UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

ADMINISTRATIVE PROCEEDINGS RULINGS
Release No. 3627/February 19, 2016

ADMINISTRATIVE PROCEEDING
File No. 3-16978

In the Matter of BEHRUZ AFSHAR, SHAHRYAR AFSHAR, RICHARD F. KENNY, IV, FINELINE TRADING GROUP LLC, AND MAKINO CAPITAL LLC	ORDER GRANTING IN PART RESPONDENTS' MOTION FOR ADDITIONAL DISCOVERY AND ISSUANCE OF SUBPOENAS

On December 3, 2015, the Securities and Exchange Commission issued an order instituting administrative and cease-and-desist proceedings (OIP) against Respondents. The hearing is scheduled to commence in Chicago on May 4, 2016.

On February 8, 2016, Respondents filed a Motion for Additional Discovery and Issuance of Subpoenas (Motion). The Division of Enforcement filed an Objection to the Motion (Objection) on February 12, 2016, Respondents filed a Reply (Reply) on February 18, 2016, and the Motion is now ripe for decision.

A party may request the issuance of a subpoena requiring the production of documentary or other tangible evidence. 17 C.F.R. § 201.232. However, a subpoena may be quashed "[i]f compliance with the subpoena would be unreasonable, oppressive or unduly burdensome." 17 C.F.R. § 201.232(e)(2). Also, I may sua sponte refuse to issue a subpoena, or modify it, if the "subpoena or any of its terms is unreasonable, oppressive, excessive in scope, or unduly burdensome." 17 C.F.R. § 201.232(b).

Additional Discovery

The OIP alleges, in part, as follows. Between May 2011 and December 2012, Respondents placed All-Or-None (AON) orders – undisplayed orders that must be executed in their entirety or not at all – in options on the Nasdaq OMX PHLX exchange (PHLX), and then placed smaller, displayed orders for the same option series and at the same price, but on the opposite side of the market. OIP at 3. The smaller orders were not bona fide, but were placed to alter the options' best bid and offer prices by "one penny" for the purpose of "spoofing" other market participants into submitting orders at the altered prices, which would then execute against

the AON orders. *Id.* at 3, 12. The smaller orders were canceled after the AON orders were filled, and the strategy was repeated on the opposite side of the market to close out the position. *Id.* at 12. Respondents were motivated to execute this scheme because at the relevant time, PHLX paid "rebates" for orders that provided liquidity, such as AON orders, but did not penalize orders which were cancelled, such as the smaller orders. *Id.* at 13, 15. PHLX paid over $225,000 in rebates to Lightspeed Trading, LLC, Respondents' broker. *Id.* at 3, 13.

Respondents request "documents containing the specific trade data that constitutes the alleged 'spoofing' scheme as alleged in the OIP." Motion at 2. Respondents do not request a subpoena for such documents, however, nor is the Division required to present a "roadmap" to its case. *See* Motion at 1-2; *John Thomas Capital Mgmt. Grp. LLC*, Securities Act of 1933 Release No. 9492, 2013 WL 6384275, at *6 (Dec. 6, 2013). Alternatively, Respondents request identification of the specific dates on which the alleged spoofing occurred. Motion at 2. Although I agree with Respondents that this request could have been presented as a motion for more definite statement, Respondents did not timely file such a motion. *See* 17 C.F.R. § 201.220(d) (any motion for more definite statement must be filed with a respondent's Answer); Reply at 2. It is therefore unclear whether I have the authority to grant the relief Respondents seek.

Nonetheless, the Division's response to the Motion was needlessly coy. Its position may be that all trading activity between May 2011 and December 2012 involving "AON orders on the PHLX, accompanied by smaller orders on the opposite side of the market at the same price and in the same options series" constituted spoofing. Objection at 2. On the other hand, certain other actions may have been necessary elements of the alleged scheme, including one-penny price differentials and cancelation of the smaller orders after the AON orders were filled. I am a bit surprised that the Division's position on these issues was not conveyed to the Respondents during the investigation.

