees (who did not testify) were aware that the Options Analysis was being sent to customers by their review of facsimile and mail correspondence, we do not find the evidence conclusive that the document was ever approved by Firm management or that Applicants had a reasonable basis for believing so.[35] Although Spartis claimed his branch manager, Grace, was involved in reviewing a template of the document, Grace testified that he only saw a "rough draft" and had specifically directed Spartis to send a copy to the Firm's compliance department for approval and return a revised document to him, which Spartis never did. Grace denied knowing the document was in use until receiving complaints in late 2000.[36] In any event, even if there was supervisory approval, it is well established that the duties owed by a securities professional to his or her customer are not "abridged by a failure on the part of his [or her] supervisors."[37] As we have held, a "broker has responsibility for his own or her own actions and

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[34] For example, Brown testified that the Options Analysis did not alert him to the accelerated losses he would incur by holding concentrated positions of WorldCom stock on margin. Other customers concurred, testifying that they were unaware of the effects margin would have on their losses.

[35] As noted, *supra* note 22, the majority of Options Analyses were transmitted to customers through an unmonitored e-mail system.

[36] The Exchange's Hearing Panel dismissed a separate charge that Applicants sent unapproved correspondence during the period at issue. *See supra* note 26. In determining to dismiss, the Panel, noting "contradictory testimony," found that "the [Options] Analysis was tacitly if not expressly approved by supervisory personnel," based on the personnel's review of outgoing facsimile and mail correspondence.

[37] *Donald T. Sheldon*, 51 S.E.C. 59, 88 n.130 (1992), *aff'd*, 45 F.3d 1515 (11th Cir. 1995).

cannot blame others for [his or her] own failings."[38] Applicants thus were obligated to comply with regulatory requirements regardless of the actions of others at the Firm.[39]

Applicants further contend that the Options Analysis did not contain an omission of material fact nor was it misleading. According to Applicants, the Options Analysis "was not a recommendation" to customers but "merely a comparison of the tax consequences" under two options strategies and did not show the consequences of a decreasing stock price "because, by definition, there would be no tax savings" and the exercise-and-hold strategy "could not be more profitable." They claim the consequences of a stock price decrease were known to customers, as the Options Analysis expressly disclaimed that, "[o]f course, the most important factor . . . is that the future market value" of the stock "is higher." They assert that the risks of the exercise-and-hold strategy were discussed in the Firm's introductory materials to new customers and during their phone conversations, citing Brown's testimony as support.

We reject Applicants' position that the potential adverse consequences of a flat or declining market for WorldCom's stock were so obvious that they need not be disclosed in the document. As discussed, the Options Analysis materially misled customers by presenting a one-sided picture of the customer's earnings potential under the exercise-and-hold strategy and by omitting important risk disclosures. Given the one-sided disclosure that was made to each customer concerning the customer's earning potential, "'[a] reasonable investor would want to know of any risks or potential harms associated with his or her investment.'"[40]

While Applicants attempt to lessen the importance of these disclosures by characterizing the Options Analysis as a mere "comparison," not a "recommendation," such a distinction is irrelevant for purposes of NYSE Rule 472.30. As mentioned, the Rule covers "any communication" with the public and, thus, applies here regardless of how Applicants seek to characterize the Options Analysis.[41]

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[38] *Justine Susan Fischer*, 53 S.E.C. 734, 741 n.4 (1998); *see also Larry Ira Klein*, 52 S.E.C. 1030, 1034-35 (1993) (rejecting salesman's "attempt to shift responsibility" to his firm and finding that, "as a registered securities professional and the author of the list, he is responsible for its contents").

[39] *See, e.g.*, *Adrian C. Havill*, 53 S.E.C. 1060, 1068 (1998) (rejecting applicant's defense against fraud allegations that he relied on supervisor's guidance regarding suspicious trades) (collecting cases).

[40] *Donner Corp. Int'l*, Exchange Act Rel. No 55313 (Feb. 20, 2007), 90 SEC Docket 11, 26 & n.46 (quoting *SEC v Treadway*, 430 F. Supp. 2d 293, 330 (S.D.N.Y. 2006)).

[41] A "communication," under NYSE Rule 472.10, is broadly defined "to include, but is not limited to advertisements, market letters, research reports, sales literature, electronic communication, communications in and with the press and wires and memoranda to branch

(continued...)

We also do not view the vague "boilerplate" disclaimers included in the Options Analysis as adequately addressing the misleading aspects of the document.[42] Because the Options Analysis provided specific information tailored to the individual customer's particular situation regarding his or her potential return under the two strategies, it should have included similarly specific information regarding the potential downside of those strategies.

