SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
Release No. 102533 / March 6, 2025

Admin. Proc. File No. 3-16424

In the Matter of the Application of

LEK SECURITIES CORPORATION

For Review of Disciplinary Action Taken by the

NEW YORK STOCK EXCHANGE, INC.

OPINION OF THE COMMISSION

REGISTERED SECURITIES EXCHANGE — REVIEW OF DISCIPLINARY PROCEEDINGS

Member firm of registered securities exchange appeals from disciplinary action taken by exchange. The exchange found that the member firm improperly canceled market-on-close and limit-on-close orders; effected odd-lot limit orders in a pattern of day trading in violation of exchange rules; effected short sale transactions for customers in violation of a Commission emergency order; executed short sales in violation of Rule 204T and 204 of Regulation SHO; routed orders from the exchange floor to away markets without prior approval from the exchange; and failed to have adequate supervisory systems and procedures. *Held*, exchange's findings of violations and imposition of sanctions are *sustained* in part, *set aside* in part, and *remanded* in part.

APPEARANCES:

Kevin J. Harnisch and *David M. Crane*, for Lek Securities Corporation

Andrew J. Love and *Jennifer C. Brooks*, for FINRA on behalf of NYSE Regulation.[1]

Appeal filed: March 6, 2015
Last brief received: July 6, 2015

[1] Lek Securities Corporation appeals NYSE disciplinary action, but FINRA is representing NYSE Regulation under a Regulatory Services Agreement that became effective on June 14, 2010.

Lek Securities Corporation ("LSC"), a former registered broker-dealer and member firm of the New York Stock Exchange, Inc. ("NYSE"), seeks review of NYSE disciplinary action. NYSE found that LSC violated provisions of the Securities Exchange Act of 1934, Commission rules and regulations, and NYSE rules relating to the firm's role as a clearing broker, including by providing its customers with access to markets through its proprietary electronic trading system, as well as related supervisory failures. NYSE censured LSC and imposed a $275,000 sanction for the non-supervisory or "Primary Violations" and imposed a $300,000 sanction for the firm's "Supervisory Violations."

We affirm most of NYSE's findings of violation and sanctions, but we set aside certain findings of Primary Violations related to short sales that LSC effected on behalf of alleged market maker customers. We remand for NYSE to reassess the appropriate sanction, if any, for the remaining conduct connected to those violations.

I. BACKGROUND

A. Lek Securities Corporation

Samuel Lek founded LSC in 1990 and served as its Chief Executive Officer and Chief Compliance Officer.[2] LSC was a registered broker-dealer that became an NYSE member in 1993 and an NASD (now FINRA) member in 1997.[3] The firm offered "agency only" trade execution and clearing services for professional traders and institutional customers. LSC was also a participant of the National Securities Clearing Corporation ("NSCC").[4] In that capacity,

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[2] We take official notice that, in October 2019, Lek consented to the entry of a permanent injunction against him, barring him from violating certain provisions of the federal securities laws, and to the Commission barring him from association with any securities industry firm, with the right to reapply after ten years. *See* Final Judgment as to Defendant Samuel Lek, *SEC v. Lek Sec. Corp.*, 17-cv-1789 (S.D.N.Y. Oct. 1, 2019), ECF No. 469; *Lek Sec. Corp.*, Exchange Act Release No. 87268, 2019 WL 5088997 (Oct. 10, 2019); *see also* Rule of Practice 323, 17 C.F.R. § 201.323. We also take notice of FINRA BrokerCheck records showing that Lek resigned from LSC on October 1, 2019, following allegations that he aided and abetted manipulative trading schemes, and that he consented to permanent bars by several exchanges. *See* BrokerCheck Report for Samuel Frederik Lek at 7–20, 89, FINRA, https://files.brokercheck.finra.org/individual/individual_1642936.pdf.

[3] We take official notice from FINRA BrokerCheck records that LSC is no longer registered with FINRA or a national securities exchange and that LSC ceased operating as a brokerage firm in November 2022. *See* BrokerCheck Report for Lek Securities Corporation at 1–2, FINRA, https://files.brokercheck.finra.org/firm/firm_33135.pdf. LSC has not ceased to exist, however, as it appealed an adverse FINRA hearing panel decision against it to FINRA's National Adjudicatory Council in April 2024. *See id.* at 143.

[4] We take official notice that, on March 10, 2022, a hearing panel of NSCC and a related clearing agency, the Depository Trust Company, affirmed those clearing agencies' decisions to

(*continued . . .*)

LSC cleared orders in equity securities for its customers. As a clearing broker, LSC served as an agent for its customers and did not trade as a principal for its own account.

LSC created a proprietary electronic order entry system, the ROX system ("ROX"), which allowed its customers to electronically access various stock markets and electronic communications networks. LSC's customers could enter trade data directly into ROX, and thereby transmit orders directly to NYSE's system. LSC served as the executing broker for all of its customers' orders submitted via ROX to NYSE's system.

From January 2008 through September 2010—the period broadly at issue here—LSC processed more than 469 million electronic orders with a notional value of nearly $1 trillion through ROX. Many of the allegedly violative orders at issue here came from customers of one of LSC's introducing brokers, Dimension Securities LLC, and its two affiliates, Dimension Trading and Dimension Brokerage (together, "Dimension").[5] Dimension was one of LSC's largest customers by volume of orders and "introduced" certain of its customers to LSC.

B. Procedural History

This proceeding began in February 2012 when NYSE filed a Charging Memorandum against LSC. In doing so, NYSE alleged five categories of "Primary Violations":

1. Failing to comply with NYSE's requirements governing the cancellation of "market-on-close" and "limit-on-close" orders (*see infra* Section III.A);

2. Violating NYSE's odd-lot rules and policies by effecting odd-lot limit orders in a pattern of day trading (*see infra* Section III.B);

3. Willfully violating Exchange Act rules by effecting short sale transactions in violation of a Commission emergency order (*see infra* Section III.C);

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cease to act for LSC. *See Advance Notice of NSCC Suspension of Trade Capture Services and Subsequent Cease to Act for Lek Securities Corporation (Member No. 0512)*, DTCC (June 10, 2022), https://www.dtcc.com/-/media/Files/pdf/2022/6/10/9153.pdf. We also note that LSC appealed that decision to the Commission in a separate administrative proceeding, which remains pending. *See Lek Sec. Corp.*, Admin. Proc. File No. 3-20808.

[5] An introducing broker deals directly with the public and originates customer accounts. A clearing broker like LSC handles functions related to clearing and settling trades in its introducing broker's customers' accounts, and usually has no direct contact with the introducing broker's customers, except for periodically mailing records relating to their accounts. *See Del Mar Fin. Servs.*, Exchange Act Release No. 48691, 2003 WL 22425516, at *2 nn.5, 7 (Oct. 24, 2003).

4. Willfully violating Regulation SHO by failing to timely close out fail-to-deliver positions, accepting short sales while prohibited from doing so, and failing to provide required notifications to customers (*see infra* Section III.D);

5. Violating NYSE rules by failing to obtain approval before conducting "upstairs" operations in its booth premises on the NYSE floor (*i.e.* "Blue Line" trading), failing to implement and obtain prior approval of written supervisory procedures governing such operations, and falsely representing that it had ceased such conduct after receiving NYSE's cease-and-desist letter (*see infra* Section III.E).

NYSE also charged a sixth category of violations (the "Supervisory Violations") that encompassed LSC's alleged failure to reasonably supervise and implement adequate controls pertaining to the Primary Violations above, as well as LSC's alleged failure to reasonably supervise and implement adequate controls concerning the firm's review of its electronic order flow to detect spoofing, wash trading, and marking the close (*see infra* Section III.F).

After holding an eight-day hearing, an NYSE Hearing Board (the "Hearing Board") found that LSC engaged in all of the alleged misconduct. The Hearing Board censured LSC and imposed fines totaling $275,000 for the Primary Violations and a $500,000 unitary fine for the Supervisory Violations.

