

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 61134 / December 10, 2009

Admin. Proc. File No. 3-12668

In the Matter of the Application of

JAMES GERARD O'CALLAGHAN
c/o Andrew J. Goodman
James H. Freeman
Garvey Schubert Barer
100 Wall Street, 20th Floor
New York, NY 10005

For Review of Disciplinary Action Taken by

NYSE Regulation, Inc.

OPINION OF THE COMMISSION

NATIONAL SECURITIES EXCHANGE – REVIEW OF DISCIPLINARY
PROCEEDINGS

Sanctions Imposed by National Securities Exchange on Remand

Exchange member violated federal securities laws and exchange rules when he initiated and executed trades in an account over which he had investment discretion. *Held*, exchange's sanctions *sustained*.

APPEARANCES:

Andrew J. Goodman and *James H. Freeman*, of Garvey Schubert Barer, for James Gerard O'Callaghan.

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

Appeal filed: February 11, 2009
Last brief received: September 3, 2009

I.

James Gerard O'Callaghan, formerly a New York Stock Exchange, Inc. ("NYSE" or "Exchange") member and an independent floor broker, has appealed a decision by the NYSE, on remand from the Commission, upholding the sanctions originally imposed. The NYSE found that 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 for having initiated and executed trades for an account over which he had investment discretion. 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.

On appeal, we sustained the Exchange's findings of violation but remanded the case to the Exchange for it to reconsider the sanctions ("May 20, 2008 Opinion").³ On remand, the NYSE concluded that the three-month suspension was remedial and therefore in the public interest, and that the censure and fine were warranted. O'Callaghan now appeals the NYSE's remand decision. We base our findings on an independent review of the record.

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 *James Gerard O'Callaghan*, Securities Exchange Act Rel. No. 57840 (May 20, 2008), 93 SEC Docket 6067, 6078, 6083-84.

II.

A. Facts

For purposes of this appeal, the facts are not at issue because we previously made findings of fact in the May 20, 2008 Opinion.⁴ However, certain facts are relevant to the disposition of the remand appeal, and a brief summary therefore appears below.

O'Callaghan entered the securities industry in 1969, became a member of the NYSE in 1973, and has been employed on the floor of the Exchange for more than thirty years. In 1997, O'Callaghan 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 executed orders initiated through other NYSE members. O'Callaghan admits that he knew during the period at issue that the on-floor trading rules prohibited floor brokers from initiating and executing the same trades on the Exchange floor, and that his firm's compliance manual made it clear that such trading was improper.

O'Callaghan had investment discretion over an account 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. ("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. O'Callaghan started executing trades for the LDL account in 2000 to save Zente money on the commissions charged by floor brokers.

Zente did not place any orders for the LDL account. O'Callaghan or Frank Ali, O'Callaghan's chief clerk and compliance officer at the time, regularly transmitted reports of trade executions for the LDL account to Wall Street Discount without first receiving any orders from Zente.⁵ Upon receiving those reports, Wall Street Discount completed order tickets to memorialize those trades and credit them to the LDL account. Wall Street Discount never sent any customer orders to O'Callaghan for execution.

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

⁴ O'Callaghan states in his opening brief that he does not contest in this appeal the Commission's "earlier findings relating to [his] liability," but, because he disputes the facts and believes that he committed no violations, he "reserves the right to challenge such findings in a judicial forum on final determination by the Commission."

⁵ Ali was charged as a co-respondent in this proceeding and consented to a five-year bar in a compliance or a supervisory capacity. *Frank Joseph Ali*, New York Stock Exchange Hearing Panel Decision 05-4 (Jan. 13, 2005), <http://www.nyse.com/pdfs/05-004/.pdf>.

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 any customer order, the upstairs order ticket had "double time-stamps," meaning there were two time-stamps only seconds apart.

An NYSE investigator analyzed a sample of 159 LDL trades (from more than 700), using O'Callaghan's floor tickets, Wall Street Discount's order tickets, and NYSE reports showing the times of O'Callaghan's trade executions as captured by the NYSE's systems. The analysis revealed 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. Moreover, 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. In addition, many of Wall Street Discount's order tickets had "double time-stamps," indicating that O'Callaghan originated and executed the same trades for the LDL account.

In March 2001, the NYSE commenced an investigation of O'Callaghan's floor trading after it triggered alerts in the Exchange's surveillance systems. In October 2001, the NYSE notified O'Callaghan of its investigation. O'Callaghan stopped trading for the LDL account around this time.

