

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 57840 / May 20, 2008

Admin. Proc. File No. 3-12668

In the Matter of the Application of
JAMES GERARD O'CALLAGHAN
For Review of Disciplinary Action Taken by the
NEW YORK STOCK EXCHANGE, INC.

OPINION OF THE COMMISSION

NATIONAL SECURITIES EXCHANGE – REVIEW OF DISCIPLINARY
PROCEEDING

Trading for Account in which Member Exercised Discretion

Conduct Inconsistent with Just and Equitable Principles of Trade

Member of national securities exchange violated federal securities laws and exchange rules when he executed trades in an account over which he had investment discretion. Held, exchange's findings of violations are sustained, but proceeding is remanded for reconsideration of sanctions.

APPEARANCES:

Andrew Goodman and Robert Carrillo, of Garvey Schubert Barer, for James G. O'Callaghan.

Virginia J. Harnish and W. Kwame Anthony, for NYSE Regulation, Inc.

Appeal filed: June 26, 2007
Last brief filed: October 3, 2007

I.

James Gerard O’Callaghan, a member of the New York Stock Exchange, Inc. (“NYSE” or “Exchange”) and an independent floor broker, appeals from NYSE disciplinary action. The NYSE found that, between December 2000 and October 2001 (“the relevant period”), while on the floor of the Exchange, O’Callaghan violated Section 11(a) and Rule 11a-1 of the Securities Exchange Act of 1934, 1/ as well as NYSE Rules 90(a), 95(a), and 476(a)(6), 2/ by executing trades for an account over which he had investment discretion that was maintained at Wall Street Discount Corporation (“Wall Street Discount”), an “upstairs,” or off-the-floor, member organization. The account belonged to LDL Trading, Inc. (hereinafter “the LDL account”), a New Jersey corporation, and traded securities for the benefit of Patrick Zente, O’Callaghan’s father-in-law, and members of Zente’s family. 3/ The NYSE censured O’Callaghan, fined him \$30,000, and suspended him for three months from membership, allied membership, approved person status, and from employment or association in any capacity with any member or member organization. We base our findings on an independent review of the record. For the reasons set forth more fully below, we sustain the NYSE’s findings of violations but remand the proceeding for reconsideration of the sanctions.

II.

O’Callaghan entered the securities industry in 1969 and became a member of the NYSE in 1973. He has been employed on the floor of the Exchange for more than thirty years. In 1997, he formed an independent floor brokerage firm, which he operated as a sole proprietorship until 2003, when he converted the firm to a limited liability company. As an independent floor broker, O’Callaghan primarily executes orders initiated through other NYSE members. 4/

1/ 15 U.S.C. § 78k(a); 17 C.F.R. § 240.11a-1. Section 11(a) and Rule 11a-1, with certain exceptions not relevant here, make it unlawful for a floor broker to trade for an account in which the broker has an interest or over which the broker exercises investment discretion. These provisions are designed to prevent floor brokers from exploiting short-term trading information and opportunities not available to persons who are not on the floor and members of the general public. D’Alessio v. SEC, 380 F.3d 112, 113-14 (2d Cir. 2004).

2/ See NYSE Rules 90(a) & 95(a) (prohibiting floor brokers from engaging in proprietary and discretionary trading); NYSE Rule 476(a)(6) (prohibiting conduct inconsistent with just and equitable principles of trade).

3/ Zente was LDL’s principal and controlling shareholder. O’Callaghan’s two sisters-in-law were also shareholders.

4/ An independent floor broker is an agent who executes orders on the exchange floor, typically for other members or brokerage firms. For his services, the independent floor

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A. O'Callaghan's Discretionary Trading for the LDL Account

Former Wall Street Discount branch manager Joseph Pilovsky, who handled the LDL account, testified that Zente first opened the LDL account at Wall Street Discount in 2000. At that time, Zente informed Pilovsky that O'Callaghan and O'Callaghan's chief clerk and compliance officer, Frank Ali, 5/ would have discretion to trade for the LDL account. Pursuant to a written Trading Authorization form dated November 8, 2000, Zente, through LDL, authorized O'Callaghan and Ali to exercise investment discretion in the LDL account.

Pilovsky also testified that Zente did not place orders for the LDL account. 6/ Pilovsky related that he and another broker, Vincent Thomas, 7/ regularly received reports of executions for the LDL account from O'Callaghan or Ali, without first receiving any orders from Zente. Upon receiving those reports, Pilovsky and Thomas completed order tickets to memorialize those trades and credit them to the LDL account. While Thomas received most of the reports of trade executions and Ali placed most of the telephone calls reporting executions, 8/ "a handful of

