FINRA
Financial Industry Regulatory Authority

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June 22, 2015

VIA MESSENGER

Brent J. Fields
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

RE: Lek Securities Corporation, File No. 3-16424

Dear Mr. Fields:

Enclosed please find the original and three (3) copies of FINRA's Brief In Opposition To Application For Review in the above-captioned matter.

Very truly yours,

Andrew J. Love

Enclosure

cc: Kevin J Harnisch, Esq.
David M. Crane, Esq.

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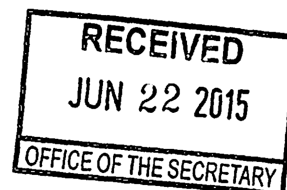

**BEFORE THE
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC**

In the Matter of the Application for Review of

Lek Securities Corporation

File No. 3-16424

BRIEF OF THE FINANCIAL INDUSTRY REGULATORY AUTHORITY IN OPPOSITION TO APPLICATION FOR REVIEW

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BEFORE THE
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC

In the Matter of the Application for Review of

Lek Securities Corporation

File No. 3-16424

FINRA'S BRIEF IN OPPOSITION TO APPLICATION FOR REVIEW[1]

I. INTRODUCTION

This case concerns Lek Securities Corporation's ("LSC") numerous and varied violations of securities rules and regulations and the firm's endemic failure to reasonably supervise its business. Based upon abundant evidence, an NYSE Hearing Board ("Hearing Board") and subsequently, the Board of Directors of NYSE Regulation ("NYSE Board") found that LSC: (1) violated the NYSE's prohibition on using its odd-lot order system for day trading; (2) violated an emergency Securities and Exchange Commission ("Commission") order that prohibited certain short sales during the height of the financial crisis; (3) failed to timely close out fail-to-deliver positions, improperly accepted short sale orders while it had open fails, and failed to notify its customers that it had open fails, in violation of Regulation SHO; (4) failed for two years to obtain NYSE Regulation's approval before it accessed other markets from its booth on the NYSE Floor in a manner similar to its "upstairs" office, and then flagrantly disregarded a cease and desist order concerning such activity and made misrepresentations that such activity had

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[1] FINRA files this brief on behalf of NYSE Regulation, Inc. ("NYSE Regulation") pursuant to a Regulatory Services Agreement among NYSE Regulation, other NYSE entities, and FINRA.

stopped; and (5) violated the NYSE's rules related to the cancellation of market-on-close ("MOC") and limit-on-close ("LOC") orders.

Underlying each of LSC's violations lies a common thread—the firm's failure to establish and implement reasonable supervisory systems and controls to monitor its business activities. Indeed, both the Hearing Board and the NYSE Board found that LSC's supervisory lapses spanned each of the areas described above, occurred for an extended period, and, in certain instances, appropriate monitoring and controls were non-existent or were deliberately sidestepped. Moreover, the NYSE found that LSC failed to have reasonable supervisory systems and controls in place with respect to its large volume of electronic orders to detect well-known, potentially manipulative misconduct such as spoofing, wash sales, and marking the close. In light of these factors, the NYSE Board censured LSC and imposed a fine totaling $575,000 for its extensive and, in certain instances, egregious and intentional misconduct.

LSC generally does not dispute the facts underlying the NYSE's findings. Instead, it argues that the rules and regulations at issue did not apply or that unwritten and self-created exemptions to the rules allowed LSC to engage in the misconduct. LSC also argues that its supervision was reasonable, based in part on its "comfort" that the introducing broker-dealer involved with many of the violations at issue had its own, separate supervisory systems and controls. This comports with LSC's attitude towards supervision as expressed by its CEO and CCO, who testified that LSC was simply not responsible as a "$2 broker" for complying with NYSE rules and regulations when executing electronic trades on behalf of customers.

The Hearing Board and the NYSE Board rejected these arguments and LSC's shirking of its supervisory responsibilities outright, and the Commission should do the same. LSC's attempts to ignore long-standing rules and regulations, or otherwise carve out unwritten

exemptions and exceptions for itself, are not supported by the plain text of the rules and regulations themselves. Further, LSC's dependence upon others to satisfy its supervisory obligations was contrary to its own independent obligation to reasonably supervise all aspects of its business. The Commission should affirm the NYSE's findings that LSC engaged in the extensive misconduct as alleged.

The Commission should also affirm the sanctions imposed upon LSC for its misconduct, as LSC has not demonstrated that they are excessive or oppressive. To the contrary, the sanctions reflect a thoughtful and thorough consideration of numerous factors, including that certain of LSC's misconduct was intentional, egregious, and occurred for an extended period of time. LSC's arguments that the sanctions imposed are punitive because it is a small firm and many of the specific violations committed by LSC cannot happen again for various reasons do not mitigate its serious misconduct. LSC glosses over the seriousness of its widespread misconduct and provides no legitimate basis for disturbing the sanctions imposed.

Accordingly, the Commission should dismiss this appeal.

II. BACKGROUND

A. LSC

LSC is a registered broker-dealer and has been a member of the NYSE since 1993. RP 83. Sam Lek ("Lek") founded LSC, and serves as LSC's CEO and CCO. RP 83, 4813. The firm's business involves executing and clearing orders on behalf of professional traders and institutional customers. RP 83. During the relevant time periods, Dimension Securities, LLC ("Dimension") was an introducing broker and one of LSC's largest customers by volume of orders. Dimension "introduced" to LSC certain of its customers. RP 4, 90, 5712, 9679.

LSC created a proprietary electronic order entry system, the ROX System ("ROX"), which allowed its customers to electronically access various stock markets, electronic communications networks, and market makers. RP 3, 89. LSC's customers utilizing ROX could enter trade data directly into ROX. LSC also granted its customers access to its lines on the NYSE's Super Designated Turnaround System ("SuperDOT"), which permitted LSC's customers to transmit orders to the NYSE. RP 3, 14, 88. LSC served as the executing broker for customer orders submitted via ROX or SuperDOT. RP 5638, 5645, 5665, 5702.

LSC executes millions of electronic orders. From January 2008 through September 2010, the firm processed more than 469 million electronic orders, with a notional value of nearly $1 trillion. *See* RP 5665-67, 13691. Contrary to what was necessary to reasonably supervise LSC's heavy electronic order flow, the firm's supervision of these orders fell far short.

B. Procedural History

1. Market Regulation Alleges Myriad Violations Against LSC

In connection with several investigations of LSC, FINRA's Department of Market Regulation ("Market Regulation") filed against LSC a Charge Memorandum in February 2012. RP 1-25. It alleged 13 separate causes against LSC, which concerned six distinct areas of misconduct: (1) Charges I-III alleged that LSC violated the NYSE's odd-lot rules and policies by introducing odd-lot limit orders for execution in a pattern of day trading; (2) Charges IV and V alleged that LSC willfully violated the Securities and Exchange Act of 1934 (the "Exchange Act") by introducing for execution short sale transactions in violation of the Commission's September 18, 2008 Emergency Order Pursuant to Section 12(k)(2) Taking Temporary Action to Respond to Market Developments ("Emergency Order"); (3) Charges VI-IX alleged that LSC willfully violated Regulation SHO by failing to timely close out fail-to-deliver positions, accepting customer short sale orders in equity securities for which LSC had open fails while LSC

and the customer were in the "penalty box," and failing to timely notify its customers that LSC had open fails that had not been closed out; (4) Charges X and XI alleged that LSC failed to obtain approval from NYSE Regulation prior to conducting "upstairs" operations in its booth premises on the NYSE Floor, failed to implement and obtain prior approval of written procedures governing such operations, and continued to conduct such business despite NYSE Regulation's order to cease and desist such activity; (5) Charge XII alleged that LSC failed to comply with the NYSE's requirements governing the cancellation of MOC and LOC orders; and (6) Charge XIII alleged that LSC violated NYSE Rule 342 by failing to reasonably supervise and implement adequate controls pertaining to Charges I through XII (collectively, the "Direct Rule Violations") and also failed to reasonably supervise and implement adequate controls concerning LSC's review of its electronic order flow to detect spoofing, wash trading, and marking the close.

2. The Hearing Board Found that LSC Engaged in Extensive Misconduct

The Hearing Board conducted an eight-day hearing and concluded that LSC engaged in all of the misconduct as alleged. *See* RP 3911-6266, 12989-13140, 13653-746. For LSC's widespread and, in certain cases, intentional and egregious misconduct, the Hearing Board censured and fined LSC $775,000 ($275,000 total for the Direct Rule Violations and $500,000 for the supervisory violations).

a. LSC Committed the Direct Rule Violations and Is Sanctioned Appropriately

First, the Hearing Board found that LSC introduced for execution approximately 169,000 odd-lot limit orders in a pattern of day trading, in violation of the NYSE's prohibition on utilizing its odd-lot order system as a day trading vehicle. RP 13662-65, 13697-704. The Hearing Board found that despite the NYSE's long-standing prohibition of such trading, LSC

introduced the violative trades anyway. The Hearing Board concluded that LSC's violation of the NYSE's prohibition on odd-lot day trading was serious, and it attempted to shift blame to others, a tactic LSC continues to utilize and apply to many other areas of its misconduct. RP 13739-40. The Hearing Board censured LSC and fined it $50,000. RP 13740.

Second, the Hearing Board held that LSC willfully effected on behalf of its customers approximately 6,468 short sale transactions (relating to approximately 2,822 orders) in the common stock of entities covered by the Emergency Order. RP 13665-67, 13704-08. The Hearing Board found that these violative short sales occurred because LSC intentionally exempted certain customers from ROX controls and failed to extend the expiration date in ROX to comport with the Emergency Order's extension. RP 13705. It rejected LSC's attempt to create an unwritten exemption from the Emergency Order and found that LSC failed to prove that certain customers were market makers and exempted from the Emergency Order. RP 13706-07. In assessing sanctions, the Hearing Board considered that most of the violative trades occurred because LSC intentionally excluded customers from its controls and LSC again attempted to minimize its misconduct and shift blame to its introducing broker. The Hearing Board censured LSC and fined it $75,000 for this "very serious" misconduct. RP 13740.