After LSC appealed, NYSE's Board of Directors ("NYSE's Board") affirmed the Hearing Board's findings of the Primary Violations and the Supervisory Violations. NYSE's Board also affirmed the censure and the $275,000 fine imposed for the Primary Violations. As to the Supervisory Violations, NYSE's Board found LSC's misconduct "egregious" and that it reflected "an independent violation warranting an appropriate sanction." But NYSE's Board expressed concern that the Hearing Panel's $500,000 unitary fine for these Supervisory Violations "may have amounted to some extent to a second sanction for LSC's Primary Violations." The Board therefore reduced the $500,000 unitary fine to a $300,000 unitary fine for the Supervisory Violations (the "Unitary Supervisory Sanction"), finding the lower amount "appropriate to serve the remedial goal" without being "excessively punitive." LSC now appeals the NYSE Board's decision.[6]

On appeal, LSC challenges aspects of NYSE's resolution of four categories of the Primary Violations, those relating to odd-lot limit orders, short sales in violation of an emergency order, Regulation SHO's requirements, and Blue Line trading. LSC also argues that these four categories of Primary Violations cannot serve as the basis for Supervisory Violations. And LSC contests NYSE's findings of violations regarding the spoofing, wash trading, and marking-the-close Supervisory Violations. LSC further challenges the cumulative $575,000 in fines, including the Unitary Supervisory Sanction, as excessive and punitive. Finally, LSC

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[6] While the decision associated with the "final action of" a self-regulatory organization is generally the decision reviewed, *Kevin M. Glodek*, Exchange Act Release No. 60937, 2009 WL 3652429, at *6 (Nov. 4, 2009), where necessary to understand findings incorporated in that decision, we look to the Hearing Board's decision for its explanations.

argues that it was prejudiced by the Hearing Officer's decision to exclude proffered expert testimony.

II. STANDARD OF REVIEW

Exchange Act Section 19(e) governs our review of this self-regulatory organization ("SRO") disciplinary action. Applying a preponderance of the evidence standard, we review de novo whether LSC engaged in the conduct found by the SRO; whether such conduct violates the Exchange Act, the Commission's rules and regulations, or the SRO's rules; and whether those provisions are, and were applied in a manner, consistent with the purposes of the Exchange Act.[7]

If we find that LSC engaged in the conduct found by the SRO, in violation of the SRO's rules, we sustain the SRO's sanctions unless we find, having due regard for the public interest and the protection of investors, that the sanctions are excessive or oppressive.[8] We consider any aggravating or mitigating factors.[9] We also consider if the sanctions serve a remedial purpose or are excessive or punitive.[10]

III. VIOLATIONS AND SANCTIONS

A. LSC improperly canceled market-on-close and limit-on-close orders and failed to reasonably supervise the cancellations of such orders.

NYSE found that LSC violated NYSE Rule 123C regarding the cancellation of market-on-close and limit-on-close orders,[11] and, for that violation, imposed a censure. NYSE further found that LSC violated NYSE Rule 342 by failing to reasonably supervise and implement adequate controls reasonably designed to achieve compliance with Rule 123C.[12] LSC does not challenge these findings of violations, nor the censure, and has therefore forfeited the

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7 15 U.S.C. § 78s(e)(1).

8 15 U.S.C. § 78s(e)(2). We may also reduce the sanctions if we determine that they impose any unnecessary or inappropriate burden on competition. *Id*. The record does not show—and with one exception addressed below at *infra* text accompanying note 128, LSC does not allege—that NYSE's sanctions impose an undue burden on competition.

9 *Saad v. SEC*, 718 F.3d 904, 906 (D.C. Cir. 2013).

10 *PAZ Sec., Inc. v. SEC*, 494 F.3d 1059, 1065 (D.C. Cir. 2007).

11 During 2009, Rule 123C provided that market-on-close and limit-on-close orders could be canceled or reduced in size between 3:40 p.m. and 3:50 p.m. only to correct a legitimate error. NYSE Rule 123C(1), (2).

12 NYSE Rule 342 mandated that members provide reasonable supervision and "appropriate supervisory control" over their employees and the member's activities. NYSE Rule 342(a)–(b).

opportunity to challenge them.[13] Consistent with the Commission's review function under Exchange Act Section 19(e)(1)(A), we have independently evaluated the support for NYSE's findings of violations, and determined that LSC engaged in acts and practices in violation of those rules.

As NYSE found, LSC's Technology Officer changed the coding in LSC's system that prevented late entry and cancellation of market-on-close and limit-on-close orders, which allowed LSC to improperly cancel approximately 899 such orders between March 9 and April 22, 2009, in violation of Rule 123C. The record further shows that Lek (LSC's Chief Compliance Officer) purported to delegate to LSC's Technology Officer, a non-registered person, the responsibility for ensuring that LSC's supervisory system screened for improper cancellations of market-on-close and limit-on-close orders. But Lek did not follow up on or review that delegation,[14] and the Technology Officer changed the coding in LSC's system based on his misunderstanding of several NYSE product updates. Indeed, the improper coding was corrected only after NYSE identified the issue and notified LSC of the improper cancellations. Through these actions and omissions, LSC failed to reasonably supervise and implement adequate controls designed to achieve compliance with Rule 123C, which violated Rule 342.

We further find that Rule 123C and Rule 342 were, and were applied in a manner, consistent with the Exchange Act's purposes.[15] And we sustain NYSE's imposition of a censure for LSC's Rule 123C violations because a censure is neither excessive nor oppressive. We

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[13] *See* Rules of Practice 420(c) (requiring the application for review to identify "the alleged errors in" the underlying decision), 450(b) (requiring identification of and support for "[e]ach exception to the findings or conclusions" on review), 17 C.F.R. §§ 201.420(c), 450(b); *see also Canady v. SEC*, 230 F.3d 362, 362–63, 365 (D.C. Cir. 2000) (upholding Commission's conclusion that respondent forfeited a defense by not raising it before administrative law judge or in exceptions to law judge's initial decision); *Anthony Fields*, Exchange Act Release No. 74344, 2015 WL 728005, at *19 & n.115 (Feb. 20, 2015) (explaining that "arguments for reversal not made in the opening brief" are forfeited).

[14] *See, e.g.*, *Midas Sec., LLC*, Exchange Act Release No. 66200, 2012 WL 169138, at *13 (Jan. 20, 2012) (recognizing that the delegation of authority implicitly includes "'the additional duty to follow-up and review that delegated authority to ensure that it is being properly exercised'") (quoting *Castle Sec. Corp.*, Exchange Act Release No. 39523, 1998 WL 3456, at *4 (Jan. 7, 1998)).

[15] *See Sierra Nev. Sec., Inc.*, Exchange Act Release No. 41330, 1999 WL 239682, at *6 (Apr. 26, 1999) (explaining that "[i]t is consistent with the purposes of the Exchange Act to require that experienced personnel supervise market making and trading"); *Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change by NYSE Relating to Permanent Approval of Expiration Day Auxiliary Closing Procedures Pilot Program*, Exchange Act Release No. 37894, 1996 WL 629756, at *3–4 (Oct. 30, 1996) (explaining Rule 123C's purposes).

discuss NYSE's imposition of the Unitary Supervisory Sanction *infra*, after discussion of all the Primary Violations.[16]

B. LSC effected odd-lot limit orders in a pattern of day trading and had no supervisory system or procedures to capture such trading.

NYSE found that LSC committed both Primary and Supervisory Violations by effecting odd-lot limit orders in a pattern of day trading and maintaining no supervisory system or procedures to capture such trading. An "odd lot" order is an order of less than a "round lot," which is typically 100 shares.[17] Odd lot orders are common among retail investors. At the time of LSC's conduct here, NYSE Rule 124 provided that odd-lot limit orders would be executed against an NYSE "specialist" (the market maker for a specific security on NYSE), as counterparty at the price—at or better than the limit price—of the next round-lot transaction on NYSE in the security following receipt of the order.[18]

To prevent potentially abusive trading, NYSE proposed a rule amendment in 1992 to curb certain practices "not consistent with traditional odd-lot investment activity."[19] One such practice it sought to restrict was introducing "odd-lot limit orders" in "any pattern of activity that would suggest day trading."[20] In approving NYSE's rule amendment, the Commission agreed with the rule's objective, expressing concern that such trading could reduce specialists' willingness to act as the counterparty for odd-lot limit orders, and concluded that, to ensure the continued functioning of the system, it was important to limit the use of the odd lot system to its intended purpose: transactions "by retail investors to buy or sell a small amount of stock."[21] Accordingly, the Commission explained, NYSE would "advise its members and member organizations, through an Information Memo, that [specified] types of trading practices," including day trading, "may not be effectuated by means of the odd-lot limit order service."[22]

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16 *See infra* Section III.F.4.

17 NYSE Rule 7.5.

18 Until 2010, odd lot orders on NYSE were handled in a system separate from round lot orders. *See Arthur James Niebauer*, Exchange Act Release No. 54384, 2006 WL 2516526, at *1–2 (Aug. 30, 2006) (describing NYSE's odd lot order service).

19 *Notice of Filing of Proposed Rule Change by NYSE Relating to Information Memo on Odd-Lot Trading Practices*, Exchange Act Release No. 31615, 1992 WL 388753, at *1–2 (Dec. 17, 1992), 57 Fed. Reg. 61,137 (Dec. 23, 1992) ("*Odd-Lot Trading Practices Notice*").