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- 4/ (...continued)
broker receives a negotiated commission. In the Matter of New York Stock Exch., Inc., Securities Exchange Act Rel. No. 41574 (June 29, 1999), 70 SEC Docket 153, 155.
- 5/ Ali was charged as a co-respondent in this proceeding, but before the hearing, entered into a stipulation of facts with the Exchange. Without admitting or denying guilt, Ali consented to a censure, five-year bar from functioning in a compliance or supervisory capacity, and agreement to cooperate based on his participation in an improper trading arrangement and failure to discharge his compliance duties. Frank Joseph Ali, Exchange Hearing Panel Decision 05-4 (Jan. 13, 2005), available at <http://www.nyse.com>. Ali did not testify at the hearing.
- 6/ Zente did not testify at the hearing. In his answer to the charges and in his opening statement, O'Callaghan asserted that Zente was too sick to testify. However, Pilovsky disputed this characterization of Zente. Pilovsky testified that Zente had visited Wall Street Discount's offices six weeks before the hearing and did not appear to be sick.
- 7/ At the time of the hearing, Thomas was no longer in the securities industry. Thomas did not testify at the hearing.
- 8/ O'Callaghan seeks to minimize Pilovsky's knowledge about Thomas' dealings with Ali. Pilovsky testified that he knew when Thomas received calls from Ali because he sat next to Thomas on the trading desk. Pilovsky could overhear Thomas' "confrontations" with Ali about his and O'Callaghan's practice of reporting trade executions without calling in customer orders.

times” Pilovsky received calls directly from O’Callaghan. ^{9/} Pilovsky stated that no one, other than O’Callaghan or Ali, gave trading instructions for the LDL account. He added that Wall Street Discount never sent any customer orders to O’Callaghan for execution. ^{10/}

According to Pilovsky, Wall Street Discount’s upstairs order tickets identified the instances in which O’Callaghan or Ali reported the execution of a trade even though no customer order had been placed. During the relevant period, Wall Street Discount’s practice was to time-stamp an upstairs order ticket twice, first on the left-hand side when it received a customer order to buy or sell stock, and then on the right-hand side when it received a report of execution of the order. At that time, it took at least five minutes to execute a trade. As a result, there usually was a several minute gap between the first and second time-stamps. However, when O’Callaghan or Ali called Wall Street Discount to report the execution of a trade for which Wall Street Discount had not received a customer order, the upstairs order ticket had “double time-stamps,” meaning two time-stamps that were only seconds apart. For example, in a January 26, 2001, trade involving O’Callaghan’s purchase of 3,500 shares of Lucent Technologies, Inc. (“LU”), the upstairs order ticket had time-stamps at 11:25:11 a.m. and 11:25:13 a.m. Attached to the upstairs order ticket was a stub labeled “Phone Order Entered,” indicating that O’Callaghan or Ali called Wall Street Discount to report the execution of the trade. Pilovsky testified that the fact that the two time-stamps on the upstairs order ticket were only seconds apart indicated that he did not receive a customer order first and then a report of execution. Rather, Pilovsky received only one telephone call from O’Callaghan or Ali reporting the execution of the trade, at which time he “clocked” the upstairs order ticket “in and out” so that it would have two time-stamps.

Pilovsky testified that he complained “numerous times” to O’Callaghan and Ali about their failure to call in customer orders before calling in reports of executions. ^{11/} Pilovsky stated that, “[a]fter quite a bit of time and frustration, not really getting anywhere,” he approached Wall Street Discount’s president to discuss the situation. The president advised Pilovsky to inform O’Callaghan and Ali that, in the future, Wall Street Discount would transmit all of their orders to

^{9/} O’Callaghan admitted in July 2002 sworn on-the-record testimony that, in some instances, he personally called Wall Street Discount to report trades instead of Ali.

^{10/} Pilovsky testified that Wall Street Discount sent customer orders for execution either to SuperDOT, the NYSE’s automated order routing system, or to certain floor brokers associated with Wall Street Discount’s clearing firm, Investec Ernst & Company.

^{11/} At the hearing, O’Callaghan denied that anyone at Wall Street Discount complained to him or Ali.

SuperDOT for execution. Pilovsky communicated this to Ali. From that point forward, Pilovsky recounted, all orders for the LDL account were executed electronically through SuperDOT. ^{12/}

NYSE investigator Michael Dalton, who conducted the investigation of O'Callaghan's trading for the LDL account, analyzed a sample of 159 (out of more than 700) LDL trades, using O'Callaghan's floor tickets, Wall Street Discount's upstairs order tickets, and NYSE reports showing the times of O'Callaghan's trade executions as captured by the NYSE's systems. ^{13/} Based on his analysis, Dalton found that O'Callaghan's floor booth tickets were almost always time-stamped before the first time-stamps on Wall Street Discount's order tickets, indicating that the trades originated on the exchange floor. Dalton explained that, "in the normal course of events, if a trade is coming from a customer and . . . routed through an upstairs order room, you would see it time-stamped . . . in the upstairs order room, . . . then relayed to the floor and . . . subsequently time-stamped on the floor." Dalton also found that nearly every execution time written on O'Callaghan's floor tickets preceded the upstairs time-stamps, further indicating that the trades originated on the floor and substantiating Pilovsky's testimony that O'Callaghan executed the trades before calling Wall Street Discount. Dalton further found that many of Wall Street Discount's order tickets had "double time-stamps," indicating again that O'Callaghan originated and executed the same trades for the LDL account.

