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

ADMINISTRATIVE PROCEEDINGS RULINGS
Release No. 3746/March 30, 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 DENYING RESPONDENTS' MOTION FOR SUMMARY DISPOSITION

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.

Respondents filed their answers on January 15, 2016. At a prehearing conference held on January 11, 2016, Respondents confirmed, through counsel, that they had received copies of the investigative file. *See* Jan. 11, 2016, Tr. 4. On February 25, 2016, Respondents filed a motion for summary disposition. The Division of Enforcement timely filed an opposition, Respondents timely filed a reply, and the motion is now ripe for decision.

BACKGROUND

The OIP alleges two fraudulent schemes, only one of which, the "customer priority" scheme, is addressed in the motion. The OIP alleges in pertinent 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. 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 Trading, LLC, by analyzing orders from the previous quarter. *Id*. at 6-7. Respondents Fineline Trading Group LLC and Makino Capital LLC 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. *Id*. 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's orders were placed only in the account of the second (customer priority) company, while the account of the first (now-"professional" designated) company would lie 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.

DISCUSSION

A. Summary Disposition Standard

After a respondent's answer has been filed and documents have been made available to that respondent for inspection and copying, a party may make a motion for summary disposition of any or all allegations of the OIP with respect to that respondent. *See* 17 C.F.R. § 201.250(a). A motion for summary disposition may be granted if there is no genuine issue with regard to any material fact and the party making the motion is entitled to summary disposition as a matter of law. 17 C.F.R. § 201.250(b). When a respondent moves for summary disposition, the allegations of the OIP must be taken as true, except as modified by stipulations or admissions made by the Division, by uncontested affidavits, and by facts officially noticed pursuant to Rule 323. *See* 17 C.F.R. § 201.250(a). "The facts on summary disposition must be viewed in the light most favorable to the non-moving party." *Jay T. Comeaux*, Securities Act of 1933 Release No. 9633, 2014 WL 4160054, at *2 (Aug. 21, 2014). Nonetheless, "[o]nce the moving party has carried its burden of establishing that it is entitled to summary disposition on the factual record[,] the opposing party may not rely on bare allegations or denials, but instead must present specific facts showing a genuine issue of material fact for resolution at a hearing." *Id*.

Respondents assert that Lightspeed used Merrill Lynch as an executing broker; the Division does not dispute this assertion, and I have treated it as a stipulation. *Compare* Motion at 7 n.6, *with* Opposition at 3-5. Otherwise, Respondents have offered no stipulations, admissions, or uncontested affidavits, and although they cite to several officially noticeable documents, those documents are immaterial. *See* Motion at 2-4. Indeed, the motion reads more like a motion to dismiss for failure to state a claim pursuant to Federal Rule of Civil Procedure 12(b)(6) than a motion for summary disposition. *E.g.*, Motion at 1 (the disputed issues "are distinctly appropriate for summary disposition taking the allegations of the OIP as true"). Except as to the stipulation regarding Merrill Lynch, therefore, I have simply taken the OIP as true.

B. Rule 10b-5(b)

Exchange Act Section 10(b) and Rule 10b-5(b) thereunder make it unlawful for any person in connection with the purchase or sale of securities to "make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading," among other requirements. 17 C.F.R. § 240.10b-5(b); *see* 15 U.S.C. § 78j(b); *SEC v. Jakubowski*, 150 F.3d 675, 678 (7th Cir. 1998). In order for primary liability under Rule 10b-5(b) to attach, the alleged violator must be the "maker" of the misleading statements. *See SEC v. Wolfson*, 539 F.3d 1249, 1257 (10th Cir. 2008). The "maker" of a statement is the person or entity with ultimate authority over the statement, including its content and whether and how to communicate it. *Janus Capital Grp., Inc. v. First Derivative Traders*, 564 U.S. 135, 142 (2011).

The OIP alleges that "[t]o avoid account aggregation, the [individual Respondents] misrepresented to Lightspeed that Fineline and Makino did not share common ownership." OIP at 7. The OIP recites a specific example, in which Respondent Richard F. Kenny, IV, allegedly "falsely represented [to Lightspeed] that only [Respondent] Shahryar [Afshar] would be trading in each of the sub-accounts and that Shahryar was the only member of Makino, attaching trade authorization forms signed by Shahryar listing only his name for each sub-account." *Id*. at 10. The alleged scheme "was intended to deceive, and did deceive, the exchanges" regarding the status of the persons placing options orders. *Id*. at 11.