Third, the Hearing Board found that LSC willfully violated Rules 204T and 204 of Regulation SHO in three different ways, as alleged by Market Regulation. RP 13667-80, 13708-25. It rejected LSC's attempt to apply unwritten exemptions and distort the rules' plain language to justify its misconduct, as well as its reliance upon the Commission's September 6, 2013 No-Action Letter ("2013 No-Action Letter") because LSC's violative misconduct predated the letter by four years. RP 13708. In assessing sanctions, the Hearing Board again found that LSC refused to accept responsibility for its violations that occurred over an extended period of time,

and that its misconduct resulted from LSC's president's passive approach to compliance. RP 13741. The Hearing Board did, however, take into account the 2013 No-Action Letter in censuring and fining LSC $50,000. *Id.*

Fourth, the Hearing Board found that for more than two years, LSC violated the NYSE's rules by failing to obtain prior NYSE Regulation approval for the firm to access other markets from its booth on the NYSE Floor in a manner similar to its "upstairs" office (a practice known as "BlueLine" trading), adopt and implement comprehensive written procedures related to its BlueLine trading, and obtain NYSE Regulation's prior approval of these procedures. RP 13680-83, 13725-30. Moreover, the Hearing Board found that LSC violated NYSE Rule 2010 by ignoring for several months an NYSE Regulation cease and desist order and misrepresenting that it had ceased its BlueLine trading. RP 13726. The Hearing Board correctly rejected LSC's attempts to dodge liability for its egregious and lengthy misconduct, and imposed a censure and $100,000 fine for these "particularly troubling" violations. RP 13727-29, 13741-43.

Fifth, the Hearing Board found that LSC improperly cancelled approximately 899 MOC and LOC orders in violation of NYSE rules. RP 13683-85, 13730. The Hearing Board concluded that such violations occurred because LSC's unregistered chief technology officer, who LSC and Lek relied upon to implement and monitor LSC's supervisory and control systems for MOC and LOC orders, changed the coding of LSC's system to permit late cancellations of trades. LSC's chief technology officer made such changes under an erroneous assumption after failing to read fully pertinent regulatory updates. The Hearing Board censured LSC for this misconduct.[2] RP 13742.

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2 On appeal, LSC does not contest that it engaged in this misconduct. *See* LSC's Brief, at 1; *see also* RP 13683-85, 13730.

b. LSC Failed to Establish, Maintain and Enforce Reasonable Supervisory Systems and Controls

In addition to finding that LSC committed the Direct Rule Violations, the Hearing Board concluded that LSC repeatedly violated NYSE Rule 342 by failing to have a reasonable supervisory system and controls in connection with each of the Direct Rule Violations and with respect to other important aspects of its electronic order flow intended to detect manipulative trades. *See* RP 13685-97, 13731-38. The Hearing Board censured LSC and fined it $500,000 for its pervasive supervisory violations.

i. Supervisory Violations Related to the Direct Rule Violations

With respect to LSC's numerous supervisory deficiencies related to the Direct Rule Violations, the Hearing Board found that:

- LSC lacked written supervisory procedures ("WSPs") to address odd-lot activity, did not have a surveillance report to capture such activity until October 2010, and had inadequate controls in place at the time of the misconduct, even though a large portion of LSC's customers were day traders; (RP 13686-87, 13731-32)
- Lek's ignorance of the odd-lot day trading prohibition was incompatible with his duties and responsibilities as CCO; (RP 13731-32)
- LSC failed to monitor its controls with respect to the Emergency Order, never ran a query to ensure that its controls were effective, intentionally and impermissibly exempted certain customers from any controls, and failed to extend the Emergency Order's expiration date in its systems; (RP 13687-88, 13732)
- LSC's president took a passive approach to compliance with Regulation SHO by ignoring red flags and permitting fails to remain open beyond the rules' time limits; (RP 13688-89, 13732-33)
- LSC ignored for two years the NYSE's BlueLine trading rules and failed to monitor its floor brokers' trading to ensure that it complied with NYSE Regulation's cease and desist order; and (RP 13689-90, 13733)
- LSC relied upon a non-registered person to implement and monitor its supervisory control systems concerning MOC and LOC orders, and Lek delegated his supervisory authority without further review. RP 13690-91, 13733-34.

ii. LSC's Additional Supervisory Violations

Additionally, the Hearing Board found that, for an extended period of time, LSC failed to have a reasonable supervisory system with respect to its electronic order flow because the firm failed to monitor for spoofing, wash trading, and marking the close. RP 13691-97, 13734-35. With respect to spoofing, the Hearing Board found that until October 2009, LSC had no surveillance system to identify large pre-market cancels. RP 13692-95, 13734. The surveillance report that LSC eventually developed to detect spoofing was inadequate and did not always function, and the firm did not consistently investigate each cancellation or contact the customer to investigate cancellations identified on the report. RP 13695, 13734-35.

Similarly, the Hearing Board concluded that LSC failed to have a reasonable supervisory system for monitoring wash sales and marking the close. RP 13696-97, 13735. It found that despite the NYSE's long-standing prohibition on wash sales, LSC did not have an electronic surveillance report to detect wash sales until mid-August 2009. RP 13696, 13735. It also found that the report relied upon by LSC to monitor for marking the close was not a reasonable tool because its parameters were not sufficiently stringent and LSC did not develop a reasonable surveillance system to detect transactions that potentially marked the close until March 2010. RP 13696-97, 13735.

The Hearing Board rejected LSC's broad argument that because it allocated its supervisory responsibilities to its introducing broker, Dimension, LSC was not liable for any of the supervisory violations. The Hearing Board found that LSC was responsible for the electronic orders, could not delegate its responsibility for such orders, and was "expected to have written procedures and controls in place" for monitoring and supervising electronic orders. RP 13737. The Hearing Board was highly troubled by Lek's testimony "that LSC, as a '$2 broker'

executing transactions on behalf of entities such as Dimension, is not responsible for complying with NYSE rules and regulations for orders it executes on the NYSE." RP 4937-39, 13738.

iii. The Hearing Board Fined LSC $500,000 for Supervisory Violations

The Hearing Board concluded that LSC's supervisory misconduct was egregious. RP 13744. It found that for approximately three years LSC's supervisory systems and procedures were, in certain instances, non-existent or otherwise deficient, LSC did not accept responsibility for its supervisory lapses, intentionally excluded certain customers from its systems and controls and failed to ensure that its systems were working properly, ignored red flags regarding compliance with applicable rules and regulations, and generally "abdicated its supervisory responsibility." *See* RP 13742-44. The Hearing Board censured and fined LSC $500,000. RP 13744.

3. The NYSE Board Found that LSC Engaged in Extensive Misconduct and Imposed Appropriately Remedial Sanctions

On appeal, the NYSE Board affirmed the Hearing Board's findings. RP 16196-97. The NYSE Board also affirmed the censures and the $275,000 total fine imposed for the Direct Rule Violations. With respect to LSC's supervisory failures, the NYSE Board agreed that "LSC's broad supervisory failure is an independent violation warranting an appropriate sanction, and the Hearing Board provided ample explanation for why it found the supervisory violations to be 'egregious.'" RP 16196. The NYSE Board reduced the fine from $500,000 to $300,000 to ensure that the supervisory sanction did not amount to a second sanction for LSC's Direct Rule Violations. It concluded that an aggregate fine of $300,000 for LSC's supervisory failures reflects "the seriousness of LSC's failure to have the requisite controls and procedures in place." RP 16197.

III. ARGUMENT

The NYSE's conclusion that LSC engaged in extensive misconduct is amply supported by the evidence. On appeal, LSC recycles arguments that the Hearing Board and the NYSE Board have already rejected, and it has presented no legitimate reason to overturn any of the NYSE's findings of violation. The Commission should also affirm the censures and $575,000 total fine imposed upon LSC for its widespread and varied misconduct. These sanctions are neither excessive nor oppressive, are appropriately remedial, and properly account for the facts and circumstances surrounding LSC's misconduct, including that certain violations were intentional and egregious, and that LSC's supervisory systems and controls were deficient for a lengthy period of time.

A. LSC Introduced for Execution Prohibited Odd-Lot Orders and Failed to Reasonably Supervise Its Odd-Lot Orders

1. The NYSE Prohibits Using Its Odd-Lot Order System for Day Trading

In 1992, the NYSE identified several practices that abused its odd-lot order system, including any pattern of activity that would suggest day trading. Consequently, it sought to prohibit such practice and submitted to the Commission for notice and comment a proposed rule change (and an amendment thereto) concerning odd-lot limit order handling procedures. *See Notice of Filing of Proposed Rule Change Relating to Information Memo on Odd-Lot Trading Practices*, Exchange Act Release No. 31615, 1992 SEC LEXIS 3261, at *4 (Dec. 17, 1992) ("Odd-Lot Notice"). In the Odd-Lot Notice, the NYSE expressly stated that it intended to advise its membership, through an Information Memo, of the prohibited use of odd-lot limit orders in any pattern of activity that would suggest day trading, "which, for example, could include entering multiple odd-lot limit orders to buy and sell the same security on the same day." *Id.*

The NYSE expected its membership to establish appropriate supervisory systems to ensure compliance with the prohibition. *Id.* at *5.

The Commission approved the NYSE's prohibition on odd-lot day trading and a clarifying amendment in February 1994. *See Order Granting Approval and Notice of Filing and Order Granting Accelerated Approval to Amendment No. 2 of a Proposed Rule Change Regarding an Information Memo on Odd-Lot Trading Practices*, Exchange Act Release No. 33678, 1994 SEC LEXIS 509, at *2 (Feb. 24, 1994) ("Odd-Lot Approval Order"). The Commission reiterated that the NYSE would notify its membership, through an Information Memo, that: (1) using its odd-lot limit order service to day trade was prohibited; (2) membership would be expected to establish appropriate systems to monitor odd-lot activity; and (3) regulatory actions would result for violations of these policies. *See id.* at *1, *5-6.