B. Procedural History

1. NYSE Original Decision

On November 2, 2005, the NYSE found that, between December 2000 and October 2001, while on the floor of the Exchange, O'Callaghan violated Exchange Act Section 11(a), Exchange Act Rule 11a-1(a), and NYSE Rules 90(a), 95(a), and 476(a)(6), by initiating and executing trades for an account over which he had investment discretion. The NYSE found O'Callaghan's hearing testimony that he did not initiate and execute orders on behalf of the LDL account to be "lacking in credibility" and "not supported by other testimony or documentary evidence." 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. On June 6, 2007, the NYSE's Board of Directors affirmed the decision.

2. Commission Opinion Remanding to the NYSE

O'Callaghan appealed to the Commission. In the May 20, 2008 Opinion, we sustained the Exchange's findings of violation but remanded the proceeding for a reconsideration of the

sanctions imposed.⁶ The remand directed the NYSE to articulate the protective interests to be served by removing O'Callaghan from the floor consistent with *McCarthy v. SEC*,⁷ a Second Circuit Court of Appeals decision. We noted that the Exchange had 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.)

We remanded all of the sanctions, instructing the NYSE to "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 suspension is appropriately remedial and not punitive."

3. NYSE Remand Decision

On remand, the NYSE hearing panel explained that its original finding that the suspension could have a "catastrophic and terminal" effect was not intended "to deliberately or effectively terminate [O'Callaghan's] business." The NYSE determined that O'Callaghan's actions "were repeated over a period of approximately ten months," "constituted a deliberate pattern of behavior, not an isolated incident or momentary lapse in judgment," and "undermined trust in the integrity of the market, which can only function properly if participants operate according to specific rules and expectations." The NYSE found that O'Callaghan acted on his own accord, was not a minor participant – unlike the court's finding in *McCarthy*, and involved his clerk in the misconduct. The NYSE also found that "the rules which [he] violated were clear-cut and required no subsequent clarification," in contrast to the ambiguity surrounding the rules violated in *McCarthy*.

The NYSE acknowledged that it originally considered the degree of harm to be a mitigating factor but found that there is "harm to the integrity of the marketplace whenever a rule is broken" as a result of the time and place advantage acquired from the misconduct. The NYSE found that the potential gain to O'Callaghan was minimal, given that he did not take fees for

⁶ *O'Callaghan*, 93 SEC Docket at 6078, 6083-84.

⁷ 406 F.3d 179, 188-89, 190 (2d Cir. 2005).

himself and did no more than favor a family member and obtain goodwill.⁸ The NYSE found that O'Callaghan continued to work on the Exchange floor. It also found that there are no measures in place to prevent him from engaging in similar misconduct, noting that he is now his firm's compliance officer.

The NYSE concluded that a three-month suspension, censure, and \$30,000 fine were "necessary to impress upon [O'Callaghan] the seriousness of his conduct and deter him from similar future misconduct." The NYSE Board of Directors affirmed the decision, and O'Callaghan filed an appeal with the Commission on February 11, 2009.

4. July 29, 2009 Suspension

On February 20, 2009, shortly after O'Callaghan filed his petition for review, we granted his request for a stay of the suspension pending this appeal. However, we denied his request for a stay of the censure and fine on the grounds that he neither addressed the merits of staying those sanctions in his motion nor provided any basis for concluding that a stay would serve the public interest.⁹ The Central Registration Depository indicates that O'Callaghan subsequently filed a Form U5 for "full termination" of his securities industry registrations and a Form BDW for "full withdrawal" of his firm's broker-dealer registration, both filings effective as of May 18, 2009. O'Callaghan failed to pay the fine, which resulted in the imposition of a suspension by the NYSE effective July 29, 2009 and continuing until the fine is paid.¹⁰ On August 10, 2009, we issued an order directing additional briefing by the parties regarding the question of whether the suspension has any impact on the merits of this proceeding. To date, O'Callaghan has served approximately four months of his suspension for failure to pay the fine.

⁸ O'Callaghan had been the subject of subsequent disciplinary action, in which he consented to findings regarding net capital and failure to supervise violations, a censure, a \$75,000 fine, and an undertaking. The NYSE, however, found this subsequent disciplinary action was not an aggravating factor, particularly because "Enforcement had an opportunity to take the current matter into consideration when negotiating an appropriate penalty with [O'Callaghan] in the subsequent action."

⁹ *Order Granting Partial Stay by Delegated Authority* (Feb. 20, 2009) (granting stay of suspension but denying stay of censure and fine).

¹⁰ See FINRA Rule 8320 (stating that FINRA may summarily suspend or expel from membership a member that fails to pay promptly a fine imposed pursuant to Rule 8310 when such fine becomes due and payable).

III.

