

Brunelle & Hadjikow Wins Acquittal on Appeal to the NYSE Board

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The facts and analysis presented here are summarized from decisions rendered by an NYSE Hearing Officer, an NYSE Hearing Panel and the NYSE Board of Directors in Matter of X, H.P. Hearing Board Case 07-148 (2007 - 2008): <http://www.nyse.com/pdfs/07-148.PDF>

Summary of the Facts

During a busy trading day on August 21, 2003, an NYSE Floor Broker received and executed orders from one of his firm's clients, a hedge fund. The client had purchased about a million shares of a volatile NYSE security, and learned, near the middle of the day, that another 500,000 shares were available for purchase, but were in the form of "sell stop" orders.

The situation can be understood only by understanding the nature of a "sell stop order." Such orders have no standing in the market until the stock trades at or below a stated "election price." If the order has an election price of \$4.25, as in this case, and the stock is trading at \$4.27, the order remains inactive and dormant. But if the stock trades at \$4.25 or lower, it automatically becomes either a "market order" (to be executed at the best price available thereafter) or a "limit order" (to be executed at the stated limit price or better), depending on the customer's choice of terms.

When the hedge fund learned of these sell stop orders, it sent the Floor Broker's employer two new orders – one to sell 100,000 shares and one to buy 500,000 shares. The Floor Broker's Trading Assistant took the orders, and although he knew that they came from the same hedge fund, he did not know whether they came from the same customer or customer account. So the Trading Assistant approached a senior officer of his firm and asked him whether the two orders could be executed concurrently. Following this discussion, the Trading Assistant informed the Floor Broker that the senior officer had said Yes.

The Floor Broker executed the sell order first. He did not sell the stock outright, but offered the stock in the Trading Crowd. In this way, the Floor Broker did not establish a new price but permitted independent buyers to respond to his offer. In the trading that followed, the Floor Broker sold 15,000 shares and then 35,000 shares from the 100,000-share order. In the process, the stock's price declined by a "two-cent differential between the highest price at which he traded and the electing sale price, represent[ing] a .0046% movement in the stock's price as the Floor Broker sold 50,000 shares. The Floor Broker's sale, at \$4.25, "elected" the sell stop orders and converted them into conventional "market orders."

The Floor Broker then executed the buy order, purchasing 500,000 shares – not at prices below \$4.25, but at the same price as the electing sale – \$4.25.

Motion and Cross-Motion for Summary Disposition

NYSE Enforcement, having charged the Floor Broker with market manipulation and with violating "just and equitable principles of trade," filed a motion for summary disposition. Such motions, made under recent changes in NYSE hearing procedure, seek a "summary" determination of guilt – without benefit of a hearing, without giving the accused an opportunity to examine and cross-examine live witnesses, and without giving the accused an opportunity to present his case before a panel of three, consisting of two securities industry representatives and an NYSE Hearing Officer. Under the previous system of procedure, determinations of guilt or innocence, with rare exceptions, could be made only by majority vote of a three-person Hearing Panel. The current system of procedure permits such decisions to be made on the basis of documents and briefs alone, by a Hearing Officer in the employ of the NYSE, acting alone.

The Floor Broker opposed Enforcement's motion for summary disposition and cross-moved for dismissal of the Charges.

The Hearing Officer granted in part the Floor Broker's motion to dismiss, rejecting the charge of market manipulation. It found that "Enforcement had failed to state a cause of action for intentional misconduct." [H.P. Penalty Decision at p. 5, and Hearing Officer's Decision on Motions, at 9-10]. Nevertheless, in the same decision, the Hearing Officer granted Enforcement's motion for summary disposition with respect to their charge that the Floor Broker had engaged in "conduct inconsistent with just and equitable principles of trade." Because the Hearing Officer had summarily found the Floor Broker guilty of one charge, he scheduled a further proceeding, before a full, three-person Hearing Panel, but limited the topics to be reviewed there to the assessment of appropriate sanctions.

Hearing on Sanctions

In the ensuing hearing on sanctions, "Enforcement sought a penalty of a censure, a one-month suspension, and a \$50,000 fine." (Hearing Panel Penalty Decision at p. 5.) In support of its recommendation, Enforcement urged the Hearing Panel to emulate the penalty determinations of two previous NYSE disciplinary decisions. The Hearing Panel refused, finding that these previous cases involved much worse conduct, namely, a "knowing and intentional . . . scheme to improperly elect stop orders . . . [and] more egregious conduct with greater adverse market impact than the instant case." (Id.) Paradoxically, both of the previous cases "resulted in lesser sanctions than those sought by Enforcement herein." (Id.)

In the case at hand, the Hearing Panel further remarked that Enforcement had failed "to state a cause of action for scienter [intent to deceive, manipulate or defraud]," that the Floor Broker had relied on professional advice, that the event had been "an isolated single incident, which took place over a time period of about 75 seconds," and that the Floor Broker's actions "constituted a one-time error in professional judgment by an otherwise conscientious, well-regarded Floor broker with a spotless regulatory and disciplinary record." Id. at 5-8.

After a detailed analysis of the facts and of the rules and decisions relating to the assessment of sanctions, the Hearing Panel refused to suspend the Floor Broker, but imposed a censure and a \$5,000 fine. (Id. at p. 8.)

Appeal to the NYSE Board of Directors

Enforcement appealed to the NYSE Board, seeking reversal of the Hearing Officer's dismissal of their charge of market manipulation. They also requested that the Board of Directors impose a much harsher penalty. The Floor Broker appealed as well, seeking reversal of the Hearing Officer's finding that he had violated "just and equitable principles of trade." The Board's Committee for Review ("CFR"), "after consideration of the Record in this matter, written submissions filed by the parties and oral argument, . . . recommended to the NYSE Regulation Board of Directors" that it dismiss all charges and vacate the sanctions. The Board accepted CFR's recommendation. At the end of its Decision, the Board instructed that, "This Decision is intended to end the litigation in this matter. Unless Respondent appeals, the Board instructs that no hearing or other proceeding be initiated by the Hearing Officer or the Panel." (NYSE Board Decision at p. 1).

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