HARD COPY

Serpe
+Ryan

RECEIVED
MAR 10 2016
OFFICE OF THE SECRETARY

March 9, 2016

VIA FED EX

Brent J. Fields, Secretary
Office of the Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E., Mail Stop 3628
Washington, DC 20549

Re: *In the Matter of Gregory T. Bolan, Jr. and Joseph C. Ruggieri*, AP File No. 3-16178

Dear Mr. Fields:

We write respectfully to correct a factual error in Mr. Ruggieri's Brief in Support of His Cross-Petition and in Opposition to the Division's Brief in Support of its Petition for Review, dated February 11, 2016 ("Ruggieri Br."). In his Brief, Mr. Ruggieri asserts, "Bolan issued ten ratings changes, and Ruggieri did not trade in front of five of them." (Ruggieri Br. at 2, 13, 34-35). For this assertion, Mr. Ruggieri cites correctly to paragraph number 65 of his Post-Trial Proposed Findings of Fact and Conclusions of Law, dated May 1, 2015 ("Between August 2009 and April 2011, Bolan issued 10 ratings changes. Ruggieri did not trade in front of 5 of them."). The Division did not deny this fact in its Response to Respondent's Post-Hearing Statement of Facts and Conclusions of Law, dated June 8, 2015. Thus, this is a stipulated fact in this case.

This stipulated fact, however, is incorrect. During the time that Mr. Ruggieri and Mr. Bolan overlapped at Wells Fargo, Mr. Bolan published a total of ten ratings changes, and Mr. Ruggieri traded in front of six of them (PRXL, CVD, AMRI, EM, ATHN and MDAS). The ALJ found that two of these trades (PRXL and CVD) were not based on inside information, and the Division's appeal does not contest that finding. With respect to MDAS, the Division did not allege in the OIP that this trade was made based on inside information, and it did not seek damages in connection with it at the hearing. Accordingly, of the ten ratings changes that Mr. Bolan issued, three are at issue in this appeal: AMRI, ATHN, and EM.

Respectfully submitted,

Paul W. Ryan

cc: Administrative Law Judge Jason S. Patil (by e-mail)
Sandeep Satwalekar (by e-mail)
Alexander M. Vasilescu (by e-mail)
Preethi Krishnamurthy (by e-mail)

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

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

Respondents.

RECEIVED
MAR 09 2016
OFFICE OF THE SECRETARY

OPPOSITION TO RESPONDENTS' MOTION FOR SUMMARY DISPOSITION

In their motion for summary disposition, Respondents raise various legal arguments challenging the sufficiency of the Division of Enforcement's allegations regarding one of the two fraudulent schemes described in the Order Instituting Proceedings ("OIP"), the "customer-priority" scheme. None has any merit. Contrary to Respondents' arguments, the customer-priority scheme involved both material misstatements and deceptive conduct, and the Division has properly alleged violations of each subsection of Rule 10b-5 of the Securities Exchange Act of 1934 ("Exchange Act") and of Sections 17(a)(1) and 17(a)(2) of the Securities Act of 1933 ("Securities Act").[1]

Respondents' final argument—an attempt to reduce their potential disgorgement under Securities Act Section 17(a)—is equally flawed in that it improperly conflates the issues of liability and disgorgement. Though Respondents are correct that purchases do not give rise to

[1] The OIP does not allege that the customer-priority scheme violated Section 17(a)(3) of the Securities Act.

liability under Section 17(a), their potential disgorgement extends to *all* fees they improperly avoided as a result of the customer-priority scheme, regardless of whether the underlying trade was a purchase or sale.

Because Respondents fail to raise any meritorious argument regarding the customer-priority scheme, the Division respectfully requests that the Court deny their motion for summary disposition.