To illustrate his findings, Dalton testified about O'Callaghan's purchase of 3,500 shares of LU on January 26, 2001 (previously discussed in Pilovsky's testimony), and O'Callaghan's subsequent sale of those shares on the same date. In this pair of trades, O'Callaghan had Ali time-stamp a floor ticket at 11:03 a.m. for the purchase of the shares, and executed the purchase in two transactions: 2,500 shares at 11:05 a.m. and 1,000 shares at 11:07 a.m., all at 17 7/16 per share. Eighteen minutes later, O'Callaghan or Ali reported the trade to Wall Street Discount, which double time-stamped an upstairs order ticket at 11:25:11 a.m. and 11:25:13 a.m. At the same time, Ali time-stamped a floor ticket at 11:25 a.m. to sell the 3,500 LU shares, and O'Callaghan executed the sale at 11:25 a.m. at 17 9/16 per share. O'Callaghan or Ali then reported the trade to Wall Street Discount's brokers, who double time-stamped an upstairs order ticket at 11:26:21 a.m. and 11:27:25 a.m. In Dalton's view, these and the other trade records made it "quite clear" that the trades for the LDL account were initiated and, in many cases, executed on the exchange floor by O'Callaghan before the trades were reported to and time-stamped by Wall Street Discount.

^{12/} Pilovsky did not provide specific dates of his conversations with Wall Street Discount's president and Ali. It appears that those conversations occurred towards the end of the relevant period because, after that time, O'Callaghan and Ali no longer called Wall Street Discount with reports of executions, although they continued to call in with orders to buy or sell stock.

^{13/} The 159 LDL trades were set forth in a chart, admitted into evidence, that showed comparisons of each trade.

Dalton testified that, from December 2000 to March 2001, O’Callaghan was “buying and selling the same amount of shares each day, day trading, and in most instances ending with a flat position.” In March 2001, the NYSE commenced an investigation of O’Callaghan’s floor trading after it triggered alerts in the Exchange’s surveillance systems. ^{14/} In October 2001, the NYSE notified O’Callaghan in writing of its investigation. Dalton testified that O’Callaghan stopped trading for the LDL account around this time. Dalton calculated that, between December 2000 and March 2001, O’Callaghan generated \$44,600.50 in profits from his trading in the LDL account. ^{15/}

B. O’Callaghan Admits Exercising Investment Discretion in the LDL Account

In July 2002, O’Callaghan appeared before the NYSE and gave sworn on-the-record testimony. In that testimony, O’Callaghan stated that it was “probably [his] idea” to obtain trading authority in the LDL account. O’Callaghan believed that the November 8, 2000, Trading Authorization signed by Zente enabled him to buy or sell as much stock for the LDL account as he wanted, at whatever price he chose, so long as he acted “prudently.” He also believed that the November 8, 2000, Trading Authorization enabled him to effect trades for the LDL account without communicating with Zente. O’Callaghan stated that Zente learned about transactions in the LDL account from the confirmation statements that he received in the mail.

O’Callaghan admitted that he exercised investment discretion in the LDL account. He testified in his 2002 on-the-record testimony and at the 2005 hearing that he started executing trades for the LDL account in 2000 in order to save Zente money on the commissions charged by floor brokers for trade executions. ^{16/} O’Callaghan also testified that he loaned funds to Zente

^{14/} Dalton stated that the NYSE’s surveillance systems “monitor[] short-term trading, either buying and selling or selling and buying, where there’s . . . either a market impact trade or a series of market impact trades in between the opening and closing of the position.” By “market impact trade” Dalton meant “any trade that would move the market one way or another.” The NYSE’s surveillance systems “kicked out” or flagged approximately sixty trades effected by O’Callaghan that occurred on nineteen separate trade dates between December 2000 and March 2001.

^{15/} Although O’Callaghan claimed that the LDL account lost money, he did not support this claim with evidence of any losses.

^{16/} The record shows that O’Callaghan saved Zente around twenty-five dollars for each trade that he executed for the LDL account.

for deposit into the LDL account. ^{17/} He affirmed that he knew those funds would be deposited into the LDL account. He did not receive interest or repayment of the loans.

C. O'Callaghan Offers Several Explanations for his Trading in the LDL Account

O'Callaghan offered several explanations for his trading in the LDL account. In his 2002 on-the-record testimony, O'Callaghan testified that he would call Ali from the exchange floor where particular stocks traded and instruct Ali to get upstairs order tickets from Wall Street Discount's brokers to buy or sell those stocks, after which he would execute the trades. Also in his 2002 on-the-record testimony, O'Callaghan was asked about his March 7, 2001 purchase of 1,000 IBM shares for the LDL account. O'Callaghan admitted that he would have been on the floor by the post where IBM was trading; that he would have initiated the trade by directing Ali, with whom he was in "constant contact" through broker-to-booth headsets, to get a time-stamped Wall Street Discount upstairs order ticket to buy 1,000 shares of IBM; that Ali would have called Wall Street Discount's brokers and told them to "clock a ticket for 1,000 shares of IBM"; and that he would have executed the trade.

In the same 2002 on-the-record testimony, O'Callaghan testified that Wall Street Discount had "a list of stocks that [were] okayed to trade," meaning there was a group of stocks approved by Zente for trading in the LDL account. ^{18/} He believed that stocks such as IBM and LU were on the list, although neither he nor Ali had a copy of the list. O'Callaghan testified that he could trade the stocks that were on the list and, based on the amount of buying power in the account, he would decide how many shares to buy or sell. O'Callaghan claimed that he always had a time-stamped upstairs order ticket from Wall Street Discount before he executed a trade. O'Callaghan professed to have "no idea" why his floor booth tickets were time-stamped before the corresponding Wall Street Discount upstairs order tickets.

