SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 50889 / December 20, 2004

Admin. Proc. File No. 3-10884

In the Matter of

LESLIE A. AROUH

OPINION OF THE COMMISSION

BROKER-DEALER PROCEEDING

CEASE-AND-DESIST PROCEEDING

Grounds for Remedial Action

Fraud

Associated person of broker-dealer, acting with scienter, engaged in a scheme to defraud in the form of adjusted trading. Held, it is in the public interest to bar person from association with any broker or dealer subject to a right to reapply after two years, order him to pay a civil money penalty of $110,000, and order him to cease and desist from committing or causing any violation or future violation of Section 17(a) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934, and Exchange Act Rule 10b-5.

APPEARANCES:

Ira Lee Sorkin and Donald A. Corbett, of Carter Ledyard & Milburn LLP, for Leslie A. Arouh.

William P. Hicks and James G. Westrick, for the Division of Enforcement.

Appeal filed: November 12, 2003
Last brief received: February 4, 2004
Oral argument: November 9, 2004

I.

Leslie A. Arouh, formerly associated with First Union Capital Markets Corp. ("First Union"), a registered broker-dealer, and the Division of Enforcement each appeal from the decision of an administrative law judge. The law judge found that Arouh willfully violated Section 17(a) of the Securities Act of 1933, 1/ Section 10(b) of the Securities Exchange Act of 1934, 2/ and Exchange Act Rule 10b-5. 3/ The law judge concluded that Arouh participated in an adjusted trading scheme which consisted of First Union's (1) buying $100 million of corporate bonds from a group of accounts at ARM Capital Advisors LLC ("ARM"), a registered investment adviser, (2) selling the same bonds back to a different group of ARM accounts shortly thereafter at a $1.376 million loss to First Union, and (3) selling to ARM accounts bonds that were marked up sufficiently to reimburse First Union's losses. The law judge suspended Arouh from association with a broker or dealer for ninety days and ordered Arouh to pay a civil money penalty of $330,000.

Arouh contends that the Division failed to establish that he knowingly or recklessly participated in a prearranged adjusted trading scheme. He argues that the sanctions imposed by the law judge, and the additional sanctions sought by the Division, are not warranted. The Division alleges that Arouh knowingly participated in the adjusted trading scheme, that this constituted fraud, and that Arouh's actions warrant that he be barred from association with any broker or dealer. The Division also seeks imposition of a cease-and-desist order in addition to the civil money penalty of $330,000 imposed by the law judge. We base our findings on an independent review of the record, except with respect to those findings not challenged on appeal.

II.

Arouh entered the industry and began selling corporate bonds in 1994. Arouh was associated with First Union from December 1997 until May 1998. At First Union, Arouh was a salesperson of fixed income products, specifically investment-grade corporate bonds.

ARM was a registered investment adviser. 4/ ARM was Arouh's largest account. By March 1998, Arouh conducted more than eighty-five percent of his business at First Union with ARM.

1/ 15 U.S.C. § 77q.

2/ 15 U.S.C. § 78j.

3/ 17 C.F.R. § 240.10b-5.

4/ ARM changed its name to Vanderbilt Capital Advisors LLC ("Vanderbilt Capital Adviser") in May 2000.

ARM employed Harvey Rubinstein as an executive vice president and senior portfolio manager in charge of ARM's corporate bond group from January 1995 until he resigned on January 12, 2000. 5/ Rubinstein managed both so-called performance/total return accounts ("performance accounts") and insurance accounts. In a performance account, clients are able to compare the total return earned in their portfolios to the total return of the market as represented in an index composed of various securities. In insurance accounts, clients' goals are to achieve yields from their asset holdings to offset their potential future liabilities. 6/

In March 1998, Rubinstein's supervisor at ARM instructed him to improve the return of the performance accounts that Rubinstein managed. Rubinstein determined to engage in trades that would result in improving the performance of Rubinstein's performance accounts at the expense of certain of his insurance accounts.

Rubinstein therefore proposed a three-legged trade to Arouh. 7/ In the first leg of the trade, First Union would purchase bonds at above-market prices from certain ARM accounts. This would result in improved performance for those accounts. In the second leg, ARM would

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5/ Vanderbilt Capital Advisers and Rubinstein settled charges arising out of the events at issue in this proceeding. See Vanderbilt Capital Advisers LLC, Investment Advisers Act Rel. No. 2053 (Sept. 3, 2002), 78 SEC Docket 1346 (ordering a censure, a $125,000 civil money penalty, and undertakings); Harvey J. Rubinstein, Securities Exchange Act Rel. No. 46449 (Sept. 3, 2002), 78 SEC Docket 1236 (barring him from association with an investment adviser, ordering a $25,000 civil money penalty, and ordering him to cease and desist from committing or causing any violation or future violation of the antifraud provisions). Rubinstein conceded that he cheated ARM customers and lied to Commission staff during the investigation of the events at issue. He testified before the law judge under a grant of immunity from criminal prosecution.

6/ Arouh's testimony reflects that he understood the nature of both performance and insurance accounts.

The record also includes testimony that insurance account clients frequently do not calculate the total return on the portfolio in a given time period or compare it to a market index.