In accordance with the Commission's approval order, the NYSE, in April 1994, issued an Information Memo alerting its membership of each of the aforementioned matters. *See* NYSE Information Memo ("IM") 94-14, *Odd-Lot Trading Practices* (Apr. 18, 1994) (RP 6267). The NYSE subsequently issued several additional Information Memos reminding its membership that the prohibition was deemed a rule change and that abusive odd-lot practices may constitute violations of NYSE Rules 401, 405, and 476(a)(6). *See, e.g.*, NYSE IM 04-14, *Odd-Lot Order Handling and Prohibited Trading Practices-Exchange Rules 124 and 411(b); "Know Your Customer" Requirements-Exchange Rule 405* (Mar. 19, 2004) (RP 6269); NYSE IM 04-32, *Odd-Lot Pricing (Rule 124)* (June 17, 2004), *available at* https://www.nyse.com/publicdocs/nyse/markets/nyse/rule-interpretations/2004/04-32.pdf.

2. <u>LSC Violated NYSE Rules and Policies Governing Odd-Lot Orders</u>

Notwithstanding the NYSE's prohibition on utilizing its odd-lot order system for day trading, the record demonstrates that LSC introduced approximately 169,000 odd-lot limit orders in a pattern of day trading for execution on the NYSE from April 1 to May 18, 2007. *See* RP 4194-96, 6507-7207, 9679. These day limit orders originated from Prestige Capital, LLC ("Prestige") and Pacific Coast Traders ("Pacific Coast"), both customers of Dimension. RP 9679-80. The 169,000 limit orders were routed to the NYSE via LSC's ROX system, and Prestige and Pacific Coast earned approximately $146,000 in profits from their odd-lot day trading. RP 4192, 7205-07, 9680-82. LSC only became aware of these violative orders after they had been routed through ROX. *See* RP 9654, 9679. Based upon these facts, the Hearing Board appropriately concluded that LSC violated NYSE Rules 401, 405, and 476(a)(6). *See* RP 13697-704.

LSC does not dispute these facts and does not dispute that the trades at issue were day trades. Rather, it argues that the Commission, in the Odd-Lot Approval Order, improperly approved the clarifying amendment on an accelerated basis, without the opportunity for public comment. It also argues that the NYSE's prohibition was not found anywhere in its rulebook. LSC therefore avers that the NYSE's prohibition on odd-lot day trading was unenforceable. *See* LSC's Brief, at 7.

LSC's argument is untenable and should be rejected. The NYSE submitted to the Commission, for notice and comment, a proposal that clearly explained its proposed prohibition on utilizing the odd-lot limit order system for exactly the kind of trading at issue here—"entering multiple odd-lot limit orders to buy and sell the same security on the same day." *See* Odd-Lot Notice, at *4. The Commission, pursuant to its authority under Exchange Act Section

19(b)(1), approved the NYSE's prohibition, and in doing so, also appropriately approved, on an accelerated basis, an amendment to the proposed rule change that made "certain technical and clarifying adjustments to the proposed rule change but leaves the overall structure and purpose of the proposal unchanged." *See* Odd-Lot Approval Order, at *7-8. Specifically, the clarifying amendment provided another example of what constituted day trading, in addition to what the NYSE had already described in the Odd-Lot Notice.[3] *Id.* at *4.

The NYSE followed the appropriate procedures under the Exchange Act and its rules, and the Commission properly approved the NYSE's prohibition on odd-lot day trading, including the clarifying amendment on an accelerated basis. The clarifying amendment altered neither the underlying prohibition on odd-lot day trading that the NYSE had previously announced nor the undisputed fact that the trades introduced by LSC were day trades.[4] Contrary to LSC's assertion, the Commission did not base its approval of the clarifying amendment on the lack of comments to the NYSE's proposal prior to the clarifying amendment. Rather, the Commission found that the clarifying amendment was a "technical and clarifying adjustment" to the prohibition and merely noted that no comments had been received on the proposal. *See id.* at *7-8.

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[3] The substance of the clarifying amendment can be distilled from the Odd-Lot Approval Order, which provided another example of what constituted day trading (odd-lot limit orders to buy and sell a group of stocks on the same day where the seller or buyer intends to capture the spread in these stocks by buying on the bid and selling on the offer) and noted that some types of buying and selling on the same day that are not pertinent here may be appropriate. *Id.* at *4.

[4] An NYSE Regulation examiner unequivocally testified that with respect to the trading by Pacific Coast and Prestige, he saw a pattern of in-and-out trading of identical amounts in the same securities and buying and selling identical amounts of shares on the same day. *See* RP 4164-66, 4170-72, 4175, 4179, 4181-82, 4205. This testimony squares with the way in which prohibited day trading was described in the Odd-Lot Notice.

Moreover, the prohibition's absence from the NYSE's rulebook is not dispositive and ignores that the Commission approved the prohibition knowing that the NYSE would alert its membership of the proscribed conduct not through a separate rule but via an Information Memo. *See also* IM 04-14, at 1 n.1 (informing membership that the prohibition was deemed to be a rule change). The NYSE provided its members with ample notice of the prohibition and that a violation of the prohibition would violate NYSE's rules. Although LSC, in an effort to absolve it of liability, relies upon the fact that the NYSE eventually abolished the odd-lot system, that occurred more than three years after LSC's misconduct and is simply not germane to the fact that LSC undisputedly violated the prohibition in place at the time. The Commission should affirm the findings that LSC violated the NYSE's odd-lot day trading prohibition.[5]

3. LSC's Supervisory Systems and Procedures for Its Odd-Lot Orders Were Not Reasonable

The Commission should also affirm the NYSE's findings that LSC failed to have in place reasonable supervisory systems and controls for its odd-lot orders, in violation of NYSE Rule 342. "NYSE Rule 342 [now Rule 3110] mandates that members provide reasonable supervision and 'appropriate supervisory control' over their employees and the members' activities." *See Schon-Ex, LLC*, Exchange Act Release No. 57857, 2008 SEC LEXIS 1194, at *4 n.4 (May 23,

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[5] Even if the Commission is persuaded that it somehow exceeded its authority by approving the NYSE's odd-lot day trading prohibition (it did not), it should affirm the Hearing Board's finding that LSC acted unethically and violated NYSE Rules 476(a)(6) and 401. *See* RP 13699, 13703; *Thomas W. Heath, III*, Exchange Act Release No. 59223, 2009 SEC LEXIS 14, at *13 (Jan. 9, 2009) (holding that unethical conduct is inconsistent with just and equitable principles of trade), *aff'd*, 586 F.3d 122 (2d Cir. 2009); *Keith Springer*, 55 S.E.C. 632, 633 (2002) (holding that NYSE Rule 401 requires brokers to conduct dealings with high standards of commercial honor, consistent with just and equitable principles of trade). LSC's argument that this finding amounts to a "backdoor way of enforcing an unenforceable rule" ignores that the NYSE's rules governing just and equitable principles are broad, ethical rules that do not necessarily require the violation of another SRO rule. *See Heath*, 2009 SEC LEXIS 14, at *13-14.

2008). This includes delegating to qualified individuals responsibility and supervisory authority, establishing appropriate supervisory procedures and controls, and establishing "a separate system of follow-up and review to determine that the delegated authority and responsibility is being properly exercised." *Id.* The standard of reasonable supervision is fact and circumstance specific. *See Christopher J. Benz*, 52 S.E.C. 1280, 1284 (1997), *aff'd*, 168 F.3d 478 (3d Cir. 1998). "Assuring proper supervision is a critical component of broker-dealer operations." *Ronald Pellegrino*, Exchange Act Release No. 59125, 2008 SEC LEXIS 2843, at *33 (Dec. 19, 2008).

During and after the violative odd-lot day trading, LSC did not have reasonable supervisory systems and controls in place to monitor and detect such prohibited trading. First, LSC did not have WSPs to address specifically the NYSE's prohibition. *See* RP 4845-46, 9654, 9671, 9687. As the Commission has explained, WSPs "serve as a 'frontline' defense to protect investors from fraudulent trading practices and help to ensure that members are complying with rules designed to promote the transparency and integrity of the market." *Robert Marcus Lane*, Exchange Act Release No. 74269, 2015 SEC LEXIS 558, at *53-54 (Feb. 13, 2015).

Second, prior to June 2007, LSC's odd-lot controls in ROX were inadequate because they only prevented the submission of odd-lot orders on the same side of the market, from the same customer, entered within 30 seconds of each other, and could not prevent a customer from submitting odd-lot orders on opposite sides of the market regardless of the time the orders were submitted. *See* RP 4816-18, 4824. Thus, ROX was not capable of detecting, and indeed did not detect, Prestige's and Pacific Coast's odd-lot day trading that occurred in April and May 2007.

Third, LSC did not develop a surveillance report to capture odd-lot limit orders in a pattern of day trading until 2010—three years after the violative day trading and approximately

16 years after the Commission approved the prohibition. *See* RP 5719; *Robert Grady*, Exchange Act Release No. 41309, 1999 SEC LEXIS 768, at *7 (Apr. 19, 1999). LSC's lapse resulted from Lek's admitted failure, as the firm's CCO, to read the Commission's approval order or any of the NYSE's memos concerning odd-lot day trading. *See* RP 4837-38, 6141-42; *see also Thomas C. Kocherhans*, 52 S.E.C. 528, 531 (1995) (holding that participants in the securities industry cannot be excused for lack of knowledge, understanding, or appreciation of regulatory requirements); NYSE IM 05-101, *Amendments to NYSE Rule 342.30-Annual Report; Chief Compliance Officer Designation*, 2005 NYSE Info. Memo LEXIS 101, at *7-8 (Dec. 16, 2005) (stating that a CCO must have adequate knowledge of the relevant rules, regulations, and standards of conduct concerning his firm's business). LSC's numerous supervisory lapses in this area are even more glaring considering that a large percentage of its customers were day traders. *See* RP 6204.

Without specifically addressing these supervisory deficiencies, LSC argues broadly that the Commission should consider that LSC obtained and reviewed Dimension's WSPs "to become comfortable with the manner in which Dimension conducted its compliance oversight." LSC further asserts that Dimension's compliance controls should be considered in determining whether LSC's supervision was reasonable. LSC's Brief, at 21-22.