Taking the OIP's allegations as true, Respondents are not entitled to summary disposition as a matter of law. Unlike the defendants in *Janus*, who did not "make" the misrepresentations at issue in that case, the OIP adequately alleges that the misrepresentations in suit were made by "the Afshars and Kenny," that is, that the individual Respondents had "ultimate authority" over the misrepresentations at issue. *Janus*, 564 U.S. at 142. *United States v. Finnerty*, 533 F.3d 143 (2d Cir. 2008), on which Respondents rely, is inapposite. *See* Motion at 7. Unlike the customers in *Finnerty*, who were not deceived, the alleged victims in this proceeding were left with the false impression that Respondents were entitled to customer priority, a false impression created by Respondents' misrepresentations to Lightspeed. *See* 533 F.3d at 148-49; Motion at 6-7. And even assuming that Respondents did not make affirmative misrepresentations, Rule 10b-5(b) imposed a duty on Respondents to disclose material facts necessary in order to make their other statements not misleading. *See* 17 C.F.R. § 240.10b-5(b); Motion at 8.

Respondents argue that they were not the makers of the "alleged misrepresentations communicated to the supposedly aggrieved parties – *i.e.* the exchanges and other market participants." Reply at 4. The Division contends that Respondents were the makers of such misrepresentations because they retained control over how their orders were designated, even though the orders were communicated to the exchanges by Merrill Lynch. *See* Opposition at 4-5. *SEC v. Pentagon Capital Mgmt. PLC*, 725 F.3d 279 (2d Cir. 2013), *cert. denied*, 134 S. Ct. 2896 (2014), is closely on point, and supports the Division's position. In *Pentagon*, the defendant was an investment adviser who was found liable for executing a late trading scheme in mutual funds, involving orders bearing misleading timestamps placed with Pentagon's broker, who transmitted the orders to a clearing broker. *See* 725 F.3d at 282-83, 285-86. The court held that Pentagon retained control over the relevant misrepresentations: "[t]o the extent that late

trading requires a 'statement' in the form of a transmission to a clearing broker, we find that in this case, [defendants] were as much 'makers' of those statements as were the brokers." *Id*. at 286. The OIP here similarly alleges misrepresentations, followed by transmission of information derived from those misrepresentations to the victims, with no direct contact between the alleged fraudfeasor and the victims. *See* OIP at 7-12. Therefore, assuming the Division proves that Respondents retained "ultimate authority" over the misrepresentations to the exchanges, and taking the OIP's other allegations as true, Respondents could be found liable under Rule 10b-5(b), notwithstanding *Janus*.[1] 564 U.S. at 142. Viewing the OIP's allegations in the light most favorable to the Division, Lightspeed and Merrill Lynch – in transmitting those misrepresentations – are more akin to "[o]ne who . . . publishe[d] a statement on behalf of another [and were] not its maker." *Id*. Accordingly, insofar as Respondents argue that *Janus* forecloses the Division's Rule 10b-5(b) claim because the misrepresentations were not made by them but rather made by the brokers to the exchanges, summary disposition is inappropriate.

Furthermore, Respondents have not identified any authority foreclosing Rule 10b-5(b) liability in an enforcement action on the basis that a person made material misstatements to a broker – rather than directly to the ultimate victim – in connection with the purchase or sale of securities. Unlike *Janus* and *Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148 (2008), which involved private litigation, to establish liability here the Division need not prove that a victim relied upon a misrepresentation. *See John P. Flannery*, Securities Act Release No. 9689, 2014 WL 7145625, at *13 (Dec. 15, 2014), *rev'd on other grounds*, 810 F.3d 1 (1st Cir. 2015). It may be that the remoteness of a misrepresentation is as irrelevant under Rule 10b-5(b), as here, as it is under Section 17(a)(2), as in *Flannery*.

But the Commission did not explicitly rule on this issue in *Flannery*. *See* 2014 WL 7145625, at *10-11. And in a recent opinion, the Commission noted – regarding the respondent's argument that he should not be held liable for fraudulent statements that he did not transmit directly to investors – that *Janus* did not preclude a finding that the respondent was secondarily liable for misstatements made by an intervening firm. *Bernerd E. Young*, Securities Act Release No. 10060, 2016 WL 1168564, at *19 (Mar. 24, 2016). In view of the relatively limited summary disposition briefing and evidence the parties have provided, and of the apparent dearth of authority addressing this precise issue, it would be imprudent to rule on it now. I therefore deny summary disposition on the Rule 10b-5(b) claim as to Respondents' alleged misstatements to Lightspeed, without prejudice to renewal of Respondents' arguments in post-hearing briefing.