Later in the NYSE's investigation, O'Callaghan asserted in a 2003 letter from counsel that Zente initiated all orders for the LDL account. ^{19/} O'Callaghan repeated this assertion in his

^{17/} O'Callaghan testified that he loaned Zente \$30,000 in September 2001 and additional funds before (\$16,000) and after (\$25,000) the relevant period. Dalton testified that during the relevant period the account was worth approximately \$80,000 to \$100,000.

^{18/} By contrast, Pilovsky testified that he was "absolutely not" aware of a list of stocks that could be traded for the LDL account. Dalton testified that his investigation revealed no evidence of any list of stocks but that, even if there were such a list, "a list of a number of stocks is not an order."

^{19/} In the same letter, O'Callaghan's counsel also asserted that all orders for the LDL account were "buy minus-sell plus" orders that were proper under NYSE Rule 95. NYSE Rule 13 defines a "buy minus" order as an order to buy a stated amount of stock provided that the
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answer to the August 2004 Charge Memorandum and at the 2005 hearing. During the 2005 hearing, O'Callaghan stated that each morning, Ali would call Wall Street Discount's upstairs trading desk to find out if there were any orders from Zente. O'Callaghan stated that there were orders most mornings and that he would execute those orders if he was not busy. However, the trade records showed that no more than six of the 159 trades analyzed by Dalton had upstairs order tickets with time-stamps before the market opened. The rest of the trades occurred throughout the trading day.

Also during the 2005 hearing, O'Callaghan admitted that he initiated some trades for the LDL account, but stated that those trades were executed electronically through SuperDOT. He denied executing any orders for the LDL account that he had initiated. He affirmed that he knew that the on-floor trading rules prohibited floor brokers from initiating and executing the same trades on the exchange floor, and that his own firm's compliance manual made it clear that such trading was improper. At one point during the 2005 hearing, O'Callaghan testified that an unidentified person at Wall Street Discount was exercising investment discretion in, and entering orders for, the LDL account. As noted previously, Pilovsky testified that Wall Street Discount did not send any customer orders to O'Callaghan for execution.

An Exchange Hearing Panel observed that O'Callaghan's 2002 on-the-record testimony and 2005 hearing testimony contradicted each other. The Hearing Panel stated that it found O'Callaghan's hearing testimony "lacking in credibility" and "not supported by other testimony or documentary evidence."

19/ (...continued)

price to be obtained is not higher than the last sale if the last sale was a "minus" or "zero minus" tick, and is not higher than the last sale minus the minimum fractional change in the stock if the last sale was a "plus" or "zero plus" tick. A "sell plus" order is defined as an order to sell a stated amount of a stock provided that the price to be obtained is not lower than the last sale if the last sale was a "plus" or "zero plus" tick, and is not lower than the last sale plus the minimum fractional change in the stock if the last sale was a "minus" or "zero minus" tick. See also Peter Martin Toczek, 51 S.E.C. 781, 782 n.5 (1993) (discussing "plus tick" and "zero plus tick").

Dalton testified that, even if O'Callaghan had been pursuing a buy minus-sell plus strategy, he still would have had to obtain a time-stamped order ticket from Wall Street Discount before the execution of any buy minus or sell plus order. Dalton also testified that he investigated this explanation of O'Callaghan's trading but found no evidence to support it. Moreover, none of the witnesses, including O'Callaghan, mentioned a buy minus/sell plus strategy in on-the-record testimony.

D. Expert Testimony on Rules Governing Floor Trading

The NYSE's expert Brendan Dowd testified that a floor broker could not generate an order on the exchange floor, determine which stock, or the amount of stock, to purchase for a customer, determine the size of an order based on the buying power in the account, or determine whether a trade should be a purchase or sale. The customer had to make those decisions.

When presented with a hypothetical example of trading, Dowd stated that a floor broker could not make an investment decision for an account in which he had a discretionary trading agreement, instruct his clerk to obtain a time-stamped ticket from an upstairs trading desk, and then execute the trade:

Q: Suppose a member is on the floor out in the crowd. He's in the crowd and he sees a lot of buy interest, say he's in the IBM crowd He decides that it would be good to buy 10,000 shares of IBM for his customer account in which he has a discretionary trading agreement. He tells his clerk, through a broker to booth headset, that he would like a ticket to purchase 10,000 shares of IBM for this customer account. He tells his clerk make sure you get a clocked ticket in the booth and make sure you get a clocked ticket with the upstairs order desk. The tickets are clocked in the booth and they are clocked upstairs. Then he goes ahead and he executes that order to buy 10,000 shares of IBM for his customer. In your opinion, is a member permitted to do that on the floor of the Exchange?

A: No Because an order has to be placed off-floor [T]he broker can call the upstairs trading desk and the upstairs trading desk through [its] clearing firm can enter the order, but it has to be executed by a non-affiliated broker. In other words, he can put it in the [Super]DOT system, he can give it to somebody else, but he cannot execute it himself. 20/

Dowd was asked how a floor broker could place an order for an account in which he had investment discretion without violating the on-floor trading rules. Dowd testified that the floor broker would have to place the discretionary order with an upstairs trading desk, which would then transmit the order to either SuperDOT or an unaffiliated floor broker for execution, thereby precluding the floor broker from exploiting his time and place advantages by executing the order himself:

20/ An "off the floor" order is an order that is not initiated on the exchange floor. Dalton testified that, under Exchange rules, an order transmitted to the upstairs office of a brokerage firm is an off-floor order if it is executed through facilities regularly used for the execution of customer orders. See generally NYSE Rule 112 (discussing orders initiated "off the floor").