THE DIVISION'S CUSTOMER-PRIORITY ALLEGATIONS

The Division's allegations regarding the customer-priority scheme appear at Paragraphs 2-6 and 29-64 of the OIP. Broadly, the Division alleges that in 2011 and 2012, Respondents schemed to avoid millions of dollars in transaction fees by alternating their trading between two accounts, one in the name of Fineline Trading Group, LLC ("Fineline"), and one in the name of Makino Capital, LLC ("Makino"), and misrepresenting Makino's true beneficial ownership. OIP, ¶¶ 4-6. Respondents held Makino out as a separate entity when in fact it was little more than Fineline by another name.

More specifically, the Division alleges that in December 2010, Respondents created Makino and misrepresented to their broker-dealer, Lightspeed Trading, that Shahryar Afshar ("Shahryar") was Makino's sole beneficial owner. *Id.* at ¶¶ 45-46. In fact, Behruz Afshar ("Behruz"), Shahryar's twin brother, invested in Makino, shared in its profits, and was one of its beneficial owners. *Id.* at ¶¶ 42, 46.

By concealing Makino's true ownership and its function as merely another account to house Fineline's trading operations, Respondents were able, throughout 2011 and 2012, to avoid the effect of various exchanges' "customer-priority" rules and their corresponding fees. *Id.* at ¶ 4. Those rules require exchange members to aggregate all trading in accounts beneficially owned by the same person or entity in order to determine, using a threshold average of 390 orders per day, whether trades in those accounts will be marked in the following quarter as "customer" or "professional." *Id.* at ¶¶ 29-32. Customer orders are given priority of trade execution over professional orders at the same price and do not incur transaction fees (unlike professional orders). *Id.* at ¶ 32.

Respondents' trading far exceeded the 390-order average daily threshold. *Id.* at ¶ 34. But by misrepresenting Makino's true beneficial ownership, Respondents ensured that Lightspeed did not aggregate trades in Fineline and Makino's accounts. *Id.* at ¶ 39. Respondents then shifted their trading operations on a quarterly basis between the Fineline and Makino accounts, allowing one account to remain largely dormant each quarter. *Id.* at ¶ 47. Lightspeed, relying on Respondents' misrepresentations, then mismarked the dormant account as "customer" in the following quarter and consequently mismarked all orders from that account before sending them to Merrill Lynch, its execution broker (and the exchange member to whom the customer-priority rules directly applied), who then passed them on to the exchanges. *Id.* at ¶¶ 4-5, 42. Over the course of two years, Respondents avoided paying over $2 million in fees as a result of their deception. *Id.* at ¶ 62.

ARGUMENT

Rule of Practice 250 permits a hearing officer to grant a motion for summary disposition if, taking the allegations of the non-moving party as true, "there is no genuine issue with regard to any material fact." 17 C.F.R. § 201.250. The facts on summary disposition must be viewed in the light most favorable to the non-moving party, and summary disposition is generally disfavored. *Ironridge Global Partners, LLC, et al.*, File No. 3-16649, A.P. Rulings Rel. No. 3298, at 5 (Nov. 5, 2015); *Jay T. Comeaux*, File No. 3-15002, 34-72896, 2014 WL 4160054, at *2 (Aug. 21, 2014).

I. Respondents Are Liable For Their Material Misrepresentations Under Exchange Act Rule 10b-5(b)

a. Respondents' Mismarked Orders Were Material Misrepresentations to the Exchanges

The Division alleges that Respondents made material misrepresentations to the exchanges in the form of mismarked, customer-designated orders in violation of Exchange Act Rule 10b-5(b). *See* OIP, ¶¶ 2, 6, 61-62, 83. Those fraudulent misrepresentations deceived the exchanges into providing benefits to Respondents to which they were not otherwise entitled. *Id.* at ¶¶ 61-62. To be clear, and contrary to Respondents' reading of the OIP (Mtn., 6), Respondents' mismarked orders are material misrepresentations that the Division alleges violated Rule 10b-5(b), not merely the alleged false statements to Lightspeed as to the beneficial owners of Fineline and Makino.

b. Respondents Had Ultimate Control Over the Designation and Destination of Their Mismarked Orders

Relying on *Janus Capital Group, Inc. v. First Derivative Traders,* 131 S. Ct. 2296, 2302 (2011), Respondents argue that they are not the "makers" of any material misrepresentations with respect to their customer-designated orders. They claim that because Lightspeed, as the introducing broker, and Merrill Lynch, as the executing broker, determined the designation of their orders and directly routed their orders to the exchanges, they cannot be the "makers" of any alleged mismarked orders for purposes of Rule 10b-5(b) liability. Mtn., 6. Respondents are wrong.