20 *Order Granting Approval and Notice of Filing and Order Granting Accelerated Approval to Amendment No. 2 of a Proposed Rule Change Regarding an Information Memo on Odd-Lot Trading Practices*, Exchange Act Release No. 33678, 1994 WL 62133, at *2 (Feb. 24, 1994), 59 Fed. Reg. 10,192 (Mar. 3, 1994) ("*Odd-Lot Trading Practices Order*").

21 *Id*.

22 *Id.*

To that end, NYSE issued Information Memo 94-14 ("IM 94-14"), which stated that the odd-lot limit order system "is not viewed as, and cannot be used as, a professional trading vehicle."[23] IM 94-14 further specified that odd-lot limit order trading in a pattern suggesting day trading—*e.g.*, "entering multiple odd-lot limit orders to buy and sell the same security on the same day"—was "inconsistent with traditional odd-lot investment activity."[24] In a subsequent information memorandum (IM 04-14),[25] NYSE further warned its members that "abusive odd-lot practices" not only violate NYSE Rule 124's requirements regarding odd-lot orders, but could also constitute a failure to adhere to principles of good business practice (NYSE Rule 401),[26] and be deemed conduct inconsistent with just and equitable principles of trade (NYSE Rule 476(a)(6)).[27] This subsequent memorandum also reminded members that they had an obligation under Rule 405(1) to use "due diligence" to learn the "essential facts relative to every customer, every order, [and] every cash or margin account accepted or carried by such organization."[28]

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[23] NYSE Information Memorandum 94-14, *Odd-Lot Trading Practices* (Apr. 18, 1994) ("IM 94-14"), https://www.nyse.com/publicdocs/nyse/markets/nyse/rule-interpretations/1994/94-14.pdf.

[24] *Id.*

[25] NYSE Information Memorandum 04-14, *Odd-Lot Order Handling and Prohibited Trading Practices—Exchange Rules 124 and 411(b); "Know Your Customer" Requirements—Exchange Rule 405*, 2004 WL 1923730 (Mar. 19, 2004) ("IM 04-14"), https://www.nyse.com/publicdocs/nyse/markets/nyse/rule-interpretations/2004/04-14.pdf (warning that prohibited odd-lot limit orders could violate these rules); *see also* NYSE Information Memorandum 04-32, *Odd-Lot Pricing (Rule 124)*, at 1 n.2 (June 17, 2004) (noting that NYSE "takes regulatory action where appropriate" with respect to certain odd-lot order trading practices, including "patterns of activity that suggest day-trading").

[26] NYSE Rule 401(a) (requiring a member firm to "adhere to the principles of good business practice in the conduct of . . . its business affairs"); *see also Anthony A. Adonnino*, Exchange Act Release No. 48618, 2003 WL 22321935, at *1 n.3 (Oct. 9, 2003) (explaining that NYSE Rule 401 requires that brokers and dealers "conduct their business consistent with high standards of commercial honor and just and equitable principles of trade") (citing *Sacks v. Reynolds Sec.*, 593 F.2d 1234, 1242 (D.C. Cir. 1978)).

[27] NYSE Rule 476(a)(6); *see also, e.g., Heath v. SEC*, 586 F.3d 122, 134 (2d Cir. 2009) (explaining that Rule 476(a)(6) operates as ""something of a catch-all which . . . preserves power [for SROs] to discipline members for a wide variety of misconduct'") (quoting *Colonial Realty Corp. v. Bache & Co.*, 358 F.2d 178, 182 (2d Cir. 1966)).

[28] IM 04-14; NYSE Rule 405(1).

In 2009, NYSE Rules 401(a) and 476(a)(6) were replaced with new NYSE Rules 2010 and 2020 as part of a harmonization of its rules with FINRA's rules. *See Notice of Filing of Proposed Rule Change by NYSE, as Modified by Amendment No. 2, Changing Certain NYSE Rules to Harmonize Them with Changes to Corresponding Rules Recently Filed by FINRA*, Exchange Act Release No. 59655, (Mar. 30, 2009), 74 Fed. Reg. 15,563, 15,565–66 (Apr. 6,

(*continued . . .*)

1. We affirm NYSE's finding that LSC committed Primary Violations relating to odd-lot limit orders.

a. LSC violated IM 94-14 by effecting odd-lot limit orders in the pattern of day trading.

NYSE found, and we agree, that LSC violated IM 94-14 by allowing customers to enter odd-lot limit orders on its ROX system in a pattern of day trading. LSC does not dispute that, between April 1, 2007, and May 18, 2007, the firm effected 169,047 odd-lot limit orders on NYSE on behalf of two Dimension customers. These orders involved in-and-out trading of identical amounts in the same securities and buying and selling identical amounts of shares on the same day. And LSC does not dispute that this conduct violated IM 94-14's prohibition against introducing odd-lot limit orders in a pattern of day trading. LSC instead argues that IM 94-14 is not an enforceable rule, did not provide adequate notice of what conduct was prohibited, was not codified in NYSE's rulebook, and has since been rescinded and so should not be applied to its conduct. None of these arguments has merit.

Under the Exchange Act, an SRO "rule" includes "any 'stated policy, practice, or interpretation' of the SRO,"[29] including "[a]ny statement made generally available to [the SRO's members] . . . that establishes or changes any standard, limit, or guideline with respect to: (i) [t]he rights, obligations, or privileges of specified persons . . . or (ii) [t]he meaning, administration, or enforcement of an existing rule."[30] Such a stated policy, practice, or interpretation is "deemed to be a proposed rule change,"[31] and thus generally only takes effect if it is approved by the Commission.[32] IM 94-14 thus meets the definition of an SRO rule. NYSE

2009); *Order Approving Proposed Rule Change, as Modified by Amendment No. 2 Thereto, Changing Certain NYSE Rules to Harmonize Them With Changes to Corresponding Rules Filed by FINRA*, Exchange Act Release No. 59965 (May 21, 2009), 74 Fed. Reg. 25,783 (May 29, 2009). In 2016, NYSE deleted NYSE Rule 405 to further harmonize its rules with FINRA's. *See Notice of Filing and Immediate Effectiveness of Proposed Rule Change Deleting Current NYSE MKT Rule 405*, Exchange Act Release No. 78106 (June 20, 2016), 81 Fed. Reg. 41,364 (June 24, 2016).

29 *ABN AMRO Clearing Chicago LLC*, Exchange Act Release No. 83849, 2018 WL 3869452, at *3 (Aug. 15, 2018) (quoting *Meyer Blinder*, Exchange Act Release No. 31095, 1992 WL 216702, at *7 & n.51 (Aug. 26, 1992)); *see also* 15 U.S.C. § 78c(a)(27) (defining an exchange rule).

30 Exchange Act Rule 19b-4(a)(6), 17 C.F.R. § 240.19b-4(a)(6) (2005).

31 *Id.* § 240.19b-4(c), (d).

32 15 U.S.C. § 78s(b)(1) ("No proposed rule change shall take effect unless approved by the Commission or otherwise permitted in accordance with the provisions of this subsection."); *see also id.* § 78s(b)(2)(D) (providing that a proposed rule change may be deemed approved where the Commission fails to approve or disapprove, or being proceedings with respect to, the change within specified time periods).

made IM 94-14's prohibition against effecting odd-lot limit orders in a pattern of day trading available to NYSE members, and IM 94-14 defined members' obligations regarding effecting odd-lot limit orders on the exchange. Further, the Commission approved IM 94-14 after providing public notice and comment.[33]

LSC disputes that "Amendment 2 to the proposal for IM 94-14" was published for public comment, but this is wrong.[34] The Commission explicitly published and solicited comments on Amendment 2 in March 1994, when it granted accelerated approval to NYSE's proposed rule change that became IM 94-14.[35] Moreover, the Commission previously had solicited public comments in December 1992 on Amendment 1, which identified odd-lot limit orders in a pattern of day trading as an example of a prohibited practice.[36] Amendment 2 further described the day-trading prohibition previously published via Amendment 1.[37]

The Commission's determination to approve Amendment 2 on an accelerated basis meant that it was not required to receive and review comments prior to approval. Exchange Act Section 19(b)(2) provides that the Commission may approve certain rule changes on an accelerated basis—that is, "earlier than 30 days after the date of publication" of the proposed rule change in the Federal Register and therefore before comments would have been received on the proposal—if "the Commission finds good cause for doing so and publishes the reason for the finding."[38] Here, the Commission found such good cause to approve Amendment 2 on an accelerated basis and published the reasons for that finding.[39] The Commission then solicited comments "concerning Amendment No. 2" within 30 days of the date of publishing the order

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33 *Odd-Lot Trading Practices Order*, 59 Fed. Reg. at 10,192–93 (approving NYSE's proposed rule change regarding odd-lot order procedures, noting that comments had been solicited but not received on the original published proposal, and soliciting further comments on amendment).