- Q: . . . Suppose a member on the floor . . . executes an agreement that grants him investment discretion to trade for a customer account. Again, suppose he wants to utilize that investment discretion in conformity with Exchange guidelines and rules. Is there any way that a broker can do that?
- A: Yes Again, it comes to off-floor entry of orders. If in fact he would like to place an order, he can call the clearinghouse, enter the order, and, again, have the order transmitted down to a non-affiliated broker for execution.
- Q: So the member is not permitted to execute orders in which he's vested with investment discretion?
- A: No. He can use the [Super]DOT system, he can use a retail broker. There are different ways to do it, but, no, the broker cannot execute the order for that account.
- Q: What do you think are the reasons that a member is not allowed to exercise discretion and execute orders on the floor of the Exchange on behalf of a customer?
- A: Because I believe it gives that account an unfair advantage over the public Obviously on the trading floor we are privy to a lot of information, and . . . by executing an order in that way you're giving your customer an unfair advantage, and it also puts the public at a disadvantage. It undermines the integrity of the marketplace.

Dowd opined that the rules governing on-floor trading were well-known to members, and that members were responsible for complying with those rules.

O'Callaghan's expert David Sobel gave similar testimony. When asked if there was anything wrong with a floor broker initiating an order on the exchange floor and then executing that order himself, Sobel stated, "Oh, absolutely [Y]ou can't create an order and execute it on the floor." Sobel testified that, by contrast, it was "perfectly legal" for a broker to initiate an order and then transmit the order to an upstairs firm for execution by an unrelated floor broker or SuperDOT because, in that case, the broker "might be creating the order, but he's not executing the order." 21/

21/ See, e.g., 17 C.F.R. § 240.11a2-2(T) (permitting members, subject to certain enumerated conditions, to effect transactions for discretionary accounts using an unaffiliated member to execute the transactions on an exchange floor); see also Securities Transactions by Members of Nat'l Sec. Exchs., Exchange Act Rel. No. 15533 (Jan. 29, 1979), 16 SEC Docket 854, 858 n.25 (stating that automated execution systems operated by an exchange, (continued...))

III.

Exchange Act Section 11(a) and Exchange Act Rule 11a-1 prohibit a floor broker from trading for an account over which the broker exercises investment discretion. The record shows that O'Callaghan exercised investment discretion in the LDL account. The November 8, 2000, Trading Authorization signed by Zente authorized O'Callaghan to trade for the LDL account. O'Callaghan admitted that he was vested with and exercised investment discretion in the LDL account by virtue of that Trading Authorization. The record shows that O'Callaghan executed trades that he initiated while on the exchange floor. O'Callaghan admitted in his 2002 on-the-record testimony that he would stand at posts on the exchange floor where certain stocks traded and, without any customer orders having been sent to him, initiate trades by directing Ali to obtain time-stamped order tickets from Wall Street Discount's upstairs brokers. O'Callaghan admitted that he then would execute the trades.

Former Wall Street Discount branch manager Pilovsky's testimony provides additional evidence that O'Callaghan engaged in improper discretionary trading. Pilovsky testified that Zente never placed any orders for the LDL account and that Wall Street Discount never sent any customer orders to O'Callaghan for execution. Pilovsky also testified that O'Callaghan or Ali regularly reported to Wall Street Discount trades that had already been executed, although no customer orders had been placed. Pilovsky further testified that Wall Street Discount's order tickets clearly identified those trades that O'Callaghan both originated and executed because the order tickets had double time-stamps that were often only seconds apart. 22/

NYSE investigator Dalton's testimony and the trade records constitute further evidence of O'Callaghan's improper discretionary trading. Dalton testified, and the trade records showed, that O'Callaghan initiated and, in many cases, executed trades for the LDL account before reporting those trades to Wall Street Discount. Wall Street Discount, in turn, would time-stamp order tickets twice in succession, to conform to its practices.

21/ (...continued)
such as the NYSE's SuperDOT, satisfy Rule 11a2-2(T)'s independent execution requirement).

22/ On appeal, O'Callaghan claims that the time-stamp discrepancies were due, alternatively, to malfunctioning clocks, human error, or "altered" upstairs order tickets. O'Callaghan states that he does not "ask the Commission to resolve these credibility issues, but only to find that the Exchange's repeated and unjustifiable delays deprived O'Callaghan of his constitutional and statutory rights to make these challenges at [the] hearing." As set forth infra at page 16, we have found that there were no unreasonable delays and that O'Callaghan received a fair hearing before the Exchange.

In his defense, O'Callaghan offered multiple theories of how trades were effected for the LDL account -- that Zente initiated orders and sent them to either O'Callaghan or SuperDOT for execution, that O'Callaghan initiated orders based on a list of stocks that could be traded at his discretion, or that someone at Wall Street Discount had investment discretion and initiated orders for the LDL account. However, O'Callaghan offered no evidence to substantiate any of those theories. O'Callaghan did not produce the list he referenced in his testimony, and Pilovsky denied that such a list existed. ^{23/} O'Callaghan could have called his father-in-law, Zente, as a fact witness, but he failed to do so. Although, as noted previously, O'Callaghan asserted that Zente was too sick to testify at the hearing, Pilovsky testified that he saw Zente several weeks before the 2005 hearing and that Zente did not appear to be sick. O'Callaghan states in his reply brief that Zente would not have remembered "which specific orders he gave four years before the hearing," but Zente could have refuted Pilovsky's testimony that he did not enter any orders for the LDL account.