Respondents retained complete control over the designation of their orders. Respondents were well aware of the 390-order average daily threshold and of Lightspeed's quarterly order-designation procedures. *Id.* at ¶¶ 26-27, 43, 48. They knew that by falsely stating to Lightspeed that Behruz solely owned Fineline and that Shahryar solely owned Makino, Lightspeed would not aggregate orders from the two master sub-accounts as part of its quarterly review. *Id.* at ¶ 39.

They also knew that as long as they kept one of the master sub-accounts essentially dormant in one quarter—with orders kept intentionally low—they could ensure that Lightspeed would designate that account as "customer" in the next quarter. *Id.* at ¶¶ 36-38. Lightspeed's designation of Respondents' orders thus was solely dependent on the number of orders that *Respondents* chose to place in each account. In turn, as the Division will show at the hearing, Merrill Lynch relied exclusively on Lightspeed's designation when routing those orders to the exchanges.

Because Respondents controlled the facts that determined how their accounts would be coded, they had "ultimate control over both the content of the communication and the decision to communicate it" to the exchanges[2] and so were "makers" of their mismarked orders, even if Lightspeed or Merrill Lynch was ultimately "responsible for the act of communication." *See SEC v. Pentagon Capital Mgmt.*, 725 F.3d 279, 285-86 (2d Cir. 2013), *cert. denied*, 134 S. Ct. 2896 (2014). In *Pentagon Capital*, the defendants orchestrated a late-trading scheme whereby their customers could submit trades for mutual fund shares before the daily 4 p.m. deadline but finalize them up to an hour after the deadline and still receive the day's net asset value, in violation of the SEC's forward pricing rule. Following a bench trial, the district court held the defendants liable for securities fraud. On appeal to the Second Circuit, the defendants argued that they could not be liable under *Janus* for any late trading because any statement to the mutual funds in the form of trade orders was transmitted through brokers. The court rejected that argument and affirmed the district court's judgment, reasoning that the defendants were as much "makers" of the transmission of trades to the clearing broker as were the brokers who ultimately

[2] Respondents were also able to determine the exchange destination of their orders. *See, e.g.*, *id.* at ¶¶ 26, 66-67, 72.

submitted the trades to the clearing broker. *Id.* at 286. *See also In re Amanat*, File No. 3-11813, 2006 WL 3199181, at *7-*8 (Nov. 3, 2006) (Commission opinion), *petition for review denied*, 269 Fed. Appx. 217 (3d Cir. 2008) (trader who falsely reported wash trades and matched orders as legitimate trades to the Nasdaq to earn rebates made material misstatements that "caused Nasdaq to believe that [Amanat's broker] had reached the trading threshold required to qualify for rebates. His misrepresentations triggered Nasdaq's payment to [his broker] of rebates for all of its reported trades, both legitimate and illegitimate").