7/ Arouh also testified that he previously had conducted a type of trade with Rubinstein that was "much smaller in size, but similar" to the trade at issue here. Arouh could not recall whether his trading in that instance involved third-leg trades intended to make up the losses for the first two legs, because he could not recall if First Union suffered a loss on the purchase and resale.

repurchase the same bonds at market prices for different accounts managed by ARM. 8/ As a result, First Union would suffer a loss due to its overpayment in the first leg. To compensate First Union for that loss, Rubinstein proposed to purchase for ARM accounts an additional $100 million of bonds from First Union at prices above prevailing market. While this third leg would compensate First Union for its losses, it would pass those losses on to the ARM customer accounts in the third leg, which would not receive the best price for their purchases of the bonds. 9/

Arouh initially proposed the adjusted trading scheme to Curtis Arledge, the head of First Union's mortgage trading desk. Arledge declined to proceed with the proposed transactions. Arouh then brought the proposal to Keith Mauney, the head trader of investment-grade bonds at First Union, who agreed to proceed with the transactions. 10/

Mauney subsequently met with Owen Williams (who, during the relevant period, was the head of First Union's fixed income department) and with Scott Ilario (then First Union's director of compliance). Ilario testified that at this meeting Mauney described only the first and second legs and did not mention that the trading scheme had a third leg. After hearing Mauney's description of the proposed trades, Ilario became concerned that ARM might want to "park" securities with First Union over the month-end to remove them from ARM's books. He also was concerned that First Union not enter into any type of prearranged trading scheme. Ilario stressed to Mauney that there should be no promises or guarantees that First Union would sell the bonds back to ARM and that the transactions had to be effected at the prevailing market price at both the time of the purchase and of the sale.

Mauney next told Arouh that the Compliance Department had approved the proposed trades, provided that there were no promises or guarantees with respect to the repurchase of the

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8/ Rubinstein testified that he told Arouh that the first leg involved ARM performance accounts and that those involved in the second leg would be insurance accounts. Arouh testified that Rubinstein "probably" told him that the ARM accounts involved in the first leg would be performance accounts. He testified that it was "very likely" that Rubinstein advised him that the second-leg accounts would be insurance accounts.

9/ There was significant overlap in the accounts at ARM that were involved in the second and third legs, although the accounts involved in those legs were not identical.

10/ It appears that the adjusted trading scheme that Arouh proposed to Arledge involved mortgage securities. After Arledge declined, Brian Farrell, Arouh's partner, asked Arouh why he was approaching Mauney when Arledge had refused the proposal. Arouh replied that Mauney had agreed to proceed with the transactions. Farrell then asked Mauney why he was willing to proceed when Arledge had declined to do so and Mauney stated that he did not view the transactions as problematic so long as no promises or guarantees were made to ARM.

bonds. Mauney also told Arouh that Mauney was going to hedge the transaction. As the ARM trades progressed, Mauney told Arouh that the hedge consisted of a short sale of $50 million in U.S. Treasury securities. In fact, Mauney never hedged the transaction, and his statements to Arouh with respect to the hedge were false.

On March 30 and 31, Rubinstein faxed Arouh lists of investment-grade corporate bonds with the prices at which Rubinstein wanted to sell those bonds to First Union. Mauney approved the trades without confirming whether the prices were at the prevailing market price. 11/ Mauney testified that his approval was based on Arouh's assurances that the bonds were competitively priced and that other broker-dealers had bid on them. 12/

Arouh knew before trading started that the sale of the bonds in the second leg would result in a loss to First Union. By March 30, Arouh knew that Mauney estimated that the loss on the second leg would be $2 to $3 million.

On April 2 and 3, Rubinstein faxed to Arouh lists of the bonds he would repurchase from First Union for ARM insurance accounts and the prices he was willing to pay for those bonds. These were the same bonds that the ARM performance accounts had sold to First Union in the first leg. Arouh knew that interest rates had decreased in the period since First Union's first-leg purchases, which should have resulted in an increase in the price of the bonds. 13/ Arouh and Mauney testified that they were surprised by how much of a loss First Union would suffer on the second leg. While Arouh, at Mauney's direction, negotiated higher prices for some of the bonds from Rubinstein, First Union's loss on the second leg was $1.376 million. Arouh calculated those losses and wrote them on the faxes that he received from Rubinstein on April 2 and 3.

Mauney testified that he did not want to sell the bonds back to ARM at lower prices. Mauney agreed to execute the second-leg trades if Arouh could recover the resulting losses by selling additional bonds to ARM. Mauney told Arouh that Arouh would not earn any

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11/ Although Arouh claims that the trader always sets the price, in general, a salesperson negotiates the price of a bond trade with the customer within levels set by the trader. The trader approves the ultimate price and decides whether the trade will be executed.

12/ Mauney claimed that he told Williams and Ilario that ARM was soliciting bids on the first leg from several broker-dealers and that, therefore, the trade would be in competition, with the winner gaining the opportunity to sell ARM $100 million of bonds. However, Ilario and Arouh testified that there was no discussion of the trade being in competition. The law judge found that Mauney's motive for maintaining that the trade was in competition was to explain why he did not check the prices on the first leg.

13/ A bond has a fixed-coupon payment and, therefore, if interest rates decrease, the price of the bond can be expected to increase. During the period from March 30 to April 6, 1998, interest rates declined by fifteen to twenty basis points.

commission until the entire trading scheme (including the purported hedge) realized a profit. According to Mauney, Arouh needed to recover a total of $2.532 million before Arouh would receive any commission. Mauney arrived at this figure by adding a purported $1.156 million loss from the nonexistent hedge to the $1.376 million loss on the repurchase of the bonds.

Mauney also urged Arouh to get Rubinstein to complete part of the third leg purchase. On March 31, Arouh made the first sale of the third leg, selling $10 million in NationsBank bonds to insurance accounts at ARM. This sale occurred before the second leg started (even before Rubinstein had faxed Arouh the lists of the second-leg bonds) and before the first leg had been completed. Arouh marked up these bonds two points above the price at which Mauney had made them available resulting in a $200,000 credit against the expected loss from the rest of the transactions.