LSC's argument is flawed legally and factually. LSC provided customers with electronic access to the market through ROX and was responsible for monitoring and supervising its electronic orders. *See* RP 5638, 8409, 10679; *see also* NYSE IM 04-14 (emphasizing, with respect to odd-lot activity, that "[m]embers and member organizations are responsible for all order activity effected through the use of their electronic order routing systems") (RP 6269-70); NYSE IM 92-15, *Electronic Transmission of Orders* (May 28, 1992) (reminding members that

they are "expected to have written procedures and controls in place for the monitoring and supervision of electronic orders" and written procedures for electronic order flow) (RP 8569-70); *see also Hold Brothers On-Line Inv. Servs.*, LLC, Exchange Act Release No. 67924, 2012 SEC LEXIS 3029, at *3 (Sep. 25, 2012) (holding that broker-dealers must establish, maintain, and enforce adequate supervisory procedures and controls "in light of the specific risks associated with the broker-dealer's business" and "broker-dealers that provide access to the markets must ensure that they have policies and procedures and systems of control in place" reasonably designed to ensure compliance with all applicable regulatory requirements).

Moreover, Lek's own testimony undercuts LSC's professed familiarity with Dimension's supervisory controls and procedures. Lek testified that he "didn't know too much" about Dimension's order management system, could not state what compliance systems Dimension had in place, did not know what exception reports Dimension generated, and could not state with any specificity whether Dimension's system addressed odd-lot trading (as well as the other areas of supervision at issue in this case). RP 5711, 6096-108. In addition, Dimension's WSPs dated January 31, 2007, did not have any specific provisions concerning supervising or monitoring odd-lot orders. *See* RP 8823. Under the circumstances, LSC's supervision was hardly reasonable. *See* NYSE IM 02-48, *Electronic Transmission of Orders* (Nov. 7, 2002) (requiring members to ensure, prior to granting access to its electronic order routing system, that reasonable written control and supervisory procedures are in place and must obtain a copy of correspondent's written control procedures) (RP 8573-75); NYSE IM 92-15 (stating that members "are required to ensure that the party entering the orders has adequate written control

procedures in place, prior to being granted access to the member organization's electronic order routing system") (RP 8569-70).[6]

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For all of these reasons, the Commission should affirm the findings that LSC improperly introduced for execution odd-lot limit orders in a pattern of day trading and failed to have reasonable supervisory systems and controls in connection with prohibited odd-lot day trading.

B. LSC Willfully Effected Short Sales in Violation of the Emergency Order and Failed to Have Reasonable Supervisory Systems and Controls

The evidence also shows that LSC willfully effected short sales, in violation of the Emergency Order, Exchange Act Section 12(k), and NYSE Rule 401, and failed to establish and maintain reasonable supervisory systems and procedures to comply with the Emergency Order.

1. LSC Willfully Violated the Emergency Order

On September 18, 2008, the Commission issued the Emergency Order to prohibit the short selling of 799 financial firms' ("Included Financial Firms") securities from September 19, 2008, through October 2, 2008. *See Emergency Order*, Exchange Act Release No. 58592, 2008 SEC LEXIS 2093 (Sept. 18, 2008). The Commission subsequently extended the Emergency Order's expiration date to October 8, 2008. *See Order Extending Emergency Order*, Exchange Act Release No. 58723, 2008 SEC LEXIS 3218 (Oct. 2, 2008).

Despite the Emergency Order's ban on certain short sales, it is undisputed that from September 19, through October 8, 2008, LSC effected on behalf of customers approximately 6,468 short sale transactions related to approximately 2,822 orders in securities of Included Financial Firms. *See* RP 4074-75, 7209-862, 9695. LSC effected these violative transactions,

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6 To the extent that LSC asserts that its supervision was reasonable in other areas based on a similar defense, the Commission should likewise reject such assertions.

notwithstanding its control systems, because it: (1) intentionally exempted several customers (including Dimension, other Dimension entities, and several others) from its controls under ROX; and (2) failed to update its systematic controls when the Commission extended the Emergency Order's terms. RP 4869-73, 9759, 9762, 9765.

Based on this undisputed evidence, the NYSE appropriately concluded that LSC violated Exchange Act Section 12(k)(4) and NYSE Rule 401 by effecting these short sale transactions in contravention of the Emergency Order.[7] *See* Exchange Act Section 12(k)(4) (providing that no broker or dealer shall effect any transaction in contravention of a Commission order); *Heath*, 2009 SEC LEXIS 14, at *12 (holding that a violation of a Commission rule or regulation constitutes a violation of just and equitable principles of trade).

LSC argues, as it did below, that it did not violate the Emergency Order because certain of the violative short sales were executed by options market makers and thus were not subject to the order's terms. LSC, however, failed to demonstrate that these entities were market makers engaged in bona fide market making in the securities of an Included Financial Firm. *See Emergency Order*, 2008 SEC LEXIS 2093, at *4-5 (exempting "[r]egistered market makers . . . that are selling short a publically traded security of an Included Financial Firm as part of bona fide market making in such security"); *cf. James E. Ryan*, 47 S.E.C. 759, 760 (1982) (holding that respondent has the burden to prove that he was a market maker to qualify as such under Exchange Act Rule 144). LSC never provided to the NYSE any evidence showing that these

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[7] Moreover, the Hearing Board appropriately concluded that LSC's violation was willful. *See* RP 13705; *see also Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (holding that "willfulness" merely requires the intentional doing of the wrongful act). LSC intentionally effected the violative short sales at issue, and thus willfully violated Exchange Act Section 12(k)(4). This analysis and conclusion similarly applies to LSC's various violations of Regulation SHO. *See infra* Part III.C.

entities were registered market makers for the securities of any of the Included Financial Firms. *See* RP 4074-75, 5968-70. LSC's assertions on appeal that these customers were market makers because: (1) Lek generally observed them making markets on various option exchanges; (2) the entities described themselves as market makers on various websites and in a letter to the Commission unrelated to this case; and (3) Lek could tell from an entity's account number or acronym that it was a market maker, are insufficient. *See* LSC's Brief, at 12-13. None of these assertions demonstrate that the pertinent entities were making markets in the securities of any Included Financial Firms. Indeed, as LSC conceded, it "does not keep track of the securities that our customers who are registered market makers make a market in, as the issues they make markets in can change frequently." RP 9796.

2. LSC's Supervisory System and Procedures for Compliance with the Emergency Order Were Not Reasonable

LSC intentionally exempted customers from its systematic controls developed to comply with the Emergency Order. As a result, LSC effected through ROX the short sales of these customers, in violation of the Emergency Order. Despite exempting these customers from LSC's systematic controls and relying on its customers to ensure compliance with the Emergency Order, for at least one customer (Dimension), Lek testified that he was not sure what controls it had in place. *See* RP 6103.

Moreover, from October 3, until October 8, 2008, no short sale order in the securities of an Included Financial Firm was subject to LSC's systemic controls because LSC failed to properly update its system. No one at LSC checked to ensure that the expiration date had been updated, LSC never did a query to ensure that its controls related to the Emergency Order were working properly, and LSC only later learned from the NYSE that it had transmitted violative

short sale transactions. *See* RP 6214-15. Under the circumstances, LSC failed to reasonably supervise its business activities as required by NYSE Rule 342.

Notwithstanding these facts, LSC argues that its supervision was reasonable because Dimension conducted short sale compliance for its customers and already had a pre-borrow arrangement to provide the borrowed stock for its customers' short sales. LSC asserts that it therefore concluded (incorrectly) that Dimension's customers would not be able to obtain locates on any stocks subject to the Emergency Order and would not violate the order. *See* LSC's Brief, at 11-12. It urges the Commission to view its decision to exempt Dimension from its supervisory controls at the time of the misconduct and not in hindsight. LSC's actions, however, are the antithesis of reasonable supervision, whether viewed in 2008 or after LSC's misconduct.

Rather than reasonably supervise its business and ensure that it had reasonable systems and controls in place to prevent violative short sales, LSC attempts to shirk its independent responsibility for electronic orders routed through its system, blame third parties for providing locates to Dimension in violation of the order, and otherwise distance itself from its misconduct. LSC was responsible for complying with the Emergency Order and ensuring that it properly supervised its electronic orders. LSC failed to do so, and its conclusion that it could exclude Dimension from its systematic controls has no basis in the language of the Emergency Order, which contained no exemption for parties who performed a stock locate.[8] LSC could not rely upon a self-created exemption to the Emergency Order and Dimension's controls and systems (about which LSC admittedly knew very little) to ensure compliance with the Emergency Order.

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[8] LSC's cursory statement that including Dimension in LSC's compliance system would have led to duplicative borrows for securities not subject to the Emergency Order has no bearing on LSC's violations. *See* LSC's Brief, at 11. Similarly, LSC's previous utilization of the same flawed approach to comply with other Commission orders is not relevant—Market Regulation did not allege that LSC failed to supervise its business in connection with those orders.

Finally, LSC argues that five of the violative orders occurred because the financial firm underlying the violative order was added to the list of Included Financial Firms on the same day as the violative trades, and there were "unavoidable delays" in updating its systems. LSC's argument ignores the thousands of remaining violative short sales caused by LSC's deliberate exclusion of customers from its systematic controls, its failure to update the Emergency Order's expiration date in ROX and to ensure that its systems were working properly, and its reliance on non-existent exemptions to the Emergency Order to justify its misconduct. Contrary to LSC's claim that a single programming error or exigent circumstance caused it to effect the violative short sales, it was a combination of factors that rendered LSC's supervision unreasonable.

C. LSC Willfully Violated Regulation SHO in Numerous Ways and Failed to Reasonably Supervise for Compliance with Regulation SHO

The NYSE found, and the evidence shows, that LSC violated Regulation SHO in numerous ways. The Commission should reject LSC's recycled arguments that several self-created exemptions to Regulation SHO militate against a finding of liability.

1. LSC Willfully Violated Regulation SHO

a. *LSC Failed to Timely Close Out Fails*

Rule 204(a) of Regulation SHO, similar to its predecessor Rule 204T(a), requires that a participant such as LSC deliver securities by settlement date for long and short sale transactions in any equity security. The rule further requires that if a participant has a fail-to-deliver position at a registered clearing agency in any equity security for a short sale transaction, the participant must close out the fail no later than the beginning of regular trading hours on the settlement day following the settlement date (T+4). The participant must do so by borrowing or purchasing

securities. For fails resulting from a long sale, the participant has two extra days (T+6) to close out the fail by borrowing or purchasing securities.[9] *See* Rule 204(a)(1).