C. Rule 10b-5(a) and (c)

Exchange Act Section 10(b) and Rule 10b-5(a) and (c) thereunder make it unlawful for any person in connection with the purchase or sale of securities to "employ any device, scheme, or artifice to defraud" or to "engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person." 17 C.F.R. § 240.10b-5(a), (c); *see* 15

[1] I also assume that Merrill Lynch's misrepresentations to the exchanges and respondents' role in causing those misrepresentations are properly alleged in the OIP. Because Merrill Lynch is not referenced in the OIP, this assumption may not be warranted.

U.S.C. § 78j(b). "Conduct itself can be deceptive," and there is no requirement that "there must be a specific oral or written statement before there [can] be liability under § 10(b) or Rule 10b-5." *Stoneridge*, 552 U.S. at 158. At the same time, "scheme liability does not preclude, outright, claims based upon a scheme to misrepresent or omit material facts." *SEC v. Goldstone*, 952 F. Supp. 2d 1060, 1206 (D.N.M. 2013); *see generally John P. Flannery*, 2014 WL 7145625, at *12-*13, *24-*25.

Respondents correctly observe that their alleged misrepresentations were important elements of the customer priority scheme outlined in the OIP. *See* Motion at 9. However, their contention that the OIP "contains no allegations of additional deceptive conduct beyond the 'misrepresentation' itself" is wrong. Motion at 9. As only one example, the alleged use of Third Rail to "facilitate money transfers between Fineline and Makino," in lieu of transferring funds between Fineline and Makino directly, is just such an additional allegation of deceptive conduct. OIP at 10-11; *see generally* Opposition at 8-9 (summarizing allegations supporting scheme liability). Respondents dispute the OIP's allegation that such fund transfers were intended to conceal the affiliation between Fineline and Makino, but offer no evidence to rebut that allegation; in the absence of such evidence, I must take the allegation as true. *See* Reply at 7. Summary disposition on the claim of scheme liability is not warranted.

D. Exchange Rules

Respondents argue that "violation of an exchange rule simply is not enough" to constitute securities fraud. Motion at 9, 11. Respondents mischaracterize the OIP. The OIP does not allege that they violated an exchange rule and thereby necessarily committed securities fraud; it alleges that they committed securities fraud by, among other things, repeatedly deceiving their broker regarding facts necessary to the broker's implementation of an exchange rule. *See* OIP at 7. Respondent's reliance on *Finnerty*, in which the government failed to prove the requisite deceptive conduct or misrepresentations, is therefore misplaced. *See* 533 F.3d at 148.

E. Purchases Under Section 17

Respondents argue that "mismarked orders in which Respondents were the purchasers" are not actionable under Securities Act Section 17, which prohibits misconduct only in the "offer or sale of any securities." Motion at 12; 15 U.S.C. § 77q(a). To be sure, if Respondents are found liable for Section 17 violations but not for Section 10(b) and Rule 10b-5 violations, any sanctions in the public interest, such as disgorgement, will have to account for the differences between the two statutes. But calculation of disgorgement is "a fact intensive [exercise] that many courts suggest should be considered only after a finding of liability." *SEC v. Conaway*, No. 2:05-CV-40263, 2009 WL 902063, at *19 (E.D. Mich. Mar. 31, 2009). Respondents will be afforded a full and fair opportunity to address this issue in post-hearing briefing. Ruling on the proper method of such calculation at this juncture, however, is impractical and inappropriate.

F. Section 17(a)(3)

Respondents argue in the motion that Securities Act Section 17(a)(3) does not apply to the customer priority scheme because no purchasers were defrauded. *See* Motion at 12-13

(citing 15 U.S.C. § 77q(a)(3)). As the Division correctly notes, the OIP contains no Section 17(a)(3) allegation as to the customer priority scheme. Opp. at 12; *see* OIP at 16-17.

ORDER

Respondents' motion for summary disposition is DENIED.

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Cameron Elliot
Administrative Law Judge