In total for the third leg, Arouh sold ARM insurance accounts $100 million of five different bonds (including the NationsBank bonds) at prices substantially above the market. Mauney testified that he made the bonds available to Arouh for sale to ARM accounts at prices that Arouh could mark up about two points, which Mauney approved. In fact, Arouh marked up the third-leg bonds from two to three and one-quarter points.

The record, including tapes of Arouh's and Rubinstein's discussions with respect to the third leg, reflects that the goal of that leg was to offset the losses First Union had suffered from the first two legs (as well as the purported hedge). 14/ Arouh also negotiated to include a sales credit for himself. The prices had no relationship to supply or demand, and there is nothing in the record to suggest that either party made any effort to check the market. For example, Arouh testified that Rubinstein initially offered to purchase bonds issued by Equitable Companies, Inc. ("Equitable") for $103.25, but that, after further discussions, Rubinstein agreed to pay $105.30 in order to credit $500,000 against First Union's losses for the first- and second-leg trades. The record contains a yield analysis page for each trade, containing Arouh's handwritten calculations of the amount that Arouh marked up the bonds and identifying the portion of the profit from the trade that was meant to compensate First Union for its purported losses. As a result of these negotiations, Arouh added approximately $2.5 million to the prices that Mauney had made the bonds available to Arouh, thereby recovering First Union's losses on the rest of the adjusted trading scheme, as well as the losses that he believed First Union had suffered on the hedge. Arouh admitted that he had marked up the third-leg trades in order to cover losses suffered in the other trades.

The third leg progressed with sales to ARM insurance accounts on April 3 and 6. On Friday, April 3, Arouh sold Sears, Equitable, and First Union bonds to ARM insurance accounts.

14/ As a matter of practice, First Union tape recorded telephone calls of traders and salesmen. During his investigation of the events in question, Ilario obtained excerpts from First Union's taping system's recordings of phone calls between Arouh's, Farrell's (another bond salesperson at First Union), and Mauney's lines and ARM.

He sold the Equitable and First Union bonds at two points above the prices at which Mauney made the bonds available and the Sears bonds at three points above their available prices. Arouh testified that he was aware that the First Union bonds were not suitable for the insurance accounts that purchased them because they were shorter in duration and lower in yield than what Rubinstein indicated was required. 15/ On Monday, April 6, Arouh completed the third leg by selling $25 million in MCI bonds to ARM insurance accounts at a price marked up three and one-quarter points above the price at which Mauney had made the bonds available to Arouh.

As a result of these trades, Arouh's sales group was given a $800,000 sales credit. In his brief, Arouh states that he was paid $415,000 in commissions for these trades.

Based on their conversation with Mauney about the trades with ARM, Williams instructed Ilario to monitor closely the transactions between First Union and ARM. Ilario commenced an investigation into the trades between First Union and ARM after learning of ARM's repurchase of the bonds in the second leg of the transaction, in order to ascertain if there was a prearranged trading scheme. In order to determine whether the transactions had been effected at the prevailing market price, Ilario looked at First Union's contemporaneous transactions with other broker-dealers and also considered whether the price of the bonds was consistent with the movement of interest rates during the period in question. He also entered the bonds into three independent pricing services.

Ilario concluded that the bonds in the first leg had been overpriced. His conclusion is consistent with the testimony of the Division's expert who determined that at least seventeen of the thirty-seven bonds in the first leg were overpriced. 16/

Upon further investigation, Ilario discovered the trades between First Union and ARM that constituted the third leg of the trade. Ilario concluded that these trades also were above the prevailing market price based upon First Union's contemporaneous transactions in those bonds with other broker-dealers. The Division's expert concluded that all five of the bonds in the third leg were overpriced. First Union repriced the third-leg trades and refunded $1,875,750 to the ARM insurance accounts. First Union also permitted the ARM performance accounts to retain the profits that those accounts had received from the first leg.

15/ Duration, which is denominated in years, is a generic term that describes the responsiveness of a bond's price to a change in interest rates. See Piper Capital Mgmt., Inc., Securities Act Rel. No. 8276 (Aug. 26, 2003), 80 SEC Docket 3594, 3600, pet. denied, No. 03-1349 (D.C. Cir. 2004) (unpublished opinion).

16/ The Division's expert concluded that the bonds sold in the second-leg trades were priced at market levels.

On April 8, 1998, First Union suspended Arouh, and First Union terminated his employment with the firm on May 6. 17/ On April 8, 1999, Arouh entered into a settlement with First Union. Arouh agreed not to receive any commissions that he might have earned for the adjusted trading with ARM, nor commissions that Arouh alleged he was due from certain unrelated transactions. 18/

III.

Securities Act Section 17(a), Exchange Act Section 10(b), and Exchange Act Rule 10b-5 prohibit fraudulent and deceptive acts and practices in connection with the offer, purchase, or sale of a security. 19/ Scienter is a necessary element of a violation of Securities Act Section 17(a)(1), Exchange Act Section 10(b), and Exchange Act Rule 10b-5. 20/ Scienter has been defined by the Supreme Court as a "mental state embracing intent to deceive, manipulate or defraud." 21/ Reckless behavior satisfies the scienter requirement. 22/

17/ In October 1998, Arouh joined Raymond James & Associates, Inc., a member firm of the New York Stock Exchange, Inc., where he is currently employed as senior vice president for institutional sales.