The generic risk disclosures included in the introductory materials and during their telephone conversations also did not sufficiently put customers on notice of the losses they could incur if the stock price remained flat or decreased. The Options Analysis itself should have alerted a customer to the specific risks involved in the customer's particular situation and not depended on scattered information available to the customer.[43] Indeed, despite Applicants' current reliance on these earlier disclosures, the Options Analysis itself neither referred back to them nor gave any indication of risk. The introductory materials, in any event, only generally referred to the "market risk" of holding stock and using margin. Nor does Brown's testimony (or any of the telephone conversations in evidence) support Applicants' claim that the risks were adequately discussed. As Brown testified, the conversations and materials gave him only a "general understanding" of margin, but in no way prepared him for the "accelerated" losses he would incur in his account due to the use of margin.

(...continued)
offices or correspondent firms which are shown or distributed to customers or the public."

[42] *See, e.g., Brian Pendergast*, 55 S.E.C. 289, 301 & n.15 (2001) ("generic disclaimer that 'markets are unpredictable' failed to cure specific misleading aspects of" offering memorandum) (citing *Donald J. Trump Casino Sec. Litig.*, 7 F.3d 357, 371-72 (3d Cir. 1993) ("vague (boilerplate) disclaimer which merely warns the reader that the investment has risks will ordinarily be inadequate"); *see also Kenneth R. Ward*, 56 S.E.C. 236, 259 n.47 (2003) ("'boilerplate' disclaimers in no way overrode Ward's unqualified recommendations regarding specific securities"), *aff'd*, 75 Fed. App'x 320 (5th Cir. 2003) (unpublished).

[43] *See, e.g., Pac On-Line*, 56 S.E.C. at 1120 ("disclaimers of the risks of online trading provided to customers at . . . seminars and when . . . customers opened new accounts" failed to cure firm's misleading advertisement because "[a]dvertisements must stand on their own" under NASD's public communications rule); *Donner Corp.*, 90 SEC Docket at 25-26 ("The research reports themselves needed to convey a complete and accurate picture and could not depend on information available to investors."); *Klein*, 52 S.E.C. at 1036 ("[D]eliver[y of] a prospectus to [an investor] that disclosed risks of investing . . . does not excuse his failure to inform her fully of the risks of the investment package he proposed."); *see also Richmark Capital Corp.*, 57 S.E.C. 1, 15 & n.26 (2003) ("A broker may not satisfy [full disclosure obligation] by pointing to bits and pieces of information that appeared . . . elsewhere and were never brought to the customer's attention.") (collecting cases), *aff'd*, 86 Fed. App'x 744 (5th Cir. 2004) (unpublished).

Applicants also contend that they cannot be held liable because they "did not act with scienter" – *i.e.*, "a mental state embracing intent to deceive, manipulate, or defraud"[44] – which they claim is a required element of NYSE Rule 472.30. For support, Applicants principally rely on *SEC v. Johnson*,[45] an unpublished district court decision in which the court observed that Rule 472.30 "mirrors § 10(b) and Rule 10b-5" of the Securities Exchange Act of 1934. Applicants argue that, because those antifraud provisions contain a scienter requirement, Rule 472.30 must also be construed as containing such a requirement.

In finding Applicants liable, the Exchange interpreted Rule 472.30 broadly, construing it as applying to any misleading communication by an Exchange member to the public, regardless of the member's state of mind. In our view, a plain reading of the Rule supports the Exchange's interpretation.[46] Rule 472.30 is very broadly worded, proscribing the "utilization of any communication which contains . . . any untrue statement or omission of a material fact or is otherwise misleading." Nowhere in the language of the Rule is there an indication that scienter is required. For instance, absent are "the words 'manipulative,' device' and 'contrivance'" that the Supreme Court held in *Ernst & Ernst v. Hochfelder* connote a state-of-mind requirement under the federal securities laws.[47] Nor have Applicants pointed to any evidence in the Rule's regulatory history (nor have we found any) that limits the Rule's application to only fraudulent

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[44] *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12 (1976).

[45] Fed. Sec. L. Rep. ¶ 93,205, 2005 WL 696891, at *5 (S.D.N.Y. 2005).

[46] In this connection, we note that the Exchange's official rule interpretation guide indicates that the Rule should be broadly construed. NYSE Interpretation Handbook No. 92-5 (1992) (noting that Rule 472.30 applies to any "untruthful, misleading, or inaccurate statements in any form of communication with customers or the public").