The record shows that in 2008 and 2009, LSC willfully violated Rules 204T(a) and 204(a) of Regulation SHO by failing to timely close out six fails resulting from long sales in the securities of HTM, GW, NG, and AZ, and 13 fails resulting from short sales in the securities of LEN, FRD, VWO, YAVY, SPG, MRGE, SSW, CVO, MSJ, and MBI.[10] *See* RP 7869-7906, 7935-48, 7951-90, 7999-8048, 8567, 9607-43.

LSC does not dispute that these fails were closed after the time periods prescribed by Rules 204T(a) and 204(a). Instead, and in an effort to excuse its violations, LSC argues that because six of the securities at issue were on "easy to borrow" lists (LEN, FRD, YAVY, CVO, MSJ, and MBI), it unilaterally decided that it would not remedy lender fails by buying shares on behalf of the customers as is required by the express language of Rules 204T(a) and 204(a). *See* LSC's Brief, at 17-18. As correctly pointed out by the Hearing Board, neither Rule 204T(a) nor Rule 204(a) contains an exception for securities that were deemed easy to borrow. *See* RP 13718. Nor does the rule contain an exemption for fails caused by a lender.[11]

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9 Rule 204T(a)(1) only permitted a fail resulting from a long sale to be closed out by purchasing securities.

10 The record shows that although LSC failed to timely close out additional fails in 2009, the additional transactions fell outside of the time period charged by Market Regulation. *See* RP 13668, 13672.

11 LSC posits that others in the industry were also creating exemptions to Regulation SHO during this time period (and does so in defense of other areas of its misconduct). *See* LSC's Brief, at 15, 18, 20. Even if true, LSC is nonetheless liable for its misconduct. *See Lane*, 2015 SEC LEXIS 558, at *42 (holding that a claim that violative practices are widespread in the industry does not excuse misconduct); *Charles E. Kautz*, 52 S.E.C. 730, 733 (1996) (holding that it is no defense that others in the industry are also acting improperly).

Similarly, LSC argues that because its customers were purportedly deemed to own four of the securities at issue (GW, HTM, AZ, and NG) under Rule 200(b) of Regulation SHO, it was entitled to rely on the extended 35-day close out exemption set forth in Rule 204(a)(2) for fails in those securities. It also argues that AZ is a sponsored international arbitrage, which the industry regards as a type of convertible security, and thus these securities also fall within the extended close-out period for deemed to own securities. LSC's Brief, at 18-20. The transactions at issue, however, all occurred prior to the July 31, 2009 effective date of Rule 204. *See* RP 7869-904, 8567, 9607. Thus, Rule 204T(a)(2) applied, and it did not contain a "deemed to own" provision or exception to the close-out requirements of Rule 204T(a). Further, Rule 204T(a)(2) did not contain an exemption for sponsored international arbitrage. Under Rule 204T(a), only securities sold pursuant to Exchange Act Rule 144—which none of the securities at issue were—were subject to an extended close-out period.

Finally, LSC continues to argue that it is not liable for the Regulation SHO violations in connection with three securities (VWO, SPG, and SSW) because it was entitled to pre-fail credit for customer purchases of these securities. LSC's Brief, at 16. LSC again misreads the applicable rules and exemptions. Rule 204T(a) required a participant of a registered clearing agency, such as LSC, to close out any fail by borrowing or purchasing securities of like kind and quantity. Rule 204T(d) permitted a participant to allocate a portion of the fail to the broker-dealer for which it clears based upon that broker-dealer's short position; a participant that allocated a portion of a fail was relieved from closing out such fails. LSC, however, admittedly did not allocate fails. *See* RP 5572, 5640.

Further, LSC cannot use the pre-fail credit exception contained in Rule 204T(e). Rule 204T(e) applied to brokers or dealers and not participants such as LSC. *See* Rule 204T(e). Thus,

LSC was solely responsible for closing out fails and could not passively wait for its customers to purchase securities to satisfy LSC's obligations. *See Amendments to Regulation SHO*, Exchange Act Release No. 58773, 2008 SEC LEXIS 2320, at *31 (Oct. 14, 2008) (stating that the close-out requirement of Rule 204T(a) "requires that the participant take affirmative action to purchase or borrow securities. Thus, a participant may not offset the amount of its settlement date fail to deliver position with shares that the participant receives or will receive[.]"); *Amendments to Regulation SHO*, Exchange Act Release No. 60388, 2009 SEC LEXIS 2563, at *45 (July 27, 2009) (same regarding Rule 204(a)); *cf.* LSC's Brief, at 16 (quoting only a portion of the language from these orders).

Moreover, the Commission's issuance of the 2013 No-Action Letter—more than four years after LSC violated Regulation SHO—does not exonerate LSC's misconduct. LSC's Brief, at 16-17. Nothing in the 2013 No-Action Letter made its relief retroactive. *See* 2013 SEC No-Act. LEXIS 455 (Sept. 6, 2013); *see also* Clark Street Capital, Denial of Request for No-Action Relief, 2003 SEC No-Act. LEXIS 707, at *1 (Aug. 20, 2003) (stating that "[a]s a matter of policy, the staff grants no-action relief only prospectively, not retroactively"); *Lake Ontario Cement Ltd.*, 45 S.E.C. 242, 247 (1973) ("The indiscriminate grant of retroactive exemptions even in cases in which prospective exemptions are found proper would condone and reward an anarchic resort to self-help that we are loath to sanction."). Indeed, the 2013 No-Action Letter reinforced that LSC violated Regulation SHO in 2008 and 2009. *See* 2013 SEC No-Act. LEXIS 455, at *2 (stating that, "[t]o meet its close-out obligation under Rule 204, a Participant must be able to demonstrate on its books and records that on the applicable close-out date it purchased or borrowed shares in the full quantity of its fail to deliver"). The Commission should reject LSC's

attempt to claim pre-fail credit as a participant for customer purchases, which is inconsistent with the rules in place at the time of its misconduct.

b. LSC Accepted Short Sale Orders While LSC and Its Customers Were In the "Penalty Box" and Failed to Timely Notify Its Customers

Rule 204T(b) provided that if a participant has not closed out a fail, it could not accept from another person a short sale order, without first borrowing the security or entering into a bona fide arrangement to borrow the security, until the participant closes out the fail by buying securities of like kind and quantity and that purchase has cleared and settled. The record undisputedly shows that LSC willfully effected short sales when it had open fails from its customers' short sales in five securities (FRD, YAVY, MRGE, SSW, and CVO) from late February 2009 until July 7, 2009. RP 7977, 9607-43, 9846-47. LSC presented no evidence that it actually borrowed the securities at issue, or entered into a bona fide arrangement to borrow the securities at issue.

It is also undisputed that, in contravention of Rules 204T(c) and 204(c), LSC failed to notify its broker-dealer customers that it had open fails that had not been closed out and failed to notify its customers once it had closed out each such fail. Thus, the Commission should affirm the findings that LSC willfully violated Rules 204T(c) and 204(c).

2. <u>LSC's Unreasonable Supervision for Compliance with Regulation SHO</u>

The record demonstrates that LSC, through its president, failed to reasonably supervise its business to ensure compliance with Regulation SHO. RP 5358, 5360-61. Even though LSC was aware of open fails via the NSCC's daily notification, the Hearing Board aptly found that, for nearly a year, LSC took a passive approach to its obligations rather than affirmative action required by the rules. *See* RP 13668, 13732. For instance, LSC sometimes waited for its open fails to be closed out by customer purchases and ignored red flags, even if that meant exceeding

the time limits prescribed in Rules 204T and 204. *See, e.g.*, RP 5376-78, 5385-89, 5422, 5467; *see also ACAP Fin.*, Exchange Act Release No. 70046, 2013 SEC LEXIS 2156, at *33 (July 26, 2013), *aff'd*, 783 F.3d 763 (10th Cir. 2015). LSC did so by unilaterally determining the rules did not apply and acting contrary to the express language of Rules 204T and 204. Moreover, LSC failed to properly monitor its fails and comply with its notification requirements, resulting in additional short sales while LSC was in the penalty box. LSC failed to satisfy the supervision standards set forth in NYSE Rule 342.

D. LSC Improperly Engaged in BlueLine Trading and Ignored the NYSE's Cease and Desist Order

The Commission should also affirm the NYSE's findings that LSC blatantly violated the NYSE's BlueLine trading rules, later ignored an NYSE Regulation order to stop its BlueLine trading activity, and made several misrepresentations to NYSE Regulation that it had stopped such activity when, in fact, it continued for three months.

1. LSC Engaged in BlueLine Trading Without NYSE Regulation's Approval

In June 2007, the NYSE amended its rules to require that each member organization: (1) obtain NYSE Regulation's prior approval to engage in BlueLine trading; (2) adopt and implement comprehensive written procedures governing the conduct and supervision of its BlueLine trading; and (3) obtain approval of its written procedures covering BlueLine trading prior to implementation. *See Notice of Filing and Immediate Effectiveness of Proposed Rule Change Relating to Rules 54 and 70*, Exchange Act Release No. 55908, 2007 SEC LEXIS 1314, at *8-10 (June 14, 2007). In July 2007, the NYSE notified its membership of NYSE Rule 70.40's requirements. *See* NYSE IM 07-77, *Requirements for Conducting "Upstairs" Operations from a Member Organization's Booth Premises* (July 30, 2007) (RP 11731).

LSC admitted that, from June 2007 until October 2009, it engaged in BlueLine trading. *See* RP 19, 05, 5838. Lek erroneously determined that NYSE Rule 70.40 did not apply to LSC, and the firm continued to operate its BlueLine trading business unabated. RP 5838-39, 6171-75. LSC did not seek NYSE Regulation's prior approval, and did not submit its BlueLine procedures to NYSE Regulation, until September 21, 2009. *See* RP 11483.