18/ As a result of the events in question, Mauney entered a settlement with the Commission in which he was ordered to cease and desist from committing or causing any violations or future violations of the antifraud provisions of the federal securities laws. Keith J. Mauney, Exchange Act Rel. No. 46448 (Sept. 3, 2002), 78 SEC Docket 1232. First Union suspended Mauney for one month, suspended him in a supervisory capacity for nine months, fined him, and required him to undergo training and counseling. At the time of the hearing, Mauney was no longer a bond trader but was in a non-supervisory underwriting position.

19/ Securities Act Section 17(a), 15 U.S.C. § 77q, Exchange Act Section 10(b), 15 U.S.C. § 78j, and Exchange Act Rule 10b-5, 17 C.F.R. § 240.10b-5.

20/ See Aaron v. SEC, 446 U.S. 680, 695, 697 (1980); Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 (1976); Steadman v. SEC, 603 F.2d 1126, 1134 (5th Cir. 1979), aff'd, 450 U.S. 91 (1981). Violations of Securities Act Sections 17(a)(2) and (a)(3) do not require proof of scienter. See Aaron, 446 U.S. at 695, 696; Steadman, 603 F.2d at 1133.

21/ Ernst & Ernst v. Hochfelder, 425 U.S. at 193.

22/ See, e.g., Hackbart v. Holmes, 675 F.2d 1114, 1117-18 (10th Cir. 1982) (defining recklessness as "an extreme departure from the standards of ordinary care, . . . which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it") (quoting Sundstrand Corp. v.

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The Supreme Court has stated that Section 10(b)'s prohibition against employing "any manipulative or deceptive device or contrivance" includes a scheme, 23/ and that Section 10(b) applies to "complex securities frauds" in which "there are likely to be multiple violators." 24/ The Court has stated that Section 10(b) encompasses deceptive "practices," 25/ deceptive "conduct," 26/ and deceptive "acts." 27/

A number of courts has concluded that a person's conduct as part of a scheme to defraud can constitute a primary violation "as long as each defendant committed a manipulative or deceptive act in furtherance of the scheme." 28/ Accordingly, a person who directly or indirectly engages in a manipulative or deceptive act as part of a scheme to defraud can be a primary violator of Section 10(b) and Rule 10b-5(a).

Adjusted trading constitutes a scheme to defraud in violation of Exchange Act Section 10(b) and Rule 10b-5 thereunder. Adjusted trading is a practice in which a person sells a security

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22/ (...continued)
Sun Chemical Corp., 553 F.2d 1033, 1045 (7th Cir.), cert. denied, 434 U.S. 875 (1977)). See also Newton v. Merrill, Lynch, Pierce, Fenner & Smith, Inc., 135 F.3d 266, 272-73 (3d Cir. 1998) ("[R]ecovery on a federal securities fraud claim requires a showing of scienter: a deliberate or reckless misrepresentation of a material fact.").

23/ Ernst & Ernst v. Hochfelder, 425 U.S. at 199 n.20.

24/ Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., 511 U.S. 164, 191 (1994).

25/ Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 475-76 (1977).

26/ United States v. O'Hagan, 521 U.S. 642, 659 (1997).

27/ Central Bank, 511 U.S. at 173.

28/ Cooper v. Pickett, 137 F.3d 616, 624 (9th Cir. 1997); see also SEC v. U.S Environmental, Inc., 155 F.3d 107, 112 (2d Cir. 1998) (holding that a primary violator is a person who "participated in the fraudulent scheme")(internal quotation marks and citation omitted); In re Lernout & Hauspie Sec. Litig., 236 F. Supp. 2d 161, 173 (D. Mass. 2003) (holding that any person can be primarily liable "who substantially participates in a manipulative or deceptive scheme by directly or indirectly employing a manipulative or deceptive device (like the creation of a financing of a sham entity) intended to mislead investors"); In re ZZZ Best Sec. Litig., 864 F. Supp. 960, 969 (C.D. Cal. 1994) (stating that Central Bank "makes clear that more than simply knowing assistance with the underlying fraudulent scheme is required" and that it is necessary to "prove that [defendants] engaged in some form of deception that is prohibited by Rule 10b-5").

above the prevailing market price and purchases another security from the buyer of the first security at a corresponding price above the prevailing market price. 29/

Here, Arouh bought for First Union $100 million of corporate bonds from one set of ARM accounts. At least some of these transactions occurred above the prevailing market price. He then sold the same bonds back to unrelated ARM accounts at a $1.376 million loss to First Union. Arouh next sold certain ARM customer accounts additional bonds that he marked up above the prevailing market price in order to reimburse First Union for the $1.376 million loss, as well as for the $1.156 million that Mauney falsely claimed First Union had lost on the nonexistent hedge. Arouh's pricing of this leg was based solely on recovering the amounts that he understood First Union had lost, as well as to make commissions. Arouh knew that the holders of accounts in the third leg were paying high prices in order to make up for the more favorable prices he offered to the first-leg accounts. We conclude that this adjusted trading was a scheme to defraud in willful violation of Securities Act Section 17(a), Exchange Act Section 10(b), and Exchange Act Rule 10b-5. Arouh's participation in these transactions and his pricing of the bonds constituted deceptive acts in furtherance of the adjusted trading scheme.

We find that Arouh acted with scienter, contrary to his assertions otherwise. Arouh was fully aware of and fully participated with Rubinstein in the plan to purchase bonds from one set of accounts advised by ARM, sell the same bonds at lower prices into different accounts at ARM, and recover the loss to First Union via a third set of trades. After Rubinstein proposed the three-leg trading scheme to Arouh, Arouh brought the proposal to Arledge who rejected it. Arouh then brought the proposal to Mauney. After receiving Mauney's approval, Arouh negotiated with Rubinstein over the details of each leg of the transaction.