Instead of calling Zente or any other fact witness, O'Callaghan testified in his own defense. As indicated, the Hearing Panel found that his hearing testimony was not credible. We give deference to the Panel's credibility findings. ^{24/} We conclude that O'Callaghan engaged in improper discretionary trading in the LDL account. By executing trades that he had initiated for the LDL account while on the trading floor, O'Callaghan exploited the time and place advantages that he and other floor brokers have, such as the ability to "execute decisions faster than public investors." ^{25/} The NYSE's findings that O'Callaghan violated Exchange Act Section 11(a), Exchange Act Rule 11a-1, and NYSE Rules 90(a), 95(a), and 476(a)(6) are sustained.

IV.

O'Callaghan contends that, in various respects, the NYSE denied him due process and otherwise failed to give him a fair hearing. Although constitutional due process requirements

^{23/} We agree with the NYSE that, even if LDL had compiled a list of "approved" stocks, that list would not constitute a substitute for an individual order. See David M. Levine, Exchange Act Rel. No. 48760 (Nov. 7, 2003), 81 SEC Docket 2303, 2315 & n.26 (stating that entries on a list did not constitute orders), petition denied, 407 F.3d 178 (3d Cir. 2005).

^{24/} Credibility determinations of an initial fact finder are entitled to considerable weight and deference because they are based on hearing the witnesses' testimony and observing their demeanor. Arthur James Niebauer, Exchange Act Rel. No. 54384 (Aug. 30, 2006), 88 SEC Docket 2728, 2737 n.36 & cases cited therein.

^{25/} Securities Transactions by Members of Nat'l Sec. Exchs., Exchange Act Rel. No. 14563 (Mar. 14, 1978), 14 SEC Docket 430, 433.

generally do not apply to self-regulatory organizations, such as the NYSE, 26/ the NYSE is required to provide fair procedures for disciplining members. 27/ We find that the NYSE provided fair procedures in this case.

An Exchange Hearing Panel conducted a hearing over several sessions from February 2005 to May 2005. O’Callaghan testified in his own defense, called an expert in his case-in-chief, and cross-examined the Exchange’s witnesses. In addition, both parties adduced into evidence numerous exhibits, including the transcript of O’Callaghan’s 2002 sworn on-the-record testimony, his floor booth records, and the corresponding Wall Street Discount upstairs order tickets for the trades that were the subject of the Charge Memorandum.

O’Callaghan claims that the NYSE failed to give him a fair hearing because it did not obtain his floor booth tape recordings, which would have demonstrated that he did not engage in improper discretionary trading. At the hearing, O’Callaghan testified that he subscribed to a telephone service from a third-party vendor, IPC. As part of that subscription, O’Callaghan paid an additional fee to have his telephone conversations recorded. O’Callaghan understood that the tapes were preserved by IPC for a one-year period. When O’Callaghan needed to obtain a tape recording of a conversation, Ali would get it for him, usually within seven hours of making the request.

O’Callaghan testified that, in October 2001, he told Dalton and another NYSE employee that his floor booth telephone lines were taped and that they should listen to those tapes. However, Dalton testified that O’Callaghan never mentioned the existence of any tapes. As noted previously, the Hearing Panel did not credit O’Callaghan’s hearing testimony. The tapes

26/ See, e.g., Desiderio v. NASD, 191 F.3d 198, 206-07 (2d Cir. 1999) (NASD is not a state actor, and constitutional requirements generally do not apply to it), cert. denied, 531 U.S. 1069 (2001); Mark H. Love, Exchange Act Rel. 49248 (Feb. 13, 2004), 82 SEC Docket 686, 692 n.13 (NASD proceedings are not state actions and therefore they are not subject to constitutional requirements).

The United States Supreme Court, in Brentwood Acad. v. Tenn. Secondary Sch. Athletic Ass'n, 531 U.S. 288 (2001), held that a private party not otherwise subject to the Fifth Amendment may be deemed to have engaged in state action sufficient to give rise to constitutional protections when there is such a “close nexus between the State and the challenged action” that the seemingly private behavior “may be fairly treated as that of the State itself.” Id. at 295. O’Callaghan does not present, and our de novo review of the record does not reveal, any facts tending to show that there was the kind of cooperation or interaction between the NYSE and the government that would justify a finding that the NYSE engaged in state action. Thus, we reject O’Callaghan’s claim that constitutional due process requirements applied to this disciplinary proceeding.