Faced with these conspicuous violations of NYSE rules, LSC argues that its booth premises was required to route orders to away markets—and therefore violate NYSE Rule 70.40—to satisfy its best execution obligations.[12] LSC's Brief, at 2-4. Specifically, LSC states that because it was a dual member of the NYSE and NASD, it was already routing orders to other markets if they offered the best prices for customers' orders. LSC further argues that eliminating the ability of LSC, as a dual member, to route orders away from the NYSE "unless and until the Exchange gave LSC explicit and, necessarily redundant, permission" to do so contradicts the objective of broadening competition for orders and getting the best prices for customers. *See* LSC's Brief, at 2.

The Hearing Board and the NYSE Board properly rejected LSC's overly narrow view of its obligations, and LSC provides no new rationale to support its argument. LSC's obligation to obtain best execution was independent of its obligations under NYSE Rule 70.40 to obtain prior approval to engage in BlueLine trading. Its obligations under both rules could, and did, co-exist. In fact, the NYSE added Rule 70.40 to remove impediments preventing floor brokers from operating within its booth premises similar to the broker's upstairs office, which allowed floor brokers greater access to markets in furtherance of Regulation NMS. *See* 2007 SEC

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[12] Curiously, LSC did not raise its purported concerns that the rule conflicted with its best execution requirements in any correspondence with NYSE Regulation in 2009. *See* RP 11440, 11466, 11608.

LEXIS 1314, at *4-6; *see also* NYSE IM 07-77 (stating that a firm's WSPs should, at a minimum, address compliance with best execution requirements) (RP 11734). As the Hearing Board correctly found, nothing in NYSE Rule 70.40 permits firms such as LSC to bypass the BlueLine approval process. *See* RP 13727.

This is true even for dual members. Nothing in the rule or the NYSE's rule filing distinguishes between members who are only NYSE members and dual members; all members were required to comply with Rule 70.40's requirements. Further, IM 07-77 provides that, "[a]ssuming a member organization has developed written policies and procedures . . . the level of trading activity that a member organization can conduct in away markets from its booth premises will depend on whether the firm has the requisite registrations and qualifications." RP 11734. The Information Memo goes on to state that dual members already have the requisite registrations and qualifications "to conduct all trading activity business from its booth premises that it could conduct from an upstairs office, subject to the requirements described in this Information Memo." *See* RP 11734-35. Another provision in the Information Memo states that NYSE Rule 70.40 grants members the ability to access other markets and trade a wider range of products from a floor broker's booth premises, "subject to approval by NYSE Regulation, *and* subject to qualifying for certain registrations and licenses required to conduct an off-Floor business." RP 11731-32 (emphasis added). Dual members therefore are required to obtain approval from NYSE Regulation before engaging in such activity, even though they have the requisite licenses and registrations to do so.[13] LSC's argument that "[t]here was simply no

[13] The clear language of Rule 70.40 undercuts LSC's narrow reading of the rule to eliminate the requirement that NYSE Regulation pre-approve a dual member's BlueLine trading and its supervisory procedures. *See* LSC's Brief, at 4-5. Moreover, the Hearing Board expressly rejected LSC's argument, referenced fleetingly on appeal, that Rule 70.40 constitutes an illegal restraint on trade. *See* RP 13728-29. The Commission should do the same.

reason for Dual Members to refrain from fulfilling their best execution obligations" while awaiting regulatory approval that it deemed to be "redundant" epitomizes its disregard for the rules as written and its tendency to ignore rules that it disagrees with or finds burdensome. *See* LSC's Brief, at 5.

2. LSC Violated NYSE Rule 2010 by Continuing to Engage in BlueLine Trading in Contravention of Cease and Desist Order

In July 2009, NYSE Regulation discovered that LSC was engaged in BlueLine trading without first obtaining its approval, and ordered that the firm immediately cease such trading. *See* RP 4379-80, 11435. LSC, however, continued to engage in BlueLine trading and falsely informed NYSE Regulation that all such activity had stopped. *See* RP 20, 106, 4378-81, 11435, 11440. LSC subsequently made two additional misrepresentations to NYSE Regulation that it had stopped its BlueLine trading. *See* RP 20, 106, 11466, 11608. LSC finally ceased its BlueLine trading on October 19, 2009—more than three months after NYSE Regulation first ordered LSC to do so. RP 4551-62, 11687-728. Irrespective of its views of the rule, LSC was required to comply with NYSE Regulation's cease and desist order. LSC's flagrant disregard of the order, and subsequent misrepresentations to its regulator, violated its obligations under NYSE Rule 2010. *See Thomas R. Alton*, 52 S.E.C. 380, 382 (1993) (holding that misrepresentations to NASD violate just and equitable principles of trade).

3. LSC Failed to Reasonably Supervise Its BlueLine Trading

The record shows, and LSC does not dispute on appeal, that LSC failed to reasonably supervise its BlueLine trading activity, in violation of NYSE Rule 342. For more than two years, the firm failed to follow NYSE Rule 70.40 in all material respects, and failed to monitor its business to ensure that it complied with NYSE Regulation's cease and desist order. The Commission should affirm these findings.

E. LSC Failed to Reasonably Supervise MOC and LOC Cancellations

The Commission should also affirm the NYSE's findings—not directly challenged on appeal—that LSC failed to reasonably supervise its activity with respect to MOC and LOC orders. Lek acknowledged that he was responsible to implement and monitor LSC's supervisory control systems and to monitor regulatory developments. RP 6190-92. Lek, however, delegated his supervisory responsibility to LSC's unregistered chief technology officer. RP 5345, 6190-91. Lek only reviewed the NYSE's regulatory guidance several weeks after LSC's chief technology officer had turned off LSC's system to detect MOC and LOC cancellations. RP 6189. Lek's delegation of supervisory authority, with no additional review or oversight, was unreasonable. *See Pellegrino*, 2008 SEC LEXIS 2843, at *47 (holding that reasonable supervision requires appropriate follow-up after delegation).

F. LSC's Additional Supervisory Failures Related to Electronic Order Flow

In addition to LSC's supervisory violations with respect to each of the Direct Rule Violations, the record shows that LSC failed to reasonably supervise and monitor for spoofing, wash trading, and marking the close. The Commission should affirm the NYSE's findings that LSC violated NYSE Rule 342 in connection with these additional supervisory lapses.

1. <u>LSC Failed to Reasonably Supervise and Monitor for Spoofing</u>

Spoofing refers to a manipulative scheme whereby a trader enters an order that he does not intend to execute to affect a security's price. *See Cary R. Kahn*, Exchange Act Release No. 50046, 2004 SEC LEXIS 1530, at *2-3 (July 20, 2004). Against this backdrop, NYSE Regulation received from designated market makers complaints regarding large, pre-market order entries and cancellations transmitted by LSC. RP 4579-80. Consequently, in June 2009 it asked LSC to explain these cancellations. RP 10831. LSC stated that Dimension's customers

were responsible. RP 10833-34. In August 2009, NYSE Regulation sent another inquiry to LSC regarding additional large, pre-market cancellations in one of the securities previously identified. RP 10835. LSC responded that it was "unaware of [the customer's] reasons for entering and quickly cancelling orders before the opening" and asked the customer (who again was introduced by Dimension) to give LSC an explanation for these trades as well as similar orders on a different date. RP 10837. In September 2009, NYSE Regulation questioned LSC about additional large, pre-market order entries and cancellations. LSC informed NYSE Regulation that the same Dimension customer behind the other cancels entered the trades at issue, and LSC contacted the customer to determine the purpose behind the cancels. *See* RP 10843, 10847. Subsequent to LSC's response, still more large, pre-market cancellations occurred in late September 2009. RP 10849, 10853-54.

LSC later informed NYSE Regulation that, in late August and early September 2009, Dimension informed LSC that certain orders and cancellations were inappropriate and that the individuals responsible for such trades were ordered to immediately stop such trading. RP 10857. Despite the fact that cancellations of orders have been part and parcel of manipulative schemes for years, and being on notice for four months that NYSE Regulation had concerns regarding specific pre-market cancellations (several of which LSC confirmed were improper), LSC had no surveillance system to monitor and detect pre-market cancels until October 20, 2009. *See* RP 4674, 10857, 10889; *see also Kahn*, 2004 SEC LEXIS 1530; *Terrance Yoshikawa*, Exchange Act Release No. 53731, 2006 SEC LEXIS 948, at *18 (Apr. 26, 2006).

Moreover, the surveillance report that LSC eventually developed failed to always capture cancellations as designed, and LSC failed to monitor the effectiveness of its report. *See, e.g.*, RP 4780-83, 5903-04, 10903, 11427. And even when LSC's report flagged pre-market

cancellations, LSC's employees did not always contact customers to determine if the cancellations were inappropriate, which was the only way to determine the trader's intent. RP 4780-88, 10858, 10911. LSC's failure to promptly surveil for pre-market cancellations, to monitor the effectiveness of its surveillance, and to follow-up consistently when suspicious orders and cancellations were flagged by its surveillance report, violated NYSE Rule 342.[14] *See ACAP Fin.*, 2013 SEC LEXIS 2156, at *33.

LSC argues that there is no proof that the large, pre-market cancellations at issue resulted in any fraudulent activity or that such cancellations even had the potential to manipulate or impact the markets because the markets had sufficient time to react. *See* LSC's Brief, at 27-28. LSC's argument misses the mark. In determining whether LSC reasonably supervised its electronic order flow with respect to pre-market cancellations, as well as the other supervisory lapses, the relevant inquiry is whether LSC had reasonable supervisory systems and controls in place to detect potentially manipulative activity, reasonably monitored the effectiveness of its systems, and conducted appropriate follow up. The evidence conclusively demonstrates that it did not, and the fortuitous fact that the orders and cancellations at issue may not have resulted in a market manipulation does not, and cannot, absolve LSC from its supervisory failures. *See*

[14] LSC argues that its supervisory violations relating to monitoring for spoofing were "speculative," pointing to an NYSE examiner's testimony concerning his investigation into certain cancellations. *See* LSC's Brief, at 28-30. It is LSC's follow up regarding these cancellations—not NYSE Regulation's—that is at issue. Regardless, the evidence showed that although LSC's report was designed to capture cancellations greater than 10,000 shares, it failed to capture a cancellation of a 16,800 share buy order, and LSC sometimes failed to contact the customer to investigate cancellations identified on its surveillance report. *See* RP 4780-88, 5903-04, 10858, 10903, 10911, 11427. Moreover, the Commission should reject LSC's passing reference to Market Regulation's motivations in bringing this case. LSC's Brief, at 27. LSC has pointed to nothing in the record to suggest that it was the victim of selective prosecution. *See Joseph Plunkett*, Exchange Act Release No. 69766, 2013 SEC LEXIS 1699, at *37-38 n.61 (June 14, 2013) (setting forth standards to demonstrate selective prosecution).