Arouh knew on March 30 that Mauney was estimating the loss to First Union at $2 to $3 million on the first and second legs. Arouh knew that the prices on the second leg were well below the prices on the first leg. He also knew that the lower prices for the second leg were inconsistent with rising prices in the bond market generally, which indicated that the prices of the first leg were too high. Arouh negotiated with Rubinstein to identify the bonds that ARM accounts would purchase in the third leg and the prices at which those accounts would purchase those bonds in order to recoup First Union's losses from the first- and second-leg transactions and its purported losses on the nonexistent hedge.

Arouh began to sell the third-leg bonds to make up for these losses before the second-leg trades began and before the first-leg trades had been completed, evidencing Arouh's awareness

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29/ See, e.g., Utica Mutual Ins. Co. v. Fireman's Fund Ins. Co., 748 F.2d 118, 120 (2d Cir. 1984) (describing as adjusted trading the sale of a large number of bonds to a broker-dealer at prices substantially above market rates and the purchase of another group of bonds of equal value from the same broker-dealer at prices also above market rates); NASD Policy on Adjusted Trading, Educational Circular 87-15 (Nov. 10, 1987) (noting that adjusted trading may violate the antifraud provisions of the federal securities laws).

from the start of the adjusted trading scheme. Arouh knew that the ARM accounts that purchased the bonds that made up the third leg were not paying market prices and that these accounts were being charged higher than market prices to make up the difference to First Union for its losses from the first- and second-leg transactions. He marked up those prices from the base price given to him by Mauney with the aim of recouping those losses. The record amply demonstrates that, at a minimum, Arouh's conduct with respect to the adjusted trading represents an extreme departure from the standards of ordinary care. We conclude that Arouh acted with scienter.

Arouh argues that the Division has failed to establish that he "agreed to or was aware of a prearrangement" with respect to the three legs of the transaction. Arouh maintains that he could not have prearranged a transaction with Rubinstein because he did not know the specific bonds to be traded or the prices at which ARM would sell them until Rubinstein faxed him the list of bonds and their prices. He also claims that, because First Union did not guarantee that the first leg bonds would be kept in First Union's inventory, there could be no prearranged agreement to engage in adjusted trading. His arguments are without merit. While there was no binding prearranged agreement that First Union would sell the first-leg bonds back to ARM, there was a strong expectation that this would occur. 30/ Moreover, Arouh entered into this scheme knowing that First Union would be made whole regardless of whether Arouh was aware of the particular bonds to be traded or the exact prices at which they would trade. His own testimony establishes that he was aware, from the time of his initial conversation with Rubinstein about the trades at issue, that ARM would sell bonds to First Union from one set of ARM customer accounts at above market prices, repurchase the same bonds at lower prices for different ARM accounts resulting in losses to First Union, and then make up the loss to First Union with a third set of trades in which ARM accounts purchased bonds at above market prices. This is sufficient to establish his scienter with respect to the adjusted trading scheme. 31/

Arouh contends that he was unaware that ARM was selling the bonds from performance accounts and buying them for insurance accounts. 32/ We note, however, that Arouh testified

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30/ Arouh cites the law judge's finding that the second-leg repurchase by First Union was conditioned on First Union still owning the bonds and that "there were no guarantees or promises." The law judge noted that "there was an expectation, however, that ARM would buy them back." The law judge also noted that "Mauney did not actively exhort the sales force to sell the bonds" during the few days that First Union held them in inventory.

31/ Arouh's counsel conceded during oral argument that, if all three steps were contemplated, the adjusted trading scheme constituted fraud.

32/ The law judge concluded that the record does not support a finding that Arouh knew that ARM was selling the bonds from performance accounts and buying them for insurance

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that Rubinstein "probably" told him that the ARM accounts involved in the first leg would be performance accounts and that it was "very likely" that Rubinstein advised him that the second-leg accounts would be insurance accounts. 33/ In any event, as the law judge found, Arouh was aware of and fully cooperated with Rubinstein in the plan to sell bonds from certain customer accounts at ARM at prices to benefit those accounts and to repurchase the same bonds at lower prices into different accounts at ARM. Even if Arouh did not know which accounts sold the first-leg bonds and which accounts bought the bonds in the second and third legs, the record establishes that he knew that the accounts in the first leg received favorable prices while the accounts in the third leg were charged high prices in order to make up the difference to First Union.

Arouh claims that he was not aware that the bonds in the first leg would be priced above the market. There are, however, numerous taped conversations between Arouh and Rubinstein that took place prior to the first-leg and second-leg transactions in which Arouh discusses how ARM can make up the losses suffered by First Union in those transactions. 34/ In addition, Rubinstein testified that he told Arouh that the initial leg of the sale to First Union would be above market price and ARM would buy back those bonds into different accounts at a lower price. Rubinstein testified further that he discussed with Arouh that ARM would purchase additional bonds at above market prices in order to make up for the loss that First Union would

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32/ (...continued)
accounts because such a finding would rest solely on the testimony of Rubinstein who has admitted lying to the Commission and cheating customers. But see infra note 33 and accompanying text.

33/ See supra note 8.