In any event, I see no prejudice to the Division in stating, simply and clearly, what it contends constituted unlawful spoofing. Accordingly, I encourage the parties to confer in an effort to resolve this issue. Respondents' request for additional discovery is therefore DENIED WITHOUT PREJUDICE. If Respondents renew their request for additional discovery, they should identify with particularity what authority I have to grant their request, and they should describe the pertinent communications, if any, they have had with the Division.

Subpoenas

The OIP also alleges, in part, as follows. Certain options exchanges distinguished between "professionals" (high-volume traders) and "customers" (low-volume traders), and, as to customers, prioritized trade execution, charged lower fees, and gave higher rebates. OIP at 2. The dividing line between professionals and customers was an average of 390 orders per day, or the number of orders a person would place in one day if one order were entered every minute from market open to market close. *Id.* at 2, 6. More precisely, a "customer priority" order was an order for the account of a non-broker-dealer, where the non-broker-dealer's orders in the aggregate fall below the 390-order average daily threshold for each calendar month in a quarter.

Id. at 6. Whether an order was customer priority for a particular quarter was determined by the broker, in this case, Lightspeed, by analyzing orders from the previous quarter. *Id.* at 6-7.

According to the OIP, Respondents Fineline and Makino had separate accounts at Lightspeed, but Respondent Behruz Afshar had an interest in both companies, and the individual Respondents divided the two companies' trading profits among themselves. OIP at 7-8. Lightspeed therefore should have determined whether Fineline and Makino had customer priority by aggregating orders in the two companies' accounts. *See id.* at 6-7. However, "[t]o avoid account aggregation, the [individual Respondents] misrepresented to Lightspeed that Fineline and Makino did not share common ownership." *Id.* at 7. The individual Respondents then placed orders in only one company's Lightspeed account during each quarter, while the second company's account lay dormant, so that each quarter one company's account would exceed the 390-order threshold and the other's would not. *Id.* The next quarter orders were placed only in the account of the second (customer priority) company, while the account of the first (now-"professional" designated) company would lay dormant, so that it would revert to customer priority the following quarter. *Id.* By alternating use of the two company's accounts, without full disclosure to Lightspeed, the individual Respondents were consistently afforded customer priority when they should not have been, thereby obtaining over $2 million in transaction fees wrongly avoided and higher rebates wrongly received between October 2010 and December 2012. *Id.* at 2-3.

Respondents request subpoenas seeking three categories of information: (1) from the various exchanges, information relating to the drafting, passing, interpretation, and enforcement of the "390-Order Rule"; (2) from the Commission, all comment letters relating to the 390-Order Rule; and (3) from Lightspeed, documents relating to Lightspeed's compliance with the 390-Order Rule. *See* Motion at 2-3. The Division takes no position on the proposed subpoena to Lightspeed, and although it is quite broad in scope, I will issue it.

The Division argues that the OIP's allegations "do not involve an undisclosed 'interpretation' of any exchange's customer priority rule," and that the documents sought from the exchanges are unlikely to be relevant. Objection at 4 n.1. I agree, and find that the proposed subpoenas to the exchanges are unreasonable and excessive in scope. *See* 17 C.F.R. § 201.232(b). Respondents seek "[a]ny and all documents relating" to each exchange's version of the Rule, including documents relating to the rulemaking process, comments, previous drafts, interpretive guidance, and enforcement guidelines. Motion at Ex. A. The relevance of almost all such documents, which pertain to third parties' thoughts on the 390-Order Rule, is not apparent from the Motion. Correspondence between Respondents and the various exchanges about the 390-Order Rule may be relevant, however, because it may shed light on Respondents' understanding of the Rule, and I would entertain a request for narrowly tailored subpoenas seeking such documents.

As for the proposed subpoena to the Commission, Respondents suggest that the parties may be able to resolve the matter themselves. *See* Reply at 3. I encourage them to do so, and I will therefore not issue the subpoena at this time.

SO ORDERED.

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Cameron Elliot
Administrative Law Judge