Robert J. Prager, 58 S.E.C. 634, 661-62 (2005) (holding that an underlying violation of securities laws is not necessary to prove a failure to reasonably supervise).

Further, LSC's assertion that pre-market cancellations can never be manipulative because the markets have sufficient time to react to any potentially manipulative cancellations improperly shifts the burden to investors and designated market makers to react to fraudulent cancellations, and away from LSC and its obligation to have reasonable surveillance systems and controls in place to detect such activity.

2. <u>LSC Failed to Reasonably Supervise and Monitor for Wash Sales</u>

NYSE Rule 476(a)(8) prohibits wash sales. Despite this long-standing prohibition, LSC admittedly did not have a surveillance report to detect such trading until mid-August 2009. RP 4848-50, 10375. LSC's WSPs governing wash sales simply provided that "[c]ompliance reviews all potential wash sales using an exception report." *See* RP 5953-54, 9339. Other than the exception report that it belatedly developed to detect wash sales, LSC does not point to any record evidence of its supervisory controls related to monitoring wash sales executed through its electronic order system, which processed millions of orders.[15] *See* LSC's Brief, at 22-23. LSC's supervisory systems and controls regarding wash sales, which, based upon the record, were non-existent prior to mid-August 2009, were not reasonable. The fact that LSC may have discovered

[15] LSC argues that while it lacked a specific surveillance report to monitor for wash sales, its other controls and reviews adequately monitored for improper wash sales. *See* LSC's Brief, at 22. Setting aside that LSC points to nothing in the record detailing precisely what these other controls and reviews consisted of, this argument conflicts with Lek's testimony on the issue. Lek testified that he asked each exchange to notify him when there are trades "where Lek Securities traded with Lek Securities" because "there is no way for us to know for sure whether somebody traded with himself." RP 5950-51. The exchanges refused to provide Lek with that information, and Lek lamented that, "I'm now being accused of not monitoring for [wash trades], when the only person who really knows is the Exchange. So now we have a wash sale report." RP 5951.

and remediated potential wash sales in the absence of appropriate supervisory controls and procedures does not, contrary to LSC's claim, absolve it of liability for failing to reasonably supervise for such activity. *See Prager*, 58 S.E.C. at 661-62.

3. <u>LSC Failed to Reasonably Supervise and Monitor for Marking the Close</u>

Marking the close is a manipulative practice that occurs when transactions in a security are executed at or near the end of the trading day in order to affect the stock's closing price. *See Kocherhans*, 52 S.E.C. at 530. Even small orders effected at or near the close of the market can constitute marking the close. *See* RP 4879, 4928, 4933 (Lek's testimony); *see also Spear, Leeds & Kellogg, L.P.*, Exchange Act Release No. 48199, 2003 SEC LEXIS 1685, at *10, *14 (July 21, 2003) (finding that seven purchase orders ranging from 300 to 15,000 shares marked the close).

LSC's WSPs prohibited the entry of orders to affect a stock's price on the close and required such orders to be reviewed for corrective action. RP 11195-96. To monitor for marking the close, the firm relied upon a "rapid succession order report." Before a transaction was flagged as potentially violative, the report required the entry of 25,000 orders within one minute, from one customer in one security. RP 4879-81, 4930-33, 10374. The report could not detect smaller numbers of transactions entered at or near the end of the trading day. RP 4933. LSC eventually fixed its surveillance system to include smaller numbers of transactions in March 2010. RP 4929, 6194.

LSC's reliance on a flawed tool to monitor and detect for marking the close did not satisfy its obligations to implement reasonable supervisory systems and controls. *See Spear, Leeds*, 2003 SEC LEXIS 1685, at *16-17 (finding that firm failed to establish and implement adequate measures because its review was not effective in preventing and detecting marking the close). Nor did LSC implement an appropriate surveillance system promptly and diligently, as

required by NYSE Rule 342. *See Grady*, 1999 SEC LEXIS 768, at *7 (holding that responses to irregularities must be vigorous and "with the utmost vigilance").

LSC argues that its surveillance for marking the close was reasonable because Market Regulation did not identify any trades that LSC's system failed to detect. LSC also argues that just because it was theoretically possible that someone could use trades smaller than the threshold set in LSC's rapid succession report to mark the close does not mean that LSC's surveillance was unreasonable. LSC's Brief, at 25-26. The Commission should reject these arguments. The relevant point is that LSC failed to implement a reasonable supervisory system to surveil for transactions that could potentially mark the close—not whether there were violative transactions. *See Prager*, 58 S.E.C. at 661-62.[16] Even though LSC knew that small orders could serve to mark the close just as readily as large orders, for a period of time LSC relied on a surveillance tool that could not detect smaller orders. *See* RP 4879, 4928, 4933. This runs contrary to the requirements of NYSE Rule 342.

G. The Hearing Officer Properly Precluded Expert Testimony

LSC rehashes its argument, rejected by the NYSE Board, that the Hearing Officer improperly denied admission of expert testimony regarding industry standards and practices related to the types of trading activities at issue. *See* LSC's Brief, at 30. The Commission too should reject this argument because LSC has not satisfied its heavy burden to show that the Hearing Officer abused her discretion by excluding such expert testimony.

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16 For similar reasons, *SEC v. Masri*, 523 F. Supp. 2d 361 (S.D.N.Y. 2007), does not support LSC's position that its supervisory controls and monitoring for marking the close were reasonable. *See* LSC's Brief, at 25-26. *Masri* did not deal with supervising trades to detect potentially fraudulent misconduct, but whether trades placed at or near the end of the day were in fact manipulative.

It is well established that a hearing officer has broad discretion to admit or deny expert testimony. *See Pagel, Inc.*, 48 S.E.C. 223, 230 (1985), *aff'd*, 803 F.2d 942 (8th Cir. 1986); *see also Meyer Blinder*, 50 S.E.C. 1215, 1222 (1992) (describing how NASD hearing panels have sufficient knowledge and expertise to render a businessman's judgment without the aid of expert testimony). A decision to exclude expert testimony should be reversed only if the complaining party demonstrates that the hearing officer abused her discretion. *Pagel*, 48 S.E.C. at 230.

The Hearing Officer acted well within her discretion in this case. LSC sought to call two expert witnesses to testify regarding industry custom and practice concerning compliance and supervisory systems and controls, what supervision would be reasonable in this case, and the market impact of the trading that occurred. *See* RP 2740, 2745. LSC argued that the experts' testimony would assist the Hearing Board in determining the relevant industry standards and practices and whether LSC engaged in the misconduct alleged by Market Regulation. *Id.* The Hearing Officer rejected LSC's request after she consulted with both Hearing Board panelists (member firm representatives who LSC conceded were familiar with industry customs and practices). *See* RP 2851, 2918, 13736. The Hearing Officer found that LSC did not demonstrate that either expert's testimony would be helpful to the Hearing Board. RP 2919. The NYSE Board affirmed the Hearing Officer's exclusion of LSC's experts as "a matter well within [her] discretion." RP 16196.

On appeal, LSC has not demonstrated that the Hearing Officer abused her discretion, and its argument that the Hearing Board could find that LSC committed supervisory violations only after hearing from experts on industry practices and standards is without merit. The Hearing Officer excluded LSC's expert testimony after consulting with the hearing panelists who were familiar with industry customs and practices. *See* RP 2918. The panelists all agreed that expert

testimony was unnecessary under the circumstances. The Hearing Board was more than capable, without the aid of expert testimony, of determining that LSC's supervisory systems and controls were unreasonable under NYSE Rule 342.[17] *See Meyer Blinder*, 50 S.E.C. at 1222. This is especially true in this case where LSC often completely lacked systems and controls in the face of clear and often long-standing obligations under securities rules and regulations.

LSC also relies upon a statement by the Hearing Officer early in this case to purportedly show that she abused her discretion in denying expert testimony. *See* LSC's Brief, at 32. The Hearing Officer, however, made this statement prior to the hearing panelists' appointments, and they later agreed that expert testimony was unnecessary. *See* RP 421-22, 2913. Further, LSC's own pleadings undercut its claim that the Hearing Officer erroneously concluded that the expert testimony would have encompassed ultimate legal issues to be determined by the Hearing Board. *See* RP 2777 (LSC's proffer that expert "may opine on . . . the reasonableness of [LSC's] controls and procedures"); *see also SEC v. Badian*, 822 F. Supp. 2d 352, 357 (S.D.N.Y. 2011) (holding that an expert may not usurp the adjudicator's role of determining legal issues and their application to the facts). For all of these reasons, LSC has not demonstrated that the Hearing Officer abused her discretion by excluding expert testimony.

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[17] Contrary to LSC's arguments, the holding in *SEC v. Geon Indus., Inc.*, 531 F.2d 39 (2d Cir. 1976), does not demonstrate that the Hearing Officer abused her discretion. *See* LSC's Brief, at 30-31. Unlike this case, *Geon* did not concern whether an NYSE Hearing Board that included panelists with knowledge of industry standards and practices could decide whether a firm's supervisory systems and controls were reasonable, without the aid of expert testimony. Similarly, *Stephen Sohmer & Spyder Sec. Inc.*, 57 S.E.C. 240 (2004), did not involve whether a hearing officer abused her discretion by excluding expert testimony on industry practices, but whether expert testimony should have been introduced in the first place. The fact that the Commission found that expert testimony was appropriate in *Sohmer* does not show that the Hearing Officer abused her discretion in reaching the opposite conclusion here.

H. The Sanctions Imposed Are Neither Excessive Nor Oppressive and Are Appropriate Under the Circumstances

The NYSE appropriately determined that censures and fines totaling $275,000 were remedial to address LSC's Direct Rule Violations and that an additional censure and fine of $300,000 were remedial to address LSC's widespread supervisory failures. LSC has not demonstrated that the sanctions imposed for its assorted, serious and, in certain instances, egregious misconduct, are excessive or oppressive.[18] Rather, the record shows that the NYSE in sanctioning LSC carefully considered numerous factors. The Commission should affirm the sanctions.