Section 19(e)(2) of the Securities Exchange Act of 1934 governs our consideration of O'Callaghan's appeal from the NYSE's decision on remand.¹¹ Section 19(e)(2) provides that the Commission will sustain the Exchange's sanctions unless it finds, having due regard for the public interest and the protection of investors, that the sanctions are excessive or oppressive or impose an unnecessary or inappropriate burden on competition.¹²

We directed the NYSE to address the protective interests to be served by removing O'Callaghan from the floor consistent with the Second Circuit's opinion in *McCarthy*. We did so based on our concern that the sanction appeared to be punitive rather than remedial, given the NYSE's comments about the potential impact of a three-month suspension on O'Callaghan's business.

On remand, the NYSE clarified that the suspension was "meant to encompass small brokerage firms generally," and that the NYSE carefully calibrated the length of the suspension to deter O'Callaghan from future misconduct, not destroy his business. O'Callaghan argues that the remand decision fails to explain adequately the remedial purpose to be served by the suspension in light of its potentially destructive effect on his business. He argues that the suspension must be vacated because it is punitive. He further asserts that the suspension, based on his failure to pay the fine, "has no impact on the merits of this proceeding" because, among other things, "the fine and the three-month suspension are based on the same order and reversal of the fine will vacate the fine suspension."¹³

O'Callaghan voluntarily terminated his individual registrations and the registration of his firm. O'Callaghan also failed to pay the fine imposed by the NYSE in this proceeding.¹⁴ As a result the NYSE suspended him on July 29, 2009. O'Callaghan has placed himself in that position as a consequence of his decision to terminate his registrations and not to pay the fine. The harm O'Callaghan asserts he might suffer from being off the floor and having to rebuild his business results from his own actions.

¹¹ 15 U.S.C. § 78s(e)(2).

¹² O'Callaghan does not claim, and the record does not show, that NYSE's action imposed an unnecessary or inappropriate burden on competition.

¹³ The NYSE stated in its brief that "O'Callaghan's failure to pay the fine further enforces the fact that a serious sanction is necessary."

¹⁴ We denied O'Callaghan's request for a stay of the fine pending resolution of this appeal. *See supra* Section II.B.4.

We believe the NYSE's sanctions at issue here are neither excessive nor oppressive. The record supports the NYSE's conclusion that O'Callaghan committed a serious offense. O'Callaghan's actions, as noted by the NYSE, occurred repeatedly for ten months, ceased only when he learned about the pending investigation, and evidenced a deliberate pattern of behavior. O'Callaghan acted on his own accord, was not a minor participant – unlike the court's finding in *McCarthy*, and involved his clerk in the misconduct. The rules that O'Callaghan violated presented little or no ambiguity in contrast to the asserted ambiguity surrounding the rules that were violated in *McCarthy*. Indeed, O'Callaghan admits that he knew during the period at issue that the on-floor trading rules prohibited floor brokers from initiating and executing the same trades on the Exchange floor, and that his firm's compliance manual made it clear that such trading was improper. The rules at issue protect investors by preventing 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.

O'Callaghan argues that there is no potential for repetition. He cites two Commission releases to support his argument that "the NYSE has installed very detailed electronic reporting systems," which, he claims, "preclude originating and trading an order on the floor."¹⁵ Those releases, however, acknowledge that technological advances have diminished, but not eradicated, the time and place advantages available to floor brokers. Moreover, the releases did not repeal the NYSE rules prohibiting initiating and executing an order on the floor. We believe that O'Callaghan's failure to accept responsibility and to recognize the wrongfulness of his conduct suggests a troubling lack of appreciation for the responsibilities of a securities professional that further indicates a potential for repetition, particularly given that he is now his firm's compliance officer.¹⁶

O'Callaghan also claims that the "mere passage of time" since 2001 without engaging in similar conduct is mitigating under *McCarthy*. In 2008, O'Callaghan settled a disciplinary action with respect to net capital and failure to supervise violations. While the NYSE declined to find that this settlement was an aggravating factor, it observed that "the existence of the disciplin[ary action] refutes Respondent's claim of a clean record." As the NYSE noted, even putting aside

¹⁵ See *Notice of Filing and Order Granting Accelerated Approval to Create a New NYSE Market Model*, Exchange Act Rel. No. 58845 (Oct. 24, 2008), 94 SEC Docket 11063; *Notice of Filing to Create a New NYSE Market Model*, Exchange Act Rel. No. 58184 (July 17, 2008), 93 SEC Docket 7869.

¹⁶ *John S. Brownson*, 55 S.E.C. 1023, 1030 (2002) (finding respondent's unwillingness to accept responsibility for his actions "suggests a troubling lack of appreciation for the responsibilities of a securities professional").