34/ Arouh argues that the tapes are incomplete and contain "obvious deletions, anomalies, distortions and omissions," and he introduced expert testimony to support this assertion. The expert testified to the existence of anomalies such as alleged unexplained breaks or gaps during certain recorded conversations and discrepancies with respect to the order of certain recorded conversations. Nevertheless, Arouh has failed to establish how these asserted anomalies support his claim that he did not engage in the alleged violative conduct. Arouh's own testimony at the administrative hearing is sufficient to corroborate the taped conversations and to establish that he participated in the adjusted trading scheme with scienter.

suffer in the first two legs. 35/ Arouh instituted the third-leg trades before the first leg had concluded and the second leg commenced, indicating that he was aware of the losses First Union would incur from the earlier legs. 36/

Arouh further argues that it was Mauney and not he who orchestrated the scheme and who must bear primary responsibility for the violative conduct. According to Arouh, the third-leg prices were set at Mauney's direction. There is ample evidence, however, that Arouh negotiated with Rubinstein for ARM insurance accounts to pay more points per bond to compensate First Union for the losses on the first- and second-leg transactions, as well as the nonexistent hedge. 37/ Through these actions, Arouh participated in deceptive acts with respect to the ARM insurance account holders who bought the third leg bonds. These account holders were defrauded because they paid an inflated price for the bonds that they purchased so that Arouh could compensate First Union for the losses it incurred in the rest of the scheme. His acts as part of the adjusted trading scheme make Arouh liable as a primary violator regardless of the level of Mauney's involvement in the scheme.

Arouh argues that the Division's investigation failed to take into account Mauney's central role in the adjusted trading scheme. Arouh argues that Mauney orchestrated the adjusted trading scheme in order to "unload his stale, low-yielding inventory and enrich himself." According to Arouh, Mauney pressured him into selling First Union bonds to ARM. Arouh alleges that only Mauney (and not Arouh) had the authority to commit the firm to a trade, and to direct whether, when, and at what price a trade would occur. The law is clear, however, that Mauney's

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35/ Nor, given this record evidence, are we persuaded by Arouh's claim that he believed that First Union was willing to price the bonds in the first leg favorably as a "loss leader" in order to retain a valuable customer.

36/ Arouh complains that the initial decision relies on three cases alleging aiding and abetting, including Nicholas P. Howard, Exchange Act Rel. No. 47357 (Feb. 12, 2003), 79 SEC Docket 2332, rev'd in part and remanded in part, 376 F.3d 1136 (D.C. Cir. 2004). Arouh correctly notes that he was charged solely as a primary violator. We have considered only that allegation. We also note that we recently dismissed Howard.

37/ Arouh contends that a finding of violation is not warranted because the portion of the markup that he received as compensation was within acceptable guidelines and he did not receive the remainder of the markup. Whether or not Arouh's compensation was within acceptable guidelines does not alter the fact that he participated in an adjusted trading scheme that resulted in certain ARM accounts receiving above-market prices at the expense of other ARM accounts that received below-market prices for their trades.

involvement in the adjusted trading scheme and his final approval of pricing do not insulate Arouh from liability. 38/

Moreover, the record establishes that Rubinstein proposed the trading scheme to Arouh after Rubinstein's supervisor at ARM instructed him to improve the performance of certain accounts managed by ARM. Arouh and Rubinstein discussed the adjusted trading scheme before Mauney ever was advised of the plan. Indeed, Arouh admits that, before he proposed the adjusted trading scheme to Mauney, he proposed the same arrangement to Curtis Arledge, the head of First Union's mortgage trading desk, who declined to proceed with the proposed transactions. Thus, Arouh's attempt to shift all of the blame for the adjusted trading scheme to Mauney does not withstand scrutiny.

Arouh alleges that Mauney withheld information from and attempted to deceive almost everyone with whom he came in contact, both during the events at issue and at the hearing. 39/ The law judge determined that Mauney's testimony with respect to certain facts was not entirely consistent with other, more credible evidence in the record and, accordingly, gave his testimony on disputed facts less weight. We see no reason to challenge the law judge's credibility determination with respect to Mauney. 40/ Arouh has failed to establish how any of Mauney's alleged misstatements are relevant to our determination. We have based our conclusions on Arouh's own testimony and other corroborative evidence that Arouh was a knowledgeable participant in the adjusted trading scheme. 41/

38/ Orkin v. SEC, 31 F.3d 1056, 1065 (11th Cir. 1994) (holding that salespersons are responsible for fair pricing and cannot escape liability by claiming that final authority to set prices rests with their superiors); SEC v. U.S. Environmental, 155 F.3d at 112 (holding that a primary violator is a person who "participated in the fraudulent scheme" regardless of the fact that someone else directed the scheme) (internal quotation marks and citation omitted).

39/ Arouh also criticizes First Union's investigation as biased and protective of Mauney. Whether or not this is true, it is not relevant. Our findings are not based on First Union's investigation but rather on the record in this administrative proceeding.

40/ As we have stated previously, the credibility determination of an initial fact finder is entitled to considerable weight and deference because it is based on hearing the witnesses' testimony and observing their demeanor. See, e.g., Daniel Joseph Alderman, 52 S.E.C. 366, 368 (1995), aff'd, 104 F.3d 285 (9th Cir. 1997); Jonathan Garrett Ornstein, 51 S.E.C. 135, 137 (1992).

41/ Arouh further contends that Mauney deceived the Commission by submitting a Wells submission that was "replete with lies" and that many of these falsehoods were incorporated into the consent cease-and-desist order entered by the Commission.

(continued...)

* * *

For the foregoing reasons, we conclude that Arouh participated, with scienter, in the fraudulent adjusted trading scheme in willful violation of Securities Act Section 17(a), Exchange Act Section 10(b), and Exchange Act Rule 10b-5.

IV.

The law judge suspended Arouh from association with any broker or dealer for ninety days and imposed a civil money penalty of $330,000. The Division has appealed the sanctions, arguing that, in addition to the civil money penalty, the violations warrant that Arouh be barred from association with any broker or dealer and warrant the imposition of a cease-and-desist order against Arouh. 42/ Arouh argues that the sanctions imposed by the law judge are excessive and that no sanctions are warranted.