c. Respondents Also Violated Section 20(b) of the Exchange Act

The Division alleges, in the alternative, that the individual Respondents violated Section 20(b) of the Exchange Act by making fraudulent misstatements in the form of their mismarked orders (in violation of Exchange Act Rule 10b-5(b)) through or by means of Lightspeed. OIP, ¶ 87. Section 20(b) makes it "unlawful for any person, directly or indirectly, to do any act or thing which it would be unlawful for such person to do under the provisions of [the Exchange Act] or any rule or regulation thereunder through or by means of any other person." 15 U.S.C. § 78t(b). By its very language, Section 20(b) imposes primary liability upon those who use another person or entity, like Lightspeed, to violate the law without requiring either a primary violation by that other person or entity or control over that person or entity. *See SEC v. Strebinger*, 114 F. Supp. 3d 1321, 1335 (N.D. Ga. 2015) (denying defendants' motion to dismiss SEC's claim that defendants violated Section 20(b) even though defendants were not "makers" of any misstatement under *Janus* and lacked control over the non-culpable third party they used to commit securities fraud). Accordingly, even assuming *arguendo* that the Division's alleged Rule 10b-5(b) violations for the mismarked orders are somehow infirm under *Janus* because

Respondents' orders were coded and routed to the exchanges by their brokers, Respondents would still be primarily liable under Section 20(b) for their misconduct.

II. Respondents Engaged In A Fraudulent Scheme In Violation Of Exchange Act Rules 10b-5(a) and 10b-5(c)

In addition to violating Rule 10b-5(b), the customer-priority scheme also violated Exchange Act Rules 10b-5(a) and 10b-5(c). Respondents argue that these claims fail because they are based on nothing more than alleged misstatements to Lightspeed regarding the beneficial owners of Fineline and Makino. Mtn., 8-9. Respondents assert that the OIP contains "no allegations of additional deceptive conduct beyond" these misstatements to Lightspeed and that the Division is "bootstrapping" a flawed misrepresentation claim into a claim for scheme liability. *Id.* at 9. Respondents are mistaken.

As an initial matter, Respondents' premise that the customer-priority scheme relates only to misstatements to Lightspeed is wrong, as explained above. The Division's misrepresentation claim is based not only on the false statements they made to Lightspeed but also on Respondents' mismarked orders submitted to the exchanges.

Further, the Commission has repeatedly rejected Respondents' argument that there can be no liability under Rules 10b-5(a) and 10b-5(c) if the alleged scheme is based upon a material misrepresentation. The Commission has long held that "[t]he three main subdivisions of . . . Rule 10b-5 have been considered to be mutually supporting rather than mutually exclusive." *In re Cady, Roberts & Co.*, File No. 8-3925, 40 S.E.C. 907, 913, 1961 WL 60638, at *4 (Nov. 8, 1961); *see also In re Francis V. Lorenzo*, File No. 3-15211, Rel. No. 33-9762, at 8 (Apr. 29, 2015) (Commission opinion) (same); *In re Anthony Fields*, File No. 3-14684, Rel. No. 33-9727, at 16 (Feb. 20, 2015) (Commission opinion) (same); *cf United States v. Naftalin*, 441 U.S. 768, 773 (1979).

The Commission's opinion in *In re Amanat* is particularly instructive on this point. In that case, the Commission found that Amanat engaged in a fraudulent scheme to generate rebates from the Nasdaq through thousands of wash trades and matched orders. *In re Amanat*, 2006 WL 3199181, at *7-*8. The Commission reasoned that by falsely reporting those trades as legitimate trades to the Nasdaq, Amanat not only made material misrepresentations to the Nasdaq, but also he engaged in a fraudulent scheme designed to deceive the Nasdaq into paying rebates (based on trading volume) to which his broker-employer was not lawfully entitled. *Id.* That reasoning applies equally in this case, where Respondents—through their mismarked orders—similarly engaged in a fraudulent scheme designed to deceive exchanges into providing benefits to which Respondents were not otherwise entitled. *See also Lorezno*, at 16 (by "knowingly sen[ding] materially misleading language from his own email account to prospective investors," respondent "employ[ed] a deceptive 'device,' 'act,' or 'artifice to defraud' for purposes of liability" under Rule 10b-5(a) and (c), and Section 17(a)(1)).