[47] *Hochfelder*, 425 U.S. at 197-201 (holding that violations of Exchange Act § 10(b) and Rule 10b-5 require scienter based on the presence of such terms and noting that "ascertainment of . . . intent with respect to the standard of liability created by a particular section . . . rest[s] primarily on the language of that section"). Similarly absent from Rule 472.30's language is any requirement that the "member know or has reason to know" the communication is misleading. *Cf.* NASD Rule 2210(d)(1)(B) (proscribing use of "any public communication that the member *knows or has reason to know* contains any untrue statement of material fact or is otherwise false or misleading" (emphasis added)).

communications. In agreeing with the Exchange, we further note that self-regulatory organizations are accorded "some level of deference"[48] in interpreting and applying their rules.[49]

The *Johnson* decision does not alter our conclusion. At issue in that case was whether a research analyst at a NYSE member firm violated the antifraud provisions of the federal securities laws, not Rule 472.30. The complaint alleged that Johnson violated Exchange Act Section 10(b), Rule 10b-5 thereunder, and Section 17(a) of the Securities Act of 1933, by failing to disclose his financial interest in companies that he covered as an analyst. Johnson challenged the allegations, claiming he was "under no duty to disclose" the information. In rejecting his claim, the court referenced Rule 472.30, by analogy, to underscore the industry standard applicable to him that a "philosophy of full disclosure should pervade a member's communications with the public."[50] Contrary to Applicants' contentions, the court did not render any opinion as to whether NYSE Rule 472.30 requires scienter.[51]

Although we acknowledge some similarities in wording between Rule 472.30 and subsection (b) of Exchange Act Rule 10b-5 (as *Johnson* observed),[52] our reading of Supreme

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[48] *Heath v. SEC*, 586 F.3d 122, 139 (2d Cir. 2009) (citing *Shulz v. SEC*, 614 F.2d 561, 571 (7th Cir. 1980) ("[B]ecause these are rules of the Exchange, the Exchange should be allowed broad discretion in determining their meaning.").

[49] Although we need not address Applicants' motive or whether they acted with scienter, we note that the evidence indicates that Applicants' objective of establishing long-term brokerage relationships with these customers was furthered by the exercise-and-hold strategy, which required customers to establish brokerage accounts; the exercise-and-sell strategy did not require customers to set up Smith Barney accounts.

[50] *Johnson*, 2005 WL 696891, at *5.

[51] Applicants further argue that liability under Rule 472.30 requires evidence of scienter because the definition of materiality used by the Exchange in interpreting that aspect of the Rule was found in a Supreme Court decision, *Basic Inc. v. Levinson,* which applied a scienter-based antifraud provision. 485 U.S. at 231-32, 242. However, we find no basis to support Applicants' position that the materiality definition in *Basic* cannot be severed from the remainder of its analysis. The *Basic* definition of materiality is the "general test for determining whether a fact is material under the federal securities laws," irrespective of the mental state involved. *Media Gen. Inc. v. Tomlin*, 387 F.3d 865, 869 (D.C. Cir. 2004); *see also Oxford Asset Mgmt., Ltd. v. Jaharis*, 297 F.3d 1182, 1189 (11th Cir. 2002) (applying *Basic* definition to non-scienter-based violation and noting its "test of materiality is well known").

[52] *Compare* NYSE Rule 472.30 (prohibiting use of a communication containing "any untrue statement or omission of a material fact or is otherwise misleading"), *with* 17 C.F.R. § 240.10b-5(b) (prohibiting the making of "any untrue statement of a material fact or . . .

(continued...)

Court precedent interpreting this language does not support Applicants' position. In *Hochfelder*, the Court determined that it was not the express language contained in Rule 10b-5 that required a showing of scienter – noting, in fact, that "viewed in isolation the language of subsection (b) . . . could be read as proscribing . . . any type of material misstatement or omission."[53] The Court, nonetheless, held that scienter was required under the entirety of Rule 10b-5 because the rule was adopted pursuant to a statute, Exchange Act § 10(b), that required scienter.[54] Subsequently, in *Aaron v SEC*, the Court considered whether a similarly worded section of the Securities Act required scienter in the absence of legislative intent indicating scienter was required: the Court held that scienter was not required under Securities Act Section 17(a)(2) because "the language . . . prohibit[ing] any person from obtaining money or property 'by means of any untrue statement of a material fact or any omission to state a material fact,' is devoid of any suggestion whatsoever of a scienter requirement."[55] The language of Rule 472.30, as discussed, is even broader than these provisions and the Exchange has not otherwise indicated that a scienter requirement should be read into the express language of the Rule.[56]

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52 (...continued)
omit[ting] 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").

53 425 U.S. at 212.

54 *Id.* 212-14 ("[D]espite the broad view of [Rule 10b-5] advanced by the Commission in this case, its scope cannot exceed the power granted the Commission by Congress under § 10(b).").

55 446 U.S. 680, 696 (1980) (holding that neither Securities Act Section 17(a)(2) nor (a)(3) contains a scienter requirement).