1. The Sanctions Imposed for LSC's Direct Rule Violations Are Appropriate

The Hearing Board concluded, and the NYSE Board agreed, that censures and fines totaling $275,000 were appropriately remedial sanctions for LSC's Direct Rule Violations. As correctly observed by the Hearing Board, "[t]he integrity of the NYSE market is dependent on the adherence of its members to its trading rules." RP 13738. LSC failed to comply with many of those rules, and the Commission should affirm these sanctions.

Despite the NYSE's prohibition on utilizing its odd-lot order system for day trading, LSC introduced approximately 169,000 odd-lot limit orders in a pattern of day trading. The Hearing Board found that, rather than accepting responsibility for its misconduct, LSC strenuously denied the prohibition's existence and blamed Dimension for any misconduct. *See N. Woodward Fin. Corp.*, Exchange Act Release No. 74913, 2015 SEC LEXIS 1867, at *44 (May 8, 2015) (holding that applicants' continued refusal to acknowledge wrongdoing demonstrates a misunderstanding

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[18] LSC does not contend, and the record does not show, that the sanctions are an undue burden on competition. *See* Exchange Act Section 19(e).

or lack of regard for regulatory obligations). It also considered that Prestige and Pacific Capital earned $146,000 in profits from this violative activity, and viewed LSC's misconduct as serious even though the NYSE later decommissioned the odd-lot system. RP 13740. The Hearing Board's determination that a censure and $50,000 fine were appropriately remedial should be affirmed.

With respect to the Emergency Order, the Hearing Board considered that LSC again attempted to shift blame for its misconduct to Dimension, and that "[t]he majority of the violations occurred because LSC deliberately excluded certain customers from its screening controls." *See* RP 13740; *see also* NYSE IM 05-77, *Factors Considered in Determining Sanctions*, 2005 NYSE Info. Memo. LEXIS 74, at *4 (Oct. 7, 2005) (stating that intentional or knowing misconduct "will generally be treated with greater severity"). LSC's disregard of the Emergency Order resulted in it effecting more than 6,000 short sale transactions in securities of Included Financial Firms during a time of unprecedented market turmoil. The Hearing Board appropriately censured LSC and fined it $75,000 for this misconduct.[19]

For LSC's various violations of Regulation SHO, the Hearing Board imposed a censure and $50,000 fine. The Hearing Board considered that LSC's misconduct occurred for nearly a year and resulted directly from LSC's president's passive approach to Regulation SHO compliance. *See* IM 05-77 (consider the length of time over which misconduct occurred). Indeed, LSC violated Regulation SHO's close-out requirements despite full awareness of its

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[19] In support of its sanctions, the Hearing Board cited to *Lightspeed Trading, LLC*, Exchange Act Release No. 60540, 2009 SEC LEXIS 2858 (Aug. 19, 2009). *See* RP 13740. In that case, the Commission affirmed a censure, $75,000 fine, and disgorgement for far fewer violations of the Emergency Order (724 short sales). *Lightspeed*, 2009 SEC LEXIS 2858, at *5-7, 9; *see also Arthur James Niebauer*, Exchange Act Release No. 54384, 2006 SEC LEXIS 1937, at *27-28 n.46 (Aug. 30, 2006) (noting that sanctions imposed by the NYSE fell within the range of sanctions imposed in similar cases).

fails, and refused to accept responsibility for the violations. The Hearing Board properly weighed these factors, as well as the 2013 No-Action Letter, in fashioning its sanctions.

Finally, with respect to LSC's multi-year BlueLine trading violations and subsequent defiance of NYSE Regulation's cease and desist order, the Hearing Board found that LSC ignored the NYSE's rules for more than two years and determined for itself that the rule did not apply. LSC then ignored the cease and desist order and misrepresented to NYSE Regulation on several occasions that its BlueLine trading activity had ceased. For this egregious misconduct, the Hearing Board appropriately imposed a censure and a $100,000 fine.

2. A Censure and $300,000 Fine Are Appropriately Remedial Sanctions for LSC's Widespread and Egregious Supervisory Failures

The NYSE Board held that "LSC's broad supervisory failure is an independent violation warranting an appropriate sanction, and the Hearing Board provided ample explanation for why it found the supervisory violations to be 'egregious.'" RP 16196. The Hearing Board explained generally that LSC's supervisory procedures and controls were deficient in various areas for approximately three years. *See* RP 13742-44.

The Hearing Board found a number of aggravating circumstances related to each supervisory deficiency. Specifically, it found that LSC:

- Had for several months a deficient supervisory system to detect odd-lot limit orders in a pattern of day trading (despite the long-standing prohibition on such activity), lagged for years in developing a surveillance report to detect such trading, lacked WSPs covering the NYSE's prohibition, and Lek was generally unaware of the odd-lot day trading prohibition;

- Deliberately excluded Dimension from its supervisory controls for the Emergency Order and failed to test and monitor its controls;

- Ignored, through its president, red flags related to open fails for approximately one year and failed to monitor its fails;

- Ignored NYSE Rule 70.40 for two years, blatantly disregarded NYSE Regulation's cease and desist order, made misrepresentations that its

BlueLine trading had stopped, and was unaware of its ongoing violative trading or unable to stop it (all of which the Hearing Board found "particularly troubling");

- Permitted an unregistered person to make changes to its supervisory systems regarding MOC and LOC order cancellations without any oversight and Lek admittedly did not timely read the applicable regulatory guidance; and

- Had for an extended period no supervisory system in place to detect and prevent potential manipulations related to spoofing, wash sales, and marking the close.

See RP 13742-44. The Hearing Board was highly troubled by Lek's general view of LSC's supervisory obligations as a $2 broker-dealer. RP 13738.

The NYSE Board soundly concluded, after considering all of these factors, that a censure and an aggregate fine of $300,000 for LSC's supervisory failures reflect "the seriousness of LSC's failure to have the requisite controls and procedures in place." RP 16197. The NYSE carefully explained its rationale for LSC's sanction for this egregious misconduct, and considered a number of aggravating factors—including several areas where LSC intentionally disregarded its supervisory obligations and had absolutely no supervisory controls for an extended period of time—in determining LSC's sanctions. The Commission should uphold these sanctions.

3. <u>LSC's Arguments in Support of Eliminating Sanctions Are Meritless</u>

LSC does not make any specific arguments concerning each of the fines imposed for the Direct Rule Violations and the supervisory violations. Instead, it argues broadly that certain of the misconduct it engaged in cannot occur again for various reasons. As a result, LSC argues that these factors, along with its claim that everyone in the industry was engaging in the violative practices, show that any fines imposed for its prior misconduct related to these areas are necessarily punitive. *See* LSC's Brief, at 33-34.

LSC is mistaken. The firm violated the rules in place at the time of its misconduct and ignored prohibitions against such misconduct or simply created exemptions for itself that were beneficial or convenient. The fines imposed impress upon LSC and others that they must comply with NYSE rules—as written—and will serve as a deterrent to LSC and others from future violations.[20] *See Niebauer*, 2006 SEC LEXIS 1937, at *25-26 (affirming fine and suspension imposed for misconduct that was later addressed by amendments to NYSE's rules and holding that the sanctions were warranted to act as a deterrent to others); *McCarthy v. SEC*, 406 F.3d 179, 189 (2d Cir. 2005) (holding that the deterrent value to the offending broker and others is a relevant factor to be considered). Moreover, changes to supervisory procedures and controls after detection by a regulator are not considered "mitigating" factors, and the Commission has rejected applicants' arguments that significant sanctions are unwarranted because they acted consistently with industry practices. *See, e.g.*, *ACAP Fin.*, 2013 SEC LEXIS 2156, at *69-73.

Finally, LSC states that it is a "very small firm" and none of its misconduct involved manipulation. *See* LSC's Brief, at 33. The Hearing Board, however, considered that LSC had a net capital of approximately $10 million and had the "financial means to create" certain surveillance reports but failed to do so. *See* RP 13744. Moreover, "an otherwise remedial sanction does not become punitive simply because its imposition might cause some harm to a small firm. Rather, such harm is one factor, among others, to consider as part of the overall remedial inquiry." *N. Woodward*, 2015 SEC LEXIS 1867, at *49. Further, the fact that LSC did not engage in any manipulative misconduct is not relevant to the numerous areas of misconduct

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[20] For example, giving credence to LSC's argument that it should not be sanctioned because the Emergency Order has expired would lead to absurd consequences by permitting firms to violate future Commission orders without any repercussions so long as the misconduct is detected after the order expires.

in which it did engage and where it abdicated its supervisory responsibilities in numerous areas. For all of these reasons, the Commission should affirm the NYSE's sanctions.

IV. CONCLUSION

The undisputed facts of this case demonstrate that LSC committed numerous violations of securities rules and regulations, and failed to have in place reasonable supervisory systems and controls with respect to these violations and other aspects of its voluminous electronic order flow. LSC's application of unwritten exemptions and exceptions to rules and regulations, and tortured reading of these rules and regulations, provide no refuge for LSC's misconduct. Similarly, LSC's laissez-faire attitude towards supervising its business cannot be condoned. The record demonstrates that the NYSE carefully considered a number of factors when it sanctioned LSC for its misconduct, and LSC has not presented any legitimate arguments on appeal to reverse the NYSE's findings or to show that the sanctions that the NYSE imposed are excessive or oppressive. The Commission should sustain the NYSE's findings of violations, and sustain the censures and $575,000 total fine imposed upon LSC.

Respectfully submitted,

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Dated: June 22, 2015

CERTIFICATE OF SERVICE

I, Andrew Love, certify that on this 22nd day of June, 2015, I caused a copy of the foregoing Brief in Opposition to Application for Review to be served by messenger and fax on:

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I, Andrew J. Love, certify that this Brief in Opposition to Application for Review (File No. 3-16424) complies with the length limitation set forth in SEC Rule of Practice 450(c). I have relied on the word count feature of Microsoft Word in verifying that this brief contains 13,971 words.

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