Under *Amanat*, the Division need not allege deceptive conduct beyond sending mismarked orders to the exchanges to establish liability under Rules 10b-5(a) and (c). But in any event, the Division alleges multiple other deceptive acts by Respondents as part of their scheme to maintain customer priority for their orders, including:

(a) forming Makino and attempting to open other accounts at multiple other firms under different names to avoid aggregation;

(b) Behruz, the owner of Fineline, investing in Makino;

(c) opening a master-sub account at Lightspeed for Makino to allow the sub-account traders to continue trading during the quarters when Fineline's account was designated "professional";

(d) falsely representing to Lightspeed that Shahryar solely owned Makino;

(e) falsely representing to Lightspeed that Shahryar was the only individual trading in Makino's sub-accounts;

(f) limiting the trading activity of the professional-designated account to ensure its customer designation for the next quarter;

(g) alternating their trading operations between the accounts on a quarterly basis;

(h) ensuring that the sub-account traders had proper log-in credentials to enable them to seamlessly transition between accounts on a quarterly basis;

(i) transferring trading funds between Fineline and Makino to ensure trading continuity on a quarterly basis; and

(j) using Third Rail's bank account as a middleman for these fund transfers to avoid raising any suspicious that Fineline and Makino were somehow affiliated.

OIP, ¶¶ 7-12.

Viewed alone or together, these allegations independently satisfy the requirements of scheme liability under Rules 10b-5(a) and 10b-5(c). *See Pentagon Capital*, 725 F.3d at 287 (defendants were "architects" of a late-trading scheme that went "beyond the communication of the trade themselves"); *VanCook v. SEC*, 653 F.3d 130, 138-139 (2d Cir. 2011) ("VanCook did not 'merely communicat[e] trader order[s],' but rather took a series of actions over several years to implement a [late-trading] scheme that he devised.").

III. The Customer-Priority Scheme Constitutes Securities Fraud

Respondents cite *United States v. Finnerty*, 533 F.3d 143 (2d Cir. 2008), and argue that because their scheme was designed to avoid the effect of an exchange rule, they cannot be liable for securities fraud. Mtn., 9-11. Their reliance on *Finnerty* is misplaced.

In *Finnerty*, the defendant engaged in "interpositioning," a practice whereby he took "a profit on the spread between the bid price and the ask price of [his] customers' orders," in violation of NYSE rules. *Id.* at 145. In overturning his criminal conviction for violating Rules 10b-(5)(a) and (c), the Second Circuit held that Finnerty had not engaged in a deception. While the court acknowledged that "some customers may have expected that Finnerty would not engage in [interpositioning]," it concluded that "unless their understanding was based on a statement or conduct by Finnerty, he did not commit a primary violation of § 10(b)." *Id.* at 150.

The facts of this case are wholly distinguishable from those in *Finnerty*. Unlike Finnerty, Respondents affirmatively misrepresented Makino's ownership and engaged in a series of deceptive acts to preserve the impression that Makino was more than a vehicle to facilitate Respondents' circumvention of the exchanges' customer-priority rules. *See supra* at 8-9.

This case falls more squarely in line with *VanCook v. SEC*, 653 F.3d 130 (2d Cir. 2011). In that case, VanCook, the respondent in an administrative proceeding, orchestrated a late-trading scheme similar to the scheme considered in *Pentagon Capital*. The Commission's opinion affirmed the ALJ's initial decision that VanCook had committed securities fraud. On appeal to the Second Circuit, VanCook cited *Finnerty* and argued that "merely communicating a trade order, without more, is not a communicative act that can support a finding of [securities fraud]." *Id.* at 139. The court rejected that position, explaining that VanCook had done more than "merely communicate trade orders," but in fact had taken "a series of actions over several years to implement a scheme that he devised." *Id.*

Like VanCook, Respondents in this case did far more than merely communicate trade orders. Among other things, they established a new entity, misrepresented its true beneficial ownership, and masked the transfer of funds between it and Fineline to preserve its appearance of separateness—when in fact it was no more than an extension of Fineline. The Court should reject Respondents' argument that *Finnerty* bars the Division's claims based on the customer-priority scheme.

IV. Respondents Are Liable For Fees They Avoided On Both Their Purchases And Sales

In an attempt to limit their potential disgorgement, Respondents argue that they can only be liable under Section 17(a) of the Securities Act for fees they avoided on their sales during the relevant period. Mtn., 11-12. Setting aside their liability for both their sales *and* purchases under Rule 10b-5, Respondents improperly conflate their violations of Section 17(a), which are limited to their sales, with the disgorgement analysis if they are found to be liable under the Securities Act, which is not so limited.

The essential flaw in Respondents' argument is that *all* of their trades (sales *and* purchases) in the second quarter of 2011 through the end of 2012 were mismarked—and Respondents wrongly avoided paying transaction fees thereon—because of their deceptive conduct in the preceding quarter.[3] If, for example, Respondents are found to have violated Section 17(a) in the first quarter of 2011, then *all* of their trades in the second quarter of 2011 were mismarked and Respondents wrongly avoided fees on each of those trades. The same holds for each subsequent quarter of 2011 and 2012. At most, Respondents' argument would allow them to avoid only the fees they avoided on purchases for the first quarter of 2011, when the purchases themselves did not violate Section 17(a) *and* the purchases were not mismarked as a result of a violation of Section 17(a) in the previous quarter.

[3] Trades in the first quarter of 2011 were mismarked, but not because of deception in the preceding quarter.

V. The Division Does Not Allege That The Customer-Priority Scheme Violated Securities Act Section 17(a)(3)

Respondents' argument that the Division's customer-priority allegations do not state a claim under Section 17(a)(3) of the Securities Act (Mtn., 12) is moot as the Division has not pleaded that claim. *See* OIP, ¶¶ 83-86. The Court need not enter summary disposition on a claim the Division has not brought.

CONCLUSION

For the foregoing reasons, the Court should deny Respondents' motion for summary disposition.

Dated: March 9, 2016

Respectfully submitted,

Melissa Armstrong (202) 551-4724
Frederick L. Block (202) 551-4919
Paul E. Kim (202) 551-4504
Rami Sibay (202) 551-4815
Division of Enforcement
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549
COUNSEL FOR THE DIVISION OF ENFORCEMENT

CERTIFICATE OF SERVICE

I certify that on March 9, 2016, in accordance with the parties' agreement, I served by email a copy of the foregoing document on counsel for all Respondents at the following email addresses:

Gerald M. Miller - gmiller@vgmlaw.com
Howard J. Stein - hsteinlaw@aol.com

Melissa Armstrong

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-16178

In the Matter of Gregory T. Bolan, Jr. and Joseph C. Ruggieri, Respondents.

CERTIFICATE OF SERVICE

I hereby certify that I served a copy of the letter from Paul W. Ryan, dated March 9, 2016, to Brent J. Fields, Secretary of the U.S. Securities and Exchange Commission, upon the following parties on March 9, 2016 either by electronic mail in accordance with the parties' agreement, or as otherwise specified:

By Fed Ex:
Brent J. Fields, Secretary
Office of the Secretary
Securities and Exchange Commission
100 F Street N.E., Mail Stop 3628
Washington, DC 20549
Facsimile: (202) 772-9324

By Email:
The Hon. Jason S. Patil
Administrative Law Judge
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549
Facsimile: (202) 777-1031
alj@sec.gov

By Email:
Sandeep Satwalekar
(satwalekars@sec.gov)
Alexander M. Vasilescu
(vasilescua@sec.gov)
Preethi Krishnamurthy
(krishnamurthyp@sec.gov)
Facsimile: (212) 336-1348

Dated: New York, New York
March 9, 2016

SERPE RYAN LLP

B Kressel Itkin

Beth Kressel Itkin
Attorneys for Joseph Ruggieri
1115 Broadway, 11th Floor
New York, New York 10010
(212) 257-5011
bkresselitkin@serperyan.com