27/ 15 U.S.C. § 78f(b)(7).

were available through the third-party vendor, IPC. O’Callaghan, by his own admissions, could have obtained the tapes, yet failed to do so. 28/ He admitted that he did not request the tapes from IPC in October 2001 when the Exchange notified him of the investigation; that he did not request the tapes from IPC in discovery; and that he did not refer to the existence of the tapes during his 2002 on-the-record testimony with Dalton. 29/ Instead, O’Callaghan waited until the 2005 hearing to raise the matter of the tapes when they were no longer available to corroborate or refute his claims. 30/

O’Callaghan claims that the NYSE failed to give him a fair hearing because of its delay in investigating and prosecuting the charges against him. As discussed, O’Callaghan’s improper trading began in December 2000 and ended in October 2001. The NYSE notified O’Callaghan that he was under investigation in October 2001, and O’Callaghan testified before the Exchange in July 2002. In August 2004, the NYSE filed the Charge Memorandum that instituted this proceeding, and a hearing on the charges commenced in February 2005. In these circumstances, we find no unreasonable delay. Moreover, O’Callaghan has not made the required showing of prejudice resulting from a delay. 31/

28/ See Robert Thomas Clawson, 56 S.E.C. 584, 595 & n.25 (2003) (stating that it is the respondent’s obligation to marshal all evidence in his defense), petition denied, 2005 WL 2174637 (9th Cir. 2005) (unpublished opinion).

29/ O’Callaghan claims that the NYSE never advised him of the trade dates at issue, and therefore made it “impossible” for him to review the tape recordings. However, at his 2002 on-the-record testimony, O’Callaghan was questioned about certain trades, and O’Callaghan knew that the NYSE was focused on his LDL trades. While O’Callaghan states in his brief that, in October 2001, he knew only that an “initial investigation” had been commenced, O’Callaghan could have acted at that time to preserve the tapes.

30/ O’Callaghan claims that Wall Street Discount had recorded telephone lines and that the NYSE should have obtained those recordings as well. The record contains no evidence to substantiate this claim. Pilovsky testified generally that Wall Street Discount once had a dictaphone reel-to-reel but that it no longer existed. Pilovsky did not testify that his and Thomas’ conversations with O’Callaghan were recorded or that such recordings existed at the time that the NYSE conducted its investigation.

31/ Robert W. Armstrong, III, Exchange Act Rel. No. 51920 (June 24, 2005), 85 SEC Docket 3011, 3037 & n.79; see, e.g., Stephen Michael Sohmer, Exchange Act Rel. 49052 (Jan. 12, 2004), 81 SEC Docket 4066 (holding no prejudicial delay where respondents’ two sets of misconduct ended in June and November 1997, respectively, they were notified in January 1999 that they were under investigation, one respondent’s testimony was taken in November 2000, and respondents were charged in February 2002); Anthony A. Adonnino, 56 S.E.C. 1273, 1292-93 (2003) (holding no prejudicial delay when
(continued...))

O’Callaghan claims that the NYSE failed to give him a fair hearing because of certain alleged ex parte communications made by a Hearing Panel member to O’Callaghan during the hearing. The record shows that, on May 20, 2005, the Panel announced its findings and set May 24, 2005, as the date for the penalty argument. On May 24, 2005, O’Callaghan’s counsel filed a motion for a mistrial based on those alleged ex parte communications. The motion alleged that, on February 7, 2005, after the first two hearing sessions, the member stated, “Round 1 for you”; after the April 12, 2005, hearing session, he stated, “Keep doing what you’re doing. Everything is going fine”; and on May 6, 2005, after another hearing session, he stated, “Why did you testify? You shouldn’t have testified.” 32/

The Hearing Officer called the Panel member to the stand and questioned him under oath. The Panel member testified that he said, “Round one is over,” not “Round one for you”; that he said, “Long night,” not “Keep doing what you’re doing, everything is going fine”; and that he did not make the third statement attributed to him. In denying the motion for a mistrial, the Hearing Officer determined that there was no evidence of bias or prejudice, and that the Panel’s prior credibility findings against O’Callaghan could not be ignored in evaluating his allegations. We see no prejudice to O’Callaghan resulting from the Panel member’s participation in the 2005 hearing. 33/ We find, based on an independent review of the record, that O’Callaghan received a fair hearing. In addition, our de novo review affords O’Callaghan “ample protection from any claimed partiality or bias.” 34/

31/ (...continued)
respondents were charged in September 1999 for two sets of misconduct that ended in May 1996 and July 1997, respectively), aff’d, 111 Fed. Appx. 46 (2d Cir. 2004).

32/ Noting that all of the alleged ex parte communications occurred weeks, if not months, before the Panel announced its findings of violations, the Hearing Officer asked O’Callaghan’s counsel when he first became aware of those alleged communications. Counsel replied, “yesterday.”

33/ See, e.g., Robert Fitzpatrick, 55 S.E.C. 419, 431-32 (2001) (finding no evidence of impermissible bias by hearing panel member where there was no allegation that panel member, even if he made the statement at issue, formed his opinion on the basis of anything other than the case that respondent presented to the hearing panel), petition denied, 63 Fed. Appx. 20 (2d Cir. 2003) (unpublished opinion).

34/ David C. Ho, Exchange Act Rel. No. 54481 (Sept. 22, 2006), 88 SEC Docket 3194, 3202, aff’d, 2007 U.S. App. LEXIS 9882 (7th Cir. Apr. 18, 2007) (unpublished opinion).