56 For similar reasons, we reject Applicants' reliance on common law fraud cases to assert that Rule 472.30 requires a showing that customers directly relied on the communication. We agree with the Exchange that the language of Rule 472.30 does not require a showing of customer reliance. *See supra* note 27.

IV.

The Exchange found that censures were warranted for both Applicants.[57] Although, as discussed above, Applicants challenge the Exchange's findings of violations, they make no separate argument regarding sanctions.

Under Exchange Act Section 19(e), we evaluate disciplinary sanctions to determine if, "having due regard for the public interest and the protection of investors," they are "excessive or oppressive."[58] Applying that standard, we sustain the Exchange's imposition of censures as amply warranted.[59]

NYSE Rule 472.30 serves an important policy objective by encouraging NYSE members and their associated persons to provide full and fair disclosure to their investors. The Rule, as we have previously stated, "promote[s] just and equitable principles of trade, prevent[s] fraudulent and manipulative acts, and, in general, protect[s] investors and the public interest."[60] Applicants' actions thwarted this policy objective by providing an unbalanced picture of the risks and rewards of the exercise-and-hold strategy. While the Options Analysis showed, with precision, the potential gains under the strategy if WorldCom's stock increased, it left the customers to guess as to their possible losses and the risks involved if the stock remained flat or declined. As the Exchange's Hearing Panel observed, "[t]he customers in question relied on [Applicants] to provide them with sound financial advice regarding the largest investment of their lives; they instead received information that omitted material facts and was misleading."

Under the circumstances, we find that the censures imposed by the Exchange are in the public interest and remedial. In doing so, we note a troubling failure by Applicants to accept responsibility for their actions, seeking to pass the blame to others – such as the Firm, their supervisors, research analysts, and even their customers (*e.g.*, for providing them with the price

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[57] The Exchange vacated suspensions that had been imposed by the Hearing Panel, citing the "unique circumstances" of the case, as both Applicants had "left the securities industry in February 2002 and have been defending themselves from the same general nucleus of charges for approximately the last eight years."

[58] We also evaluate sanctions to determine if they impose any unnecessary or inappropriate burden on competition. Applicants do not claim, nor does the record show, that the Exchange's sanctions impose such a burden.

[59] We note that "Exchange Act Section 19(e)(2), 15 U.S.C. § 78s(e)(2), permits us to 'cancel, reduce, or require the remission of' a sanction imposed by a self-regulatory organization but does not permit us to increase the sanction." *Gregory W. Gray, Jr.*, Exchange Act Rel. No. 60361 (July 22, 2009), 96 SEC Docket 19038, 19055 n.41.

[60] *Order Approving Proposed Rule Change*, Exchange Act Rel. No. 27819 (Mar. 19, 1990), 45 SEC Docket 1517, 1517.

projections used in the Options Analysis) – and ignoring Spartis's role in creating the document and Applicants' central role in disseminating it. Although Applicants are not currently working in the securities industry, the censures will serve to alert the public, including other self-regulatory organizations, of the unacceptability of Applicants' conduct.[61] The sanctions imposed will have the additional salutary effect of encouraging other member firms and their associated persons to communicate in a balanced way with their customers.

An appropriate order will issue.[62]

By the Commission (Commissioners CASEY, WALTER, AGUILAR, and PAREDES); Chairman SCHAPIRO not participating.

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Elizabeth M. Murphy
Secretary

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[61] *See, e.g., Salvatore F. Sodano*, Order Reversing Initial Decision and Remanding for Further Proceedings, Exchange Act Rel. No. 59141 (Dec. 22, 2008), 94 SEC Docket 12714, 12719 (noting that censure can "serve the remedial purpose of alerting the public, including other SROs and their officers and directors, of the unacceptability of the conduct at issue").

[62] We have considered all of the parties' contentions. We have rejected or sustained them to the extent that they are inconsistent or in accord with the views expressed in this opinion.

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 64489 / May 13, 2011

Admin. Proc. File No. 3-13979

In the Matter of the Application of

PHILIP L. SPARTIS
and
AMY J. ELIAS
c/o Jeffrey L. Liddle, Esq.
Liddle & Robinson, L.L.P
800 Third Avenue
New York, New York 10022

For Review of Disciplinary Action Taken by

NYSE Regulation, Inc.

ORDER SUSTAINING DISCIPLINARY ACTION TAKEN BY REGISTERED SECURITIES ASSOCIATION

On the basis of the Commission's opinion issued this day, it is

ORDERED that the disciplinary action taken by NYSE Regulation, Inc., against Philip L. Spartis and Amy J. Elias, be, and it hereby is, sustained.

By the Commission.

Elizabeth M. Murphy
Secretary