Exchange Act Section 15(b)(6) authorizes the Commission to censure, place limitations on, suspend, or bar a person associated with a broker, dealer, or municipal securities dealer when such sanction is in the public interest and the person has, among other things, willfully violated the federal securities laws. 43/ When Congress grants an agency the responsibility to impose sanctions to achieve the purposes of a statute, "the relation of remedy to policy is peculiarly a matter for administrative competence." 44/ We have indicated that, in determining what sanction is in the public interest, we consider the following factors:

> the egregiousness of the [respondent's] actions, the isolated or recurrent nature of the infraction, the degree of scienter involved, the sincerity of the [respondent's] assurances against future violations, the [respondent's] recognition of the

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41/ (...continued)
However, our findings are not based on those documents but rather on the record in this administrative proceeding.

42/ Although the law judge did not address whether a cease-and-desist order was warranted, that question is properly before us because the Division requested imposition of a cease-and-desist order in its Order Instituting Proceedings.

43/ 15 U.S.C. § 78o(b)(6).

44/ Butz v. Glover Livestock Comm'n Co., Inc., 411 U.S. 182, 185 (1973), quoting American Power Co. v. SEC, 329 U.S. 90, 112 (1946).

> wrongful nature of his conduct, and the likelihood that the [respondent's] occupation will present opportunities for future violations. 45/

Arouh's violation was egregious. He participated in a scheme that exposed his firm and ARM customers to substantial losses. Absent the restitution paid by First Union, certain ARM accounts would have paid unfair prices that were unrelated to the forces of supply and demand simply to make up First Union's losses from the first two legs of the scheme. Arouh negotiated prices to recover First Union's losses on the first- and second-leg transactions, although he knew that the accounts purchasing the bonds in the third leg would not receive the best price and that at least some of those bonds were not suitable for Rubinstein's accounts. 46/ He sought to accommodate a favored customer and generate commissions. His conduct clearly evidences a high level of scienter. While the conduct pertained to a series of transactions that were conducted with one trading partner over the course of a few days, the transactions were large, amounting to hundreds of millions of dollars of trades and generated substantial losses to First Union. 47/

Consistent with a vigorous defense of the charges against him, Arouh has not acknowledged the wrongful nature of his conduct. He has attempted to shift all responsibility for the scheme to Mauney despite the unambiguous record evidence that Rubinstein proposed the scheme to Arouh, that Arouh then approached Arledge and subsequently Mauney, and that Arouh and Rubinstein negotiated over the details of the second and third legs. Arouh currently is employed in the securities industry, and his occupation will present opportunity for future violations of the federal securities laws. All of these factors support imposition of a more severe sanction than that imposed by the law judge.

We recognize that Mauney's misrepresentations about the nonexistent hedge increased the loss to First Union by almost doubling the price adjustments that Arouh made on the third-leg sales to ARM. We also take into consideration the fact that Arouh, who has continued to work in the industry since the trades at issue here, has not been subject to further disciplinary action or investigation.

Given all of these factors, we believe that a bar from association with any broker or dealer with a right to reapply will ensure that Arouh is unable to use his position in the securities

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45/ Donald T. Sheldon, 51 S.E.C. 59, 86 (1992) (citations omitted), aff'd, 45 F.3d 1515 (11th Cir. 1995).

46/ See supra text accompanying note 15.

47/ Arouh notes that First Union used some of his commissions to make this restitution. He also complains that First Union made restitution for the non-existent hedge. However, whether or not the hedge existed, the prices charged the ARM accounts in the third leg included the amount of that purported hedge.

industry to engage in further fraudulent schemes. We will permit Arouh to reapply for association with a broker or dealer after two years. Requiring Arouh's removal from the securities industry for a substantial period of time will protect investors and the markets and help to ensure his compliance with those provisions in the event he is subsequently permitted to return to the industry.

Exchange Act Section 21B authorizes the Commission to impose a civil penalty for each act or omission constituting a willful violation of the Exchange Act or a rule thereunder when such penalty is in the public interest. Section 21B establishes three tiers of penalties, each with a larger maximum penalty amount, applicable to increasingly serious misconduct. 48/ We believe that under the circumstances of this case the public interest is served by imposing one maximum third tier penalty of $110,000.

This monetary penalty is at the level permitted in administrative proceedings for willful violations of the federal securities laws of the type committed here and takes into account the range of factors specified in the relevant statute. 49/ Arouh's actions with respect to the adjusted trading scheme constituted fraud and, at a minimum, a reckless disregard for the requirements of the federal securities laws. Arouh engaged in a scheme that served to benefit the participants of the scheme at the expense of accounts participating in the third leg of the trade. His actions resulted in substantial losses to ARM insurance accounts that were redressed only because Arouh's misconduct was discovered. 50/

48/ Section 21B(a)(1) of the Exchange Act, 15 U.S.C. § 78u-2(a)(1), allows the Commission to impose a civil money penalty for willful violations of federal securities laws where such penalty is in the public interest. Exchange Act Section 21B(b)(3), 15 U.S.C. § 78u-2(b)(3) provides that the maximum third-tier penalty for each act or omission is $100,000 for a natural person. The Commission increased the penalty amount to $110,000 for violations occurring after December 9, 1996. See 17 C.F.R. § 201.1001.

49/ Factors that may be considered in determining whether a penalty is in the public interest are set forth in Exchange Act Section 21B(c), 15 U.S.C. § 78u-2(c).

50/ First Union reimbursed the ARM insurance accounts for inappropriate pricing of the third leg while allowing the ARM performance accounts to retain the profits from the above-market prices of the first leg.