O'Callaghan's subsequent record, the *McCarthy* court stated that the absence of further violations does not necessarily entitle a trader, such as O'Callaghan, to a reversal.¹⁷

O'Callaghan claims that he "felt unfettered in his challenged conduct [*i.e.*, the violations at issue] because he believed that an earlier investigation into something similar – which closed with no action taken – vindicated him," and that "[u]ncertainty that conduct is violative is itself a mitigating factor." However, O'Callaghan admits that he knew during the period at issue that the on-floor trading rules prohibited floor brokers from initiating and executing the same trades on the Exchange floor, and that his firm's compliance manual made it clear that such trading was improper. If O'Callaghan was uncertain about the propriety of his conduct, it was his duty to determine whether his conduct complied with the securities laws.¹⁸ O'Callaghan does not claim that he made any effort to determine whether his conduct was appropriate.

In considering the mitigating factors raised by O'Callaghan, the NYSE found that O'Callaghan's misconduct resulted in "little or no harm" and that O'Callaghan received no personal financial gain.¹⁹ The NYSE concluded that a three-month suspension, in contrast to the three-year suspension sought by NYSE's Division of Enforcement, appropriately accounted for those mitigating circumstances.

We conclude that the sanctions – a censure, which O'Callaghan concedes is appropriate, fine, and suspension – serve the public interest. We agree with the NYSE that the combination of sanctions serves to stress the importance of those rules and deter O'Callaghan and others from engaging in similar misconduct in the future.²⁰

¹⁷ See *McCarthy*, 406 F.3d at 191 (stating that the court did "not hold that when a trader's suspension is stayed pending appeal, he is entitled to a reversal of that suspension if he engages in no further violations during the period of the stay").

¹⁸ Cf. *Jason A. Craig*, Exchange Act Rel. No. 59137 (Dec. 22, 2008), 94 SEC Docket 12694, 12700 & n.22 (finding that applicant's uncertainty about his disclosure on Form U4 imposed a duty to determine the form's accuracy) (citing *James Alan Schneider*, 52 S.E.C. 840, 843 (1996) (holding applicant responsible for accuracy of Form U4's contents), *aff'd*, 118 F.3d 1577 (3d Cir. 1997)).

¹⁹ In the remand decision, the NYSE acknowledged the degree of harm was a mitigating factor, but also stated that "there is harm to the integrity of the marketplace whenever a rule is broken." The NYSE further stated that, although it originally found that O'Callaghan received no personal financial gain, "[f]avoring a family member constitutes a form of gain, even if it cannot be quantified."

²⁰ See *Robert E. Strong*, Exchange Act Rel. No. 57426 (Mar. 4, 2008), 92 SEC Docket 2875, 2895 (finding that a fine serves the public interest by encouraging future

(continued...)

O'Callaghan argues that the NYSE denied him a "fair procedure" when it rejected his request for an evidentiary hearing on remand. O'Callaghan had two full evidentiary hearings below – one for the violations at issue and another for the sanctions – at which both parties introduced evidence and where O'Callaghan cross-examined the NYSE's witnesses, called his own witnesses, and testified on his own behalf. He also had the opportunity on remand to file briefs with the NYSE and the Commission. O'Callaghan fails to specify what additional facts he would adduce that would warrant further evidentiary hearings.²¹ Accordingly, we find no merit to O'Callaghan's argument that the NYSE denied him a "fair procedure."

On this record, we find that the sanctions are remedial and are neither excessive nor oppressive.

An appropriate order will issue.²²

By the Commission (Chairman SCHAPIRO and Commissioners CASEY, WALTER, AGUILAR and PAREDES).

Elizabeth M. Murphy
Secretary

²⁰ (...continued)

compliance with the rules at issue by the applicant and others with similar responsibilities); *see also SEC v. Palmisano*, 135 F.3d 860, 866 (2d Cir. 1998) (noting that the deterrent effect of a fine serves important nonpunitive goals, such as "encouraging investor confidence, increasing the efficiency of financial markets, and promoting the stability of the securities industry"). A fine is normally imposed as a deterrent against future misconduct, and its amount need not be related to the amount of an applicant's wrongful gain. *See Patten Sec. Corp.*, 51 S.E.C. 568, 579 (1993). The NYSE found that the amount of the fine represents a portion of the account's (*i.e.*, his father-in-law's) profits that he generated through his misconduct.

²¹ The issues for which O'Callaghan seeks to present additional factual evidence are either moot (*i.e.*, the effect of a three-month suspension) or are not in dispute (*i.e.*, minimal harm to the trading public and personal gain, and NYSE electronic safeguards).

²² We have considered all of the arguments advanced by the parties. 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
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For Review of Disciplinary Action Taken by

NYSE Regulation, Inc.

ORDER SUSTAINING DISCIPLINARY ACTION

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

ORDERED that the disciplinary action by NYSE against James Gerard O'Callaghan be,
and it hereby is, sustained.

By the Commission.

Elizabeth M. Murphy
Secretary