We review sanctions imposed by the NYSE to determine whether they are excessive, oppressive, or impose an unnecessary or inappropriate burden on competition. ^{35/} The appropriate sanctions in a case depend on the particular facts and circumstances and cannot be determined by comparison with action taken in other cases. ^{36/}

On the record before us, we are unable to evaluate the propriety of the NYSE's sanctions imposed against O'Callaghan, particularly the three-month suspension. Courts have held that a suspension from securities trading should serve a remedial purpose to protect the public, rather than as punishment for the offender. ^{37/} As the Second Circuit stated in McCarthy v. SEC, "[i]t is familiar law that the purpose of expulsion or suspension from trading is to protect investors, not to penalize brokers." ^{38/}

While the NYSE stated that it found O'Callaghan's violations to be "serious," it also found that there were mitigating factors, such as the fact that "little or no harm" resulted from O'Callaghan's misconduct and that there was "no gain" to O'Callaghan because he took no fees for his trading. Nevertheless, in considering the deterrent value of a suspension, the Exchange stated:

Respondent is a \$2 broker, not a specialist or a broker for a large wire house. If Respondent is not there to service his clients, they will find new brokers to handle their trades. A specialist or wire house broker could easily have a job to come back to after three months. Respondent will likely have to rebuild his business. The financial and business impact on a \$2 broker of a three month suspension has the potential to be catastrophic and terminal. This represents a serious deterrent to other similarly situated brokers. (Emphasis supplied.)

^{35/} 15 U.S.C. § 78s(e)(2).

^{36/} See Butz v. Glover Livestock Comm'n Co., 411 U.S. 182, 187 (1973).

^{37/} See, e.g., Paz Sec., Inc. v. SEC, 494 F.3d 1059, 1065 (D.C. Cir. 2007); McCarthy v. SEC, 406 F.3d 179, 188-89 (2d Cir. 2005).

^{38/} McCarthy, 406 F.3d at 188.

The Exchange described the impact of a three-month suspension on O’Callaghan as potentially “catastrophic and terminal,” but failed to explain how the suspension would protect the trading public from further harm. ^{39/} The McCarthy court made it clear that no “ritualistic incantation” regarding remedial effect is required, but that “[s]ome explanation addressing the nature of the violation and the mitigating factors presented in the record of each case” must be made. ^{40/} The absence of any such explanation by the NYSE suggests that the suspension was inappropriately punitive and thus excessive or oppressive.

In its brief, the Exchange represents that, in January 2006, after the misconduct at issue, the NYSE brought a new Charge Memorandum alleging that, in or about January 2004, O’Callaghan engaged in acts detrimental to the NYSE’s interest or welfare by surreptitiously obtaining a confidential list of other floor brokers’ customers from an NYSE employee. O’Callaghan was also charged with failing to supervise the activities of his firm’s employees. In April 2007, the NYSE amended the Charge Memorandum to allege additional violations against O’Callaghan’s firm. A hearing was set for November 2007, but the record does not indicate the current status of those charges, and we have not considered them in our disposition of this proceeding.

The Exchange, while recognizing that O’Callaghan has yet to have a hearing on the new charges, argues that “[l]eaving O’Callaghan on the [t]rading [f]loor in the face of a new Charge Memorandum, after he has been found guilty of illegal trading, poses a risk of substantial harm to the public.” The Exchange contrasts O’Callaghan’s position with that of the petitioner in McCarthy, who had been operating lawfully on the exchange floor for nine years after his violative conduct. In light of our remand, we do not address this argument. The NYSE should address the relevance of this issue, if any, in the first instance, on remand.

Consequently, we remand the proceeding to give the NYSE an opportunity to reconsider the sanctions imposed against O’Callaghan in accordance with this opinion. On remand, the NYSE should address the protective interests to be served by removing O’Callaghan from the floor, the mitigating factors presented in the record, and any other factors related to whether a

^{39/} While the Exchange considered the deterrent effect of a three-month suspension on other similarly situated brokers, general deterrence by itself is not sufficient justification for the suspension, although it is a relevant factor. See McCarthy, 406 F.3d at 189.

^{40/} Id. at 190.

suspension is appropriately remedial and not punitive. At the conclusion of the Exchange's proceedings, if he is aggrieved, O'Callaghan will have the right to file an application for review of the Exchange's decision with us pursuant to Exchange Act Section 19(d)(2) and our Rule of Practice 420. 41/ We do not intend to suggest any view on the outcome of the Exchange's consideration of these questions.

An appropriate order will issue. 42/

By the Commission (Chairman COX and Commissioners ATKINS and CASEY).

Nancy M. Morris
Secretary

41/ 15 U.S.C. § 78s(d)(2); 17 C.F.R. § 201.420.

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

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934

Rel. No. 57840 / May 20, 2008

Admin. Proc. File No. 3-12668

In the Matter of the Application of
JAMES GERARD O'CALLAGHAN
For Review of Disciplinary Action Taken by the
NEW YORK STOCK EXCHANGE, INC.

ORDER SUSTAINING IN PART AND REMANDING IN PART

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

ORDERED that the findings of violations made by the New York Stock Exchange, Inc. against James Gerard O'Callaghan be, and they hereby are, sustained; and it is further

ORDERED that the sanctions imposed by the New York Stock Exchange, Inc. against James Gerard O'Callaghan be, and they hereby are, vacated; and it is further

ORDERED that the proceeding be, and it hereby is, remanded to the New York Stock Exchange, Inc. for reconsideration of sanctions in accordance with this opinion.

By the Commission.

Nancy M. Morris
Secretary