First Union's purchase of the first-leg bonds at above-market prices and its sale of those bonds in the second leg at market prices resulted in a loss to First Union. First Union repriced the third-leg trades to appropriate market levels. As part of this repricing, First Union paid ARM $1.875 million for the trades that had already settled. In the end, First Union did not suffer a financial loss because it retained Arouh's commissions that exceeded its actual losses from the violative trading.

As a further result of Arouh's action, First Union had to make restitution to ARM, as well as permit the ARM accounts from the first leg to keep their inflated profits. Section 21B requires us to consider whether restitution was made. Arouh's commissions were retained by First Union and used to make a portion of the restitution. However, in our view, other factors in Section 21B outweigh this factor: the harm to others and the need to deter Arouh and others from engaging in this type of fraudulent behavior. This form of adjusted trading exposes both firms and customer accounts that have no knowledge of the scheme to risk of loss. We believe a penalty will serve to deter Arouh and others from committing such acts in the future.

We also conclude that Arouh's conduct raises a sufficient risk of future violation to warrant imposition of a cease-and-desist order against him. 51/ We have stated that we would consider risk of future violation, and other factors akin to those used by courts in determining whether an injunction is appropriate. In addition to the factors we consider in imposing a bar, 52/ we have stated that we will consider whether the violation is recent, the degree of harm to investors or the marketplace resulting from the violation, and the remedial function to be served by a cease-and-desist order. 53/ In addition to the factors discussed above, we believe the harm to the accounts in the third leg of the trade would have been substantial but for the restitution made to them. We also believe this type of trade that sets prices without relation to the forces of supply and demand and to the detriment of at least some of those accounts puts firms at risk and results in erroneous information going to the market. Arouh also admitted that he previously conducted a similar, although smaller, trade where he purchased bonds from Rubinstein and then sold those bonds back to ARM. 54/ In light of the above, we find that a cease-and-desist order is appropriate.

Arouh argues that the sanctions imposed are unjust and grossly disproportionate to the sanctions imposed on Mauney, who Arouh claims is more culpable. Mauney was ordered to cease and desist from further violations of the antifraud provisions of the federal securities laws. As an initial matter, we have consistently held that the appropriate sanction depends on the facts and circumstances of each particular case; it cannot be precisely determined by comparison with

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51/ KPMG Peat Marwick, LLP, Exchange Act Rel. No. 43862 (Jan. 19, 2001), 74 SEC Docket 384, 429 (showing of "some risk" of future violation necessary to warrant issuance of a cease-and-desist order), motion for reconsideration denied, Exchange Act Rel. No. 44050 (Mar. 8, 2001), 74 SEC Docket 1351, pet. denied, 289 F.3d 109 (D.C. Cir. 2002).

52/ See supra text accompanying note 45.

53/ KPMG Peat Marwick LLP, 74 SEC Docket 1351.

54/ See supra note 7.

action taken in other proceedings. 55/ To the extent that Arouh relies on Mauney's settlement, "it is well established that respondents who offer to settle may properly receive lesser sanctions than they otherwise might have received based on 'pragmatic considerations such as the avoidance of time-and-manpower-consuming adversary proceedings.'" 56/ Given these various factors, we conclude that the sanctions we are imposing on Arouh are not disproportionate and are fully warranted in the public interest.

An appropriate order will issue. 57/

By the Commission (Chairman DONALDSON and Commissioners GLASSMAN, GOLDSCHMID, and CAMPOS); Commissioner ATKINS dissents as to the sanctions.

Jonathan G. Katz
Secretary

55/ See Butz v. Glover Livestock Comm'n Co., 411 U.S. 182, 187 (1973); Jonathan Feins, Exchange Act Rel. No. 41943 (Sept. 29, 1999), 70 SEC Docket 2116, 2131 & n.36.

56/ Stonegate Sec. Inc., Exchange Act Rel. No. 44933 (Oct. 15, 2001), 76 SEC Docket 111, 118 (quoting Nassar & Co., 47 S.E.C. 20, 26 (1978)); David A. Gingras, 50 S.E.C. 1286, 1294 (1992); see also Butz, 411 U.S. at 187 (sanction imposed not invalid because in excess of sanctions in other cases).

57/ We have considered all of the parties' contentions. We have rejected or sustained these contentions to the extent that they are inconsistent or in accord with the views expressed herein.

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 50889 / December 20, 2004

Admin. Proc. File No. 3-10884

In the Matter of

LESLIE A. AROUH

ORDER IMPOSING REMEDIAL SANCTIONS

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

ORDERED that Leslie A. Arouh be, and he hereby is, barred from association with any broker or dealer subject to a right to reapply after two years, such application to be made to the appropriate self-regulatory organization or, if there is none, to the Commission; and it is further

ORDERED that Arouh cease and desist from committing or causing any violations or future violations of Section 17(a) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934, and Exchange Act Rule 10b-5; and it is further

ORDERED that Arouh be, and he hereby is, assessed a civil money penalty in the amount of $110,000.

Payment of the civil money penalty shall be: (i) made by United States postal money order, certified check, bank cashier's check, or bank money order; (ii) made payable to the Securities and Exchange Commission; (iii) mailed or delivered by hand to the Office of Financial Management, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Alexandria, Virginia 22312; and (iv) submitted under cover letter that identifies respondent and the file number of this proceeding. A copy of the cover letter and check shall be sent to William P. Hicks, counsel for the Division of Enforcement, Securities and Exchange Commission, 3475 Lenox Road, NE, Suite 1000, Atlanta, Georgia 30326-1232.

By the Commission.

Jonathan G. Katz
Secretary