34 We do not address LSC's arguments that NYSE was required to solicit comments because the Commission published Amendment 2 for public comment. *See id.*

35 *Id.* at 10,193.

36 *Odd-Lot Trading Practices Notice*, 57 Fed. Reg. at 61,138–39. The Commission received no comments on this proposal. *Odd-Lot Trading Practices Order*, 59 Fed. Reg. at 10,192 & n.3.

37 *See id.* at 10,192 n.4.

38 15 U.S.C. § 78s(b)(2) (flush text) (eff. Dec. 17, 1993, to Nov. 2, 1998); *see also id.* § 78s(b)(2)(C)(iii) (eff. July 22, 2010 to present); 5 U.S.C. § 553(d)(3) (authorizing an agency to make a rule effective immediately upon publication, rather than "not less than 30 days" after publication, if it makes and "publish[es] with the rule" a finding of "good cause" to do so).

39 *Odd-Lot Trading Practices Order*, 59 Fed. Reg. at 10,193 (explaining that approval on an accelerated basis was appropriate because the amendment made "certain technical and clarifying adjustments to the proposed rule change but [left] the overall structure and purpose of the proposal unchanged," and because "no comments were received on the proposal as noticed").

approving that amendment.[40] LSC does not dispute that the Commission complied with these procedural requirements for approving Amendment 2 on an accelerated basis, or claim that the Commission lacked good cause for doing so. Nor does LSC explain why post-approval comments would render invalid an amendment approved on an accelerated basis consistent with Section 19(b)(2).[41]

LSC also contends that IM 94-14 did not provide adequate notice of its prohibitions, but notice arguments fail "where reasonable persons would know that their conduct is at risk."[42] IM 94-14 more than adequately provided such notice here. It specified that it prohibited "entering multiple odd-lot limit orders to buy and sell the same security on the same day," and warned of the consequences for doing so, specifying that, "[s]hould such [prohibited] trading activity occur . . ., the Exchange intends to take regulatory action."[43] And NYSE reiterated in other IMs

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40 *Id.*

41 Post-approval comments may inform whether the Commission should undertake rulemaking to "abrogate, add to, and delete from" the rule. Exchange Act Section 19(c), 15 U.S.C. § 78s(c). Additionally, the Division of Trading and Markets may approve proposed SRO rules on an accelerated basis, *see* 17 C.F.R. § 200.30-3(a)(12), and comments received shortly after such an approval order may bear on whether the Commission will order review of such action under Rule of Practice 431(c), 17 C.F.R. § 201.431(c).

LSC cites two opinions supporting its argument that the approval of Amendment 2 was improper, but the cases are inapposite. In one case, two months after promulgating a rule, the agency changed the definition of a key term in the rule through a "correction notice," abandoning the prior longstanding definition, and did not provide its reasoning for the change until after the comment period for the correction notice had closed. *See Michigan v. EPA*, 213 F.3d 663, 692 (D.C. Cir. 2000) (holding that agency failed to provide adequate opportunity for comment under those circumstances). In the other case, an agency sought to invoke the good cause exception to enable a major definitional change to take effect before receiving public comments but based its good cause finding on "a desire to save money" by implementing the new definition by the start of the fiscal year. The court concluded that the change was not the type of "technical or minor" change for which notice-and-comment procedures were unnecessary and that good cause did not support deviating from such procedures. *See Levesque v. Block*, 723 F.2d 175, 184–85 (1st Cir. 1983). By contrast, here the Commission explained that the Amendment 2 made only technical and clarifying adjustments to the proposed rule change and discussed the purposes served by the amendments and then provided a comment opportunity consistent with Section 19(b)(2).

42 *Maynard v. Cartwright*, 486 U.S. 356, 361 (1988).

43 IM 94-14, at 1, 2; *see also* NYSE Information Memorandum 07-60, *Odd-Lot Order Requirements*, at 1–3 (June 29, 2007), available at https://www.nyse.com/publicdocs/nyse/markets/nyse/rule-interpretations/2007/07-60.pdf (reminding members that certain trading practices on the odd-lot system are prohibited, including "any pattern of activity that would suggest day trading," that "violations will be pursued by the

(*continued . . .*)

that the pattern of trading described in IM 94-14 could violate NYSE Rules 401, 405, and 476(a).[44] This was more than enough for LSC to know that its conduct was at risk.

LSC further argues that IM 94-14 is not an enforceable rule because it was not codified in NYSE's rulebook. But the conduct that IM 94-14 prohibited need not be described in NYSE's rulebook to constitute an enforceable NYSE rule. NYSE may impose a final disciplinary sanction if it finds that a respondent has engaged in acts or practices "in violation of . . . the rules of the self-regulatory organization."[45] For this purpose, NYSE's "rules" include more than the contents of its rulebook.[46] The Commission approved IM 94-14 as an NYSE rule change, and through a subsequent information memorandum, NYSE informed its members that effecting odd-lot limit orders in a manner that suggested day trading "violate[s] the requirements" of the rule in IM 94-14.[47] In addition to constituting an independent rule violation, NYSE further warned its members that violations of IM 94-14's prohibition "may also constitute" violations of Rules 401, 405, and 476(a)(6), all of which are rules in NYSE's rulebook.[48]

Finally, LSC contends that the fact that NYSE subsequently rescinded IM 94-14 renders it unenforceable. But NYSE's decision to rescind IM 94-14 in 2010 as part of NYSE dismantling the then-existing odd-lot limit order system does not negate LSC's liability for violating IM 94-14 while the rule was in effect. NYSE made clear that, in withdrawing IM 94-14, it was not foreclosing disciplinary actions for misconduct that had already occurred, stating that the withdrawn prohibition in IM 94-14 would "remain relevant and applicable to any trading of odd-lot sized . . . orders through the separate odd-lot order system . . . occurring before July 29, 2010."[49]

b. LSC violated NYSE Rule 405 by not conducting sufficient due diligence into its odd-lot limit orders.

NYSE also found that LSC violated NYSE Rule 405(1) by failing to exercise sufficient due diligence to determine whether its customers were entering odd-lot limit orders in a pattern of day trading. By failing to contest this finding of violation, LSC forfeited the opportunity to

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relevant regulatory authority," and that members "must establish and enforce appropriate internal systems and controls to monitor odd-lot activity by customers").

44 *See supra* notes 25–28 and accompanying text; *see also Heath*, 586 F.3d at 140 (holding that Rule 476(a)(6)'s "standard of unethical conduct does not fail to provide Petitioner with adequate notice that the conduct in question was sanctionable").

45 15 U.S.C. § 78s(e)(1)(A).

46 *See supra* notes 29–32 and accompanying text.

47 IM 04-14, at 2.

48 *Id.*

49 NYSE Information Memorandum 10-35, *Implementation of Trading in Shares and Decommissioning of the Odd-Lot System* (July 30, 2010).

challenge it[50] and, after independently reviewing the record, we find that LSC engaged in acts and practices in violation of NYSE Rule 405(1).

Rule 405(1) required members to use "due diligence" to learn the "essential facts relative to every customer, every order, [and] every cash or margin account accepted or carried by such organization."[51] As NYSE found, LSC failed to learn essential facts relative to odd-lot limit orders from Dimension's customers, most significantly Prestige Capital LLC and Pacific Coast Trading, for which LSC acted as a clearing broker for trades executed on the NYSE. Because LSC's ROX system had not been programmed to detect odd-lot limit orders entered on both sides of the market by the same customer, or trades on the same side of the market entered more than 30 seconds apart, ROX failed to detect or flag the pattern of trades that Dimension's customers entered—in-and-out trading of identical share amounts in the same securities on the same day—even though IM 94-14 identified this activity as an example of prohibited odd-lot trading. LSC thus failed to exercise due diligence to determine whether its customers were entering odd-lot limit orders in a pattern of day trading in violation of Rule 405(1).

c. LSC violated NYSE Rules 401 and 476 by virtue of violating other NYSE rules and by effecting odd-lot limit orders in the pattern of day trading.

LSC's effecting odd-lot limit orders in a pattern of day trading also violated NYSE Rules 401 and 476(a)(6). As we have long held, a violation of an SRO rule (here, IM 94-14 and NYSE Rule 405(1)) will "automatically constitute" a violation of another rule prohibiting conduct inconsistent with just and equitable principles of trade.[52] LSC argues that the Rule 401 and 476(a)(6) violations are a "backdoor way of enforcing an unenforceable rule" and therefore cannot stand. But this argument fails because IM 94-14's prohibition on effecting odd-lot limit orders in a pattern of day trading was an enforceable rule. Thus, we agree with NYSE that LSC violated NYSE Rules 401 and 476(a)(6) by virtue of its violating IM 94-14 and NYSE Rule 405(1).

2. NYSE Rules 401, 405(1), and 476(a)(6) and IM 94-14 were, and were applied in a manner, consistent with the purposes of the Exchange Act.

NYSE Rules 401, 405(1), and 476(a)(6) and IM 94-14 were consistent with the Exchange Act's purposes. The Exchange Act requires that NYSE's rules be designed "to promote just and

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50 *See supra* note 13.

51 NYSE Rule 405(1).

52 *Thomas W. Heath, III*, Exchange Act Release No. 59223, 2009 WL 56755, at *4 n.8 (Jan. 9, 2009), *petition denied*, 586 F.3d 122 (2d Cir. 2009); *cf. Adonnino*, 2003 WL 22321935, at *1 n.3 ("As construed by the Commission and the courts, NYSE Rule 401 requires brokers and dealers to conduct their business consistent with high standards of commercial honor and just and equitable principles of trade.").

equitable principles of trade" and "protect investors and the public interest."[53] Rules 401, 405(1) and 476(a)(6) served these purposes.[54] And when approving IM 94-14, we stated that NYSE's prohibition against abusive trading in the odd-lot limit order service similarly was "designed to promote just and equitable principles of trade, to prevent fraudulent and manipulative acts, and, in general, to protect investors and the public."[55]

NYSE applied Rules 401, 405(1), and 476(a)(6) and IM 94-14 in a manner consistent with the purposes of the Exchange Act. LSC's practice of effecting odd-lot limit orders in a pattern of day trading was not consistent with the odd-lot limit order service. Further, as noted above and explained in the order approving IM 94-14, preventing trading in a manner inconsistent with the odd-lot limit service furthers the Exchange Act's purposes of promoting just and equitable principles of trade, preventing fraudulent and manipulative acts, and protecting investors and the public.[56] As a result, we find that NYSE's application of Rules 401, 405(1), and 476(a)(6) and IM 94-14 in this case was consistent with the statutory purposes that the Exchange Act was designed to promote.

3. We affirm NYSE's imposition of a censure and a $50,000 fine for LSC's Primary Violations relating to odd-lot limit orders.

NYSE imposed a censure and $50,000 fine for LSC's violations of NYSE Rules 401, 405(1), and 476(a)(6) and IM 94-14. LSC does not challenge the censure, but argues that the fine "serves no remedial purpose." We disagree. Both the censure and $50,000 fine will impress upon LSC the need to take more seriously its obligations to become familiar with all prohibitions applicable to NYSE members and comply with NYSE's rules, in a way that censure alone would not.[57] We accordingly find that the censure and $50,000 fine serve a remedial purpose and are not either excessive or oppressive.

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53 15 U.S.C. § 78f(b)(5).

54 *See* NYSE Rule 401 (requiring that members adhere to good business practices); NYSE Rule 476(a)(6) (prohibiting conduct inconsistent with just and equitable principle of trade); *Notice of Filing of Proposed Rule Change to Adopt FINRA Rules 2090 (Know Your Customer) and 2111 (Suitability) in the Consolidated FINRA Rulebook; Correction*, Exchange Act Release No. 62718A (Aug. 20, 2010), 75 Fed. Reg. 52,562, 52,563 (Aug. 26, 2010) (explaining that the "'know your customer' . . . obligations" in Rule 405 are "critical to ensuring investor protection and fair dealing with customers").

55 *Odd-Lot Trading Practices Order*, 59 Fed. Reg. at 10,193.

56 *See id.*

57 *See, e.g.*, *Lek Sec. Corp.*, Exchange Act Release No. 82981, 2018 WL 1602630, at *11–12 & n.47 (Apr. 2, 2018) (finding that a $100,000 fine would "protect investors by impressing on [applicant] the importance of complying with FINRA rules . . . without resort to a more serious sanction such as suspension or expulsion of [applicant] from FINRA membership"); *N. Woodward Fin. Corp.*, Exchange Act Release No. 60505, 2009 WL 2488066, at *6–7 (Aug. 14,

(*continued* . . .)

4. We affirm NYSE's finding that LSC committed Supervisory Violations relating to odd-lot limit orders.

We agree with NYSE that LSC violated NYSE Rule 342 by failing to establish reasonable supervisory procedures and controls regarding odd-lot limit orders. NYSE Rule 342 mandated that members provide reasonable supervision and "appropriate supervisory control" over their employees and the member's activities.[58] LSC violated this provision by lacking adequate supervisory systems and controls to ensure that the odd-lot limit order service was not used in a pattern of day trading. Although LSC argues that it cannot have violated Rule 342 in this way because IM 94-14's prohibition on effecting odd-lot limit orders in a pattern of day trading was unenforceable, that argument fails because IM 94-14's prohibition was enforceable.

As the Commission explained in approving IM 94-14, "member organizations will be expected to establish appropriate systems to monitor odd-lot activity to ensure that the practices noted in the Information Memo are not engaged in."[59] LSC, however, lacked written supervisory procedures ("WSPs") to address the odd-lot limit order prohibition, even though over 80 percent of its customers were day traders. Instead, LSC relied unreasonably on its ROX system to conduct surveillance of odd-lot limit orders. During the period when Dimension's customers engaged in odd-lot limit order day trading, LSC's control procedures in ROX prevented the submission of odd-lot limit orders on the *same* side of the market from the same customer entered within 30 seconds of each other. But ROX neither detected nor prevented the odd-lot limit orders in a pattern of day trading, because ROX did not prevent submission of odd lot orders on *opposite* sides of the market, even though that was one example of activity that IM 94-14 had flagged as indicative of impermissible odd-lot limit order day trading. LSC only adopted a post hoc surveillance report system in October 2010, three years after the trades at issue. Lek attributed this failure to his lack of awareness of the applicable information memos and Commission approval order, not any technological infeasibility.

As explained above, Rule 342 was consistent with the Exchange Act's purposes.[60] NYSE's application of Rule 342 to LSC's failure to have reasonable supervisory systems and procedures to prohibit odd-lot limit orders in a pattern of day trading was also consistent with these purposes.

2009) (finding that FINRA's imposition of a $2,500 fine was "remedial and not excessive or oppressive," because it would "encourag[e] the Applicants, who remain in the securities business, as well as others in the industry, to take their [ ] responsibilities seriously in the future"); *see also David Adam Elgart*, Exchange Act Release No. 81779, 2017 WL 4335050, at *8 (Sept. 29, 2017) (finding fine and suspension for applicant's false statements to FINRA to be "appropriately remedial to impress upon [applicant] the need to take his responsibilities in this regard more seriously in the future"), *petition denied*, 750 F. App'x 821 (11th Cir. 2018).

58 NYSE Rule 342(a)–(b).

59 *Odd-Lot Trading Practices Order*, 59 Fed. Reg. at 10,192.

60 *See supra* note 15.

For these Supervisory Violations, NYSE imposed the Unitary Supervisory Sanction, which we discuss below.[61]

C. LSC effected short sale transactions in violation of a Commission emergency order and lacked a reasonable supervisory system to ensure compliance with the order.

Exchange Act Section 12(k)(4) prohibits members "of a national securities exchange, broker, or dealer" from effecting "any transaction in," or "induc[ing] the purchase or sale of, any security in contravention of an order of the Commission under this subsection."[62] NYSE found that LSC violated Section 12(k)(4) and NYSE Rule 401 by effecting short sales prohibited by a September 18, 2008 emergency order that the Commission issued under Section 12(k)(2) (the "2008 Emergency Order").[63] "A short sale is the sale of a security that the seller does not own or any sale that is consummated by the delivery of a security borrowed by, or on behalf of the account of, the seller."[64] In the 2008 Emergency Order, the Commission "temporarily prohibit[ed] any person from effecting a short sale in the publicly traded securities of certain financial firms"—referred to as "Included Financial Firms" and identified in an appendix to the order.[65] The 2008 Emergency Order's prohibition was in effect from September 19 through October 8, 2008 (the "Emergency Order Period"),[66] and it included exemptions that allowed certain market makers to sell short the securities of Included Financial Firms.[67]

1. We affirm NYSE's finding that LSC committed Primary Violations relating to the 2008 Emergency Order for customers who were not market makers.

a. LSC violated Section 12(k)(4) by effecting short sales on behalf of customers who were not market makers in violation of the 2008 Emergency Order.

LSC effected approximately 6,468 short sale transactions related to approximately 2,822 orders in the Included Financial Firms' securities during the Emergency Order Period. For

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61 *See infra* Section III.F.4.

62 15 U.S.C. § 78*l*(k)(4).

63 *Emergency Order Pursuant to Exchange Act Section 12(k)(2) Taking Temporary Action to Respond to Market Developments*, Exchange Act Release No. 58592, 2008 WL 4287187 (Sept. 18, 2008) ("2008 Emergency Order"), *as amended*, Exchange Act Release No. 58611, 2008 WL 4299750 (Sept. 21, 2008) ("September 21 Order"), *as extended*, Exchange Act Release No. 58723, 2008 WL 4444067 (Oct. 2, 2008) ("October 2 Order").

64 *Short Sales*, Exchange Act Release No. 50103, 2004 WL 1697019 (July 28, 2004), 69 Fed. Reg. 48,008, 48,008 (Aug. 6, 2004).

65 2008 Emergency Order, 2008 WL 4287187, at *1.

66 *See id.* at *2; October 2 Order, 2008 WL 4444067.

67 2008 Emergency Order, 2008 WL 4287187, at *1–2.

example, on September 22, 2008, NYSE provided notice to member firms that AMB Property Corp. ("AMB"), a NYSE-listed issuer, had been added to the list of Included Financial Firms.[68] The next day, LSC effected six short sale transactions in AMB stock on behalf of Dimension. LSC's other 6,462 transactions involved short sale transactions in different Included Financial Firms' stock on behalf of Dimension and others. LSC's short sales in violation of the 2008 Emergency Order thus violated Section 12(k)(4).

As NYSE found, this conduct also violated NYSE Rule 401, which required member firms to "adhere to the principles of good business practice in the conduct of . . . its business affairs."[69] It was not good business practice, nor consistent with just and equitable principles of trade, for LSC to effect prohibited short sale transactions in securities of those firms identified in the Commission's emergency order.[70]

b. LSC's arguments that it should not be held liable lack merit.

LSC does not dispute that the transactions described above violated the 2008 Emergency Order, but it argues that they should be excused because the firm made reasonable efforts to comply with the order during the Emergency Order Period. For example, LSC argues that the thousands of short sales it executed on Dimension's behalf resulted from an oversight in how LSC attempted to ensure compliance with the 2008 Emergency Order, and that the short sales on Dimension's behalf resulted from LSC's "reasonable decisions." We disagree.

According to LSC, it reasonably decided to leverage its Regulation SHO compliance controls to implement the 2008 Emergency Order. For most of its customers, LSC's Regulation SHO compliance controls rejected short sales in securities listed as "threshold securities" unless

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68 In an appendix to the 2008 Emergency Order, the Commission identified specific financial firms as Included Financial Firms that non-market maker customers could not short sell. *See* 2008 Emergency Order, 2008 WL 4287187, at *1. In the September 21 Order, the Commission amended the 2008 Emergency Order "to provide that the listing markets shall select the individual financial institutions with securities covered by the Order." *See* September 21 Order, 2008 WL 4299750, at *1. Pursuant to that authority, NYSE added AMB to the list of Included Financial Firms the following day.

69 NYSE Rule 401(a).

70 *See, e.g. Paul Joseph Benz*, Exchange Act Release No. 51046, 2005 WL 106887, at *1, *3 nn.1 & 15 (Jan. 14, 2005) (recognizing that "a violation of the securities laws" also violates an SRO rule requiring compliance with "high standards of commercial honor and just and equitable principles of trade"); *Adonnino*, 2003 WL 22321935, at *1 n.3 (noting that the Commission and courts construe Rule 401 to require "brokers and dealers to conduct their business consistent with high standards of commercial honor and just and equitable principles of trade"); *cf. Stephen J. Gluckman*, Exchange Act Release No. 41628, 1999 WL 507864, at *6 (July 20, 1999) (explaining "that a violation of [a] Commission . . . rule or regulation . . . constitutes a violation" of the rule requiring members to observe high standards of commercial honor and just and equitable principles of trade).

covering securities could be located and borrowed through LSC's stock loan desk. To implement the 2008 Emergency Order, LSC added the securities of the Included Financial Firms to its threshold securities list, thereby effectively preventing customers from using its systems to execute short sales in those securities because its stock loan desk would refuse to locate the Included Financial Firms' securities. However, according to LSC, Dimension, one of its largest customers, had entered into a pre-borrow arrangement with an outside firm, meaning that Dimension relied on a third party, not LSC's stock loan desk, to locate and borrow securities to cover its short sales. For that reason, LSC placed Dimension and customers associated with it on an "Exemption List" that permitted them to enter short sale orders into LSC's systems while bypassing LSC's threshold securities list and stock loan desk, on the assumption that the third party would refuse to locate the securities and the trades would fail. When LSC implemented its controls relating to the 2008 Emergency Order, the names of customers on the Exemption List were deliberately "typed into the computer coding to exclude those firms' transactions from the screening process"; consequently, LSC's systems failed to prevent customers on the Exemption List from executing short sales in securities of the Included Financial Firms. Beyond assuming that the outside firm hired by Dimension would block any short sale orders by Dimension's customers that violated the 2008 Emergency Order, LSC did nothing to ensure that Dimension or its customers did not enter violative trades in its system or to check, after the fact, that no such trades had been entered.

LSC contends that it was reasonable for it to have relied on the third party with whom Dimension had the pre-borrow arrangement to prevent Dimension and its customers from executing the prohibited short sales. But Section 12(k)(4) provides that "[n]o member of a national securities exchange, broker, or dealer shall make use of . . . any means or instrumentality of interstate commerce to effect any transaction in . . . any security in contravention" of a Commission order under Section 12(k), such as the 2008 Emergency Order.[71] And LSC has not identified any evidence in the record establishing that it took any steps to ensure that this third-party, Dimension, or Dimension's customers were complying with the 2008 Emergency Order before it placed them on its Exemption List. Nor has LSC identified any evidence that it made any effort after placing these entities on the Exemption List to confirm that none of the entities it had exempted were violating the 2008 Emergency Order. Under the circumstances, LSC failed in its obligation to implement the order.

LSC similarly argues that it should not be found to have violated the 2008 Emergency Order when it effected otherwise prohibited short sales on the same day that an issuer was first designated as an Included Financial Firm because it made reasonable efforts at prompt compliance. LSC notes that, despite checking the list of firms several times a day and updating its systems as promptly as possible, LSC nevertheless effected prohibited short sales because of an "inherent delay in updating LSC's controls." But the 2008 Emergency Order prohibited the short sales of issuers' securities immediately once either the Commission or an SRO listed the issuer as an Included Financial Firm (unless an exemption applied, which LSC does not claim to be the case here). Indeed, the 2008 Emergency Order specified that it was "effective

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71 15 U.S.C. § 78*l*(k)(4).

immediately."[72] And even LSC concedes in its opening brief that "SROs . . . add[ed] companies to the list during the trading day, *effective immediately*." These trades thus violated the plain terms of the 2008 Emergency Order and Section 12(k)(4). As discussed below, however, we are remanding the sanctions for LSC's Primary Violations relating to the 2008 Emergency Order, and on remand NYSE should address as part of its sanctions analysis whether LSC's compliance efforts, though technically insufficient, should be taken into account given that the order required immediate compliance as additional firms were added to the list of Included Financial Firms.

Finally, LSC contends that we should set aside NYSE's decision because a "programming error" caused LSC to effect short sales of Included Financial Firms' securities from October 2 to October 8. Specifically, LSC asserts that it failed to re-program the system to extend its expiration date after the Commission extended the 2008 Emergency Order from October 2 to October 8. As a result, LSC states, it inadvertently effected short sales in the securities of Included Financial Firms between October 3 and October 8, 2008. Attributing noncompliance to a "programming error" does not change that LSC still failed to comply with the 2008 Emergency Order during its extended period.[73]

c. Section 12(k)(4) and Rule 401 are, and were applied in a manner, consistent with the purposes of the Exchange Act.

We find that Section 12(k)(4) and Rule 401 are, and were applied in a manner, consistent with the Exchange Act's purposes. Section 12(k)(4) is consistent with the purposes of the Exchange Act because it is one of the statutory means by which Congress chose to implement those purposes.[74] And we have explained that Rule 401 is consistent with the purposes of the Exchange Act in that its prohibition on dishonest and unethical conduct protects investors and the public interest.[75]

We also find that NYSE applied Section 12(k)(4) and NYSE Rule 401 in a manner consistent with the Exchange Act's purposes, which require in relevant part that an exchange's disciplinary rules be "designed . . . to promote just and equitable principles of trade."[76] It is unlawful to effect trades in contravention of an emergency order issued by the Commission under Section 12(k)(2). Imposing liability here serves the Exchange Act's purpose of promoting

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72 2008 Emergency Order, 2008 WL 4287187, at *2.

73 We do not address the merits of an argument relating to sanctions here, because we are remanding the sanctions determination for these violations, as explained below. *See infra* Section III.C.3.

74 *Cf. Business Roundtable v. SEC*, 905 F.2d 406, 410 (D.C. Cir. 1990) (looking to "the means Congress selected" in examining "the legislative purpose[s]" of the Exchange Act) (emphasis omitted).

75 *See supra* note 54 and accompanying text.

76 15 U.S.C. § 78f(b)(5).

just and equitable principles of trade by discouraging disregard for the Commission's regulatory authority to issue emergency orders.

2. We set aside NYSE's finding that LSC violated Section 12(k)(4) and Rule 401 by effecting short sales on behalf of customers who were alleged market makers.

LSC contends that an unspecified portion of its short sales effected on behalf of three registered broker-dealers—Optiver US, Diamond Carter Trading, and Group One Trading—did not violate the 2008 Emergency Order because those broker-dealers were options market makers.[77] The 2008 Emergency Order exempted options market makers that "effect[] a short sale as part of a bona fide market making and hedging activity related directly to bona fide market making in derivatives on the publicly traded securities of any Included Financial Firm."[78] The 2008 Emergency Order also exempted "registered market makers, block positioners, [and] other market makers obligated to quote in the over-the-counter market, in each case that are selling short a publicly traded security of an Included Financial Firm as part of bona fide market making in such security."[79]

We find that NYSE did not adequately explain the basis for concluding that LSC failed to establish that at least some of the short sales were eligible for the options market maker exception. LSC argues that Optiver US, Diamond Carter Trading, and Group One Trading were options market makers that qualified for the options market maker exception to the 2008 Emergency Order. LSC provided at least some evidence that the entities were options market makers through Lek's testimony. But in its decision, the Hearing Board addressed only the general market maker exception and not the options market maker exception, and NYSE's Board affirmed without addressing the options market maker exception.[80] Accordingly, we set aside the finding of violation to the extent that it is based on the short sales effected for Optiver US, Diamond Carter Trading, and Group One Trading, and we remand for NYSE to determine in the first instance whether the options market maker exception to the 2008 Emergency Order applied

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77 LSC admitted that it effected short sales for seven other broker-dealers, including Dimension, that were not eligible for the options market maker exception. Our review of the record has not uncovered the precise number of trades effected on behalf of the three U.S. registered broker-dealers that LSC contends were options market makers.

78 2008 Emergency Order, 2008 WL 4287187, at *2. Although the options market maker exception was originally set to expire on September 19, the Commission subsequently extended it for "the duration of the Order." September 21 Order, 2008 WL 4299750, at *2.

79 2008 Emergency Order, 2008 WL 4287187, at *2.

80 The record reflects that, in its post-hearing brief, LSC did not specify which market maker exception it believed applied, but that, in the briefing to NYSE's Board, LSC explicitly relied on the options market maker exception, as it did in its briefing before the Commission.

to any of the short sales that LSC effected for those entities.[81] In so doing, we make no finding as to whether any of the sales at issue qualified for the options market maker exception.

3. Because we set aside some Primary Violation findings relating to the 2008 Emergency Order, we remand NYSE's sanctions determination.

Because we set aside the finding that LSC violated the 2008 Emergency Order with respect to short sales on behalf of its alleged options market maker customers, and NYSE imposed a single sanction for all of the violations related to the 2008 Emergency Order, we remand to NYSE to determine the appropriate sanction for the remaining violations. We express no opinion as to the appropriate sanction, if any, on remand. But we note that any sanction should reflect the facts and circumstances of the violation, including the exigency of the 2008 Emergency Order, the mitigating effect, if any, of LSC's arguments about the difficulties inherent in timely implementing its requirements and the reasonableness (or unreasonableness) of LSC's compliance efforts.

4. We affirm NYSE's finding that LSC committed Supervisory Violations relating to the 2008 Emergency Order.

NYSE found, and we agree, that LSC violated NYSE Rule 342 by failing to establish reasonable or appropriate systems for follow up and review designed to ensure short sales complied with the 2008 Emergency Order. Because Section 12(k) prohibited LSC from effecting any transactions that violated the 2008 Emergency Order, LSC needed to implement reasonable controls to prevent the firm from effecting transactions that would violate the order.

As discussed, LSC attempted to comply with the 2008 Emergency Order solely by leveraging screening controls in its ROX system designed to prevent customers from effecting certain short sales under Regulation SHO. LSC argues that those screening controls were reasonable and therefore it did not violate Rule 342. But those screening controls did not apply to all of LSC's customers—instead, LSC affirmatively exempted certain customers from the screening controls, including one of its largest customers by order volume at the time: Dimension Securities and its two affiliates. LSC relied entirely on Dimension not to engage in prohibited short sales when trading through LSC's ROX system—which Dimension did by arranging to have a third party provide stock locate services instead of using LSC's stock locate desk. LSC has not established, or even claimed, that it had any direct relationship with that third party or any information about the third party's controls relating to Regulation SHO or the 2008 Emergency Order. Nor has LSC established or claimed that it took any steps to verify that whatever controls the third party had in place were effective in preventing violative short sale trades entered by Dimension and its customers from reaching the market through LSC's ROX

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[81] *See, e.g.*, *David B. Tysk*, Exchange Act Release No. 80135, 2017 WL 782153, at *4 (Mar. 1, 2017) (remanding proceeding to SRO where, among other things, SRO failed to address one of applicant's defenses).

system.[82] LSC therefore wholly abdicated its supervision and control responsibilities over trades by one of its largest customers based on the assumption that a third party would carry out those responsibilities, without any follow up or review of that customer's transactions to ensure that no violations occurred. Doing so was not reasonable.

LSC further argues that if we uphold NYSE's findings regarding the Primary Violations relating to the 2008 Emergency Order—as we have in large part—then "those violations cannot be repackaged as a failure to supervise." LSC's argument misses the distinction between the Primary and Supervisory Violations. As discussed above, we affirmed NYSE's findings relating to the Primary Violations (other than as to alleged options market maker customers) because we found that LSC violated Section 12(k)(4) by effecting short sale transactions in contravention of the 2008 Emergency Order. By contrast, we affirm NYSE's findings relating to the Supervisory Violations because we find that LSC failed to establish reasonable systems for ensuring compliance with the 2008 Emergency Order. That is, the violative trades led to the Primary Violations, and the lack of reasonable systems for preventing such trades led to the Supervisory Violations.

Although we are remanding the Primary Violations for NYSE to determine whether any short sales by three of LSC's customers qualified for the options market maker exception to the 2008 Emergency Order, that remand does not affect our determination that LSC's system for ensuring compliance with the order was unreasonable, even as to customers that may have been options market makers. As discussed above, the 2008 Emergency Order exempted options market makers that "effect[] a short sale as part of a *bona fide market making* and hedging activity related directly to *bona fide market making* in derivatives on the publicly traded securities of any Included Financial Firm."[83] But the determination whether a market maker is engaged "in bona-fide market making" depends on "the facts and circumstances of a particular activity,"[84] meaning that not all of a market maker's activities qualify as bona fide market making.[85] It was therefore unreasonable for LSC to exempt *all* of the three alleged market makers' short sales in Included Financial Firms' securities from its system for ensuring

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82 We have recognized in other contexts that supervisory responsibilities may be delegated, but nonetheless require the person delegating such responsibilities "'to follow-up and review that delegated authority to ensure that it is being properly exercised.'" *Wilson-Davis & Co.*, Exchange Act Release No. 99248, 2023 WL 9022658, at *9 (Dec. 28, 2023) (quoting *Harry Gliksman*, Exchange Act Release No. 42255, 1999 WL 1211765, at *6 (Dec. 20, 1999)); *see also Thaddeus J. North*, Exchange Act Release No. 84500, 2018 WL 5433114, at *10 (Oct. 29, 2018).

83 2008 Emergency Order, 2008 WL 4287187, at *2 (emphasis added).

84 *Amendments to Regulation SHO*, Exchange Act Release No. 58775 (Oct. 14, 2008), 73 Fed. Reg. 61,690, 61,699 (Oct. 17, 2008).

85 *See id.* (providing examples of activities that are not bona fide market making, even if conducted by a market maker).

compliance with the 2008 Emergency Order, particularly where LSC did not follow up to ensure no violative trades had occurred.

As explained above, Rule 342 is consistent with the Exchange Act's purposes.[86] And NYSE's application of Rule 342 to LSC's failure to have reasonable supervisory systems and procedures to prevent customers from effecting short sales prohibited by the 2008 Emergency Order through its ROX system was also consistent with those purposes. For these Supervisory Violations, NYSE imposed the Unitary Supervisory Sanction, which we discuss below.

D. LSC effected short sale transactions in violation of Regulation SHO and lacked reasonable supervisory procedures and controls to prevent such transactions.

NYSE found that LSC committed Primary and Supervisory Violations resulting from its failure to close out fail-to-deliver positions, improper acceptance of short sales, and failure to provide required notifications to broker-dealer customers, as required by Rules 204T and 204 under Regulation SHO.[87]

The Commission adopted Regulation SHO, in part, to define short sellers' and broker-dealers' obligations relating to short sales.[88] As noted above, a short sale is the sale of a security that the seller does not own. A short seller therefore normally borrows the securities from a broker-dealer or an institutional investor to deliver to the purchaser, and later closes out the position by purchasing equivalent securities on the open market, or using equivalent securities it owns, and returning the borrowed securities to the lender.[89]

As relevant here, Rules 204T and 204 imposed certain obligations on LSC, as a participant of a registered clearing agency, NSCC, to deliver the equity securities to the clearing agency by a designated settlement date. If a participant like LSC did not deliver the equity securities to the clearing agency by that date, the participant incurred a fail-to-deliver position, as reported in NSCC's Continuous Net Settlement ("CNS") system.[90] Participants like LSC received daily CNS reports about their fail-to-deliver positions with NSCC.

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86 *See supra* note 15.

87 *See* 17 C.F.R. § 242.204 (eff. July 31, 2009 to Jan. 17, 2019); 17 C.F.R. § 242.204T (eff. Oct. 17, 2008 to July 30, 2009).

88 *See Short Sales*, 69 Fed. Reg. at 48,008 (summarizing initial rules adopted under Regulation SHO).

89 *Id*.

90 NSCC clears and settles the majority of equity securities trades conducted on the exchanges and in the over-the-counter markets. It does so through the CNS system, which nets the securities delivery and payment obligations of all of its members. NSCC notifies its members of their securities delivery and payment obligations daily. *See CNS, How the Service Works*, DTCC, https://www.dtcc.com/clearing-services/equities-clearing-services/cns (last

(*continued . . .*)

1. We affirm NYSE's finding that LSC committed Primary Violations of Regulation SHO.

a. LSC failed to close out its fail-to-deliver positions within the deadlines set by Rules 204T(a) and 204(a).

NYSE found, and we agree, that LSC violated Rules 204T and 204 by not closing out certain fail-to-deliver positions within the prescribed time periods.

Rules 204T and 204 imposed a "close out" requirement, under which a participant with a fail-to-deliver position in any equity security resulting from a short sale transaction generally had to "immediately close out its fail to deliver position by borrowing or purchasing securities of like kind and quantity" "by no later than the beginning of regular trading hours on the settlement day following the settlement date."[91] Here, the record shows (and LSC does not dispute) that LSC had outstanding fail-to-deliver positions resulting from customer short sales in ten securities. For example, LSC's customer sold short 50,000 shares and bought 37,500 shares of MBIA, Inc., on August 21, 2009, resulting in a net short sale of 12,500 shares, which LSC did not deliver by the settlement date. As NYSE found, LSC closed out this fail-to-deliver position 12 days after the required close-out date.

Rule 204T(a) further required that fail-to-deliver positions resulting from long sales or certain bona fide market making activity had to be immediately closed out by purchasing securities of like kind and quantity by no later than the beginning of regular trading hours on the third consecutive settlement day following the settlement date.[92] Here, the record shows (and LSC does not dispute) that LSC had outstanding fail-to-deliver positions resulting from customer long sales in four securities. For example, LSC had an outstanding fail-to-deliver position in NovaGold Resources Inc. of between 5,300 and 8,000 shares from January 13 through January 22, 2009. As NYSE found, LSC closed out this fail-to-deliver position two days after the required close-out date.

LSC suggests that its failures to deliver did not violate Regulation SHO for six equity securities that were on "easy to borrow" lists. But LSC conflates Regulation SHO's pre- and post-transaction obligations. The easy-to-borrow list can satisfy a broker-dealer's pre-transaction requirement to "locate" securities available for borrowing before effecting a short

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visited May 2, 2024); *see also optionsXpress, Inc.*, Exchange Act Release No. 78621, 2016 WL 4413227, at *8–10 (Aug. 18, 2016).

91 *See* 17 C.F.R. § 242.204T(a) (2008); 17 C.F.R. § 242.204(a) (2009); *Amendments to Regulation SHO*, Exchange Act Release No. 60388 (July 27, 2009), 74 Fed. Reg. 38,266, 38,269 (July 31, 2009) (explaining that the Commission was "adopting the close-out requirements of temporary Rule 204T(a) without modification"). Rule 204T(a) applied to fail-to-deliver positions arising from short sales on or before July 31, 2009, and Rule 204(a) applied to those arising from short sales after July 31, 2009. *See id.* at 38,279.

92 *See* 17 C.F.R. § 242.204T(a)(1), (3) (2008).

sale in an equity security or to have "reasonable grounds" for believing that the security can be borrowed and delivered when due.[93] That a security is on an easy-to-borrow list may provide the broker-dealer with such "reasonable grounds."[94] But whether a security was considered easy to borrow has no relevance to a broker-dealer's post-transaction close-out obligations under Rules 204T(a) and 204(a). Consequently, that a security was considered easy to borrow before a broker-dealer effects a short sale does not excuse LSC's fail-to-deliver positions.

LSC also contends that Regulation SHO rules did not require it to "immediately" close out fail-to-deliver positions that resulted from a failure to receive borrowed securities that were sold short. To the contrary, once LSC had a fail-to-deliver position with respect to these short sales, Rules 204T(a) and 204(a) specify that a broker-dealer like LSC must make arrangements immediately to borrow or to purchase the securities,[95] even if the failure to receive securities from a lender meant it had to purchase the securities and "buy in" the customer.

Nor do we agree with LSC's contention that compliance with Rules 204T and 204 through purchases of the securities would have unduly harmed customers, or that LSC should have been allowed to wait and work out a solution with its stock lenders. Rules 204T(a) and 204(a) contain no exceptions for broker-dealers like LSC to avoid closing out their fail-to-deliver position under these circumstances. Moreover, under the terms of the customer agreement, LSC's customers agreed to bear LSC's "cost of obtaining the securities" to close out its delivery obligations for short sales of securities "if [LSC] is unable to borrow" them.

LSC further argues that it should be excused from compliance with interim Rule 204T(a) because final Rule 204 established different close-out deadlines—observing that the amendments to final Rule 204(a)(2) provided for an extended period of time to close out fail-to-deliver positions.[96] But even if LSC would have been eligible for the extended period to close out fail-

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93 17 C.F.R. § 242.203(b)(1) (requiring a broker-dealer to have "[b]orrowed the security, or entered into a bona-fide arrangement to borrow the security," or have "[r]easonable grounds to believe that the security can be borrowed so that it can be delivered on the date delivery is due").

94 *Id.*; *see also Short Sales*, 69 Fed. Reg. at 48,014 ("'Easy to Borrow' lists may provide 'reasonable grounds' for a broker-dealer to believe that the security sold short is available for borrowing . . . . In order for it to be reasonable that a broker-dealer rely on such lists, the information used to generate the 'Easy to Borrow' list must be less than 24 hours old, and securities on the list must be readily available such that it would be unlikely that a failure to deliver would occur.").

95 17 C.F.R. § 242.204T(a) (2008) (providing that "no later than the beginning of regular trading hours" on the relevant day, the participant of a registered clearing agency must "*immediately* close out its fail to deliver position by borrowing or purchasing securities of like kind and quantity") (emphasis added); *see id.* § 242.204(a) (same).

96 *Compare* 17 C.F.R. § 242.204T(a)(2) (limiting longer close-out deadline to fail-to-deliver positions in equity securities sold pursuant to § 230.144), *with* 17 C.F.R. § 242.204(a)(2) (applying longer close-outline to fail-to-deliver positions "in any equity security resulting from a

(*continued . . .*)

to-deliver positions once final Rule 204 was in effect, nothing in final Rule 204 indicates that it was intended to apply retroactively to short sale transactions that occurred when Rule 204T was operative. Thus, we apply the rule that "the legal effect of conduct should ordinarily be assessed under the law that existed when the conduct took place."[97]

We likewise reject LSC's argument that the Regulation SHO rules were silent on "lender" fails, and that the firm should therefore benefit from industry practice consistent with final Rule 204(a)(2)'s extended close-out period. Lek and LSC's President testified that, in their experience, LSC and other firms availed themselves of an extended close-out period for certain kinds of securities. LSC's President said industry practice was to do so because "[i]t was everybody's understanding" that the final rule would adopt such extended periods for those securities. Lek also testified that, in practice, LSC had not been required to close out its fail-to-deliver positions for these securities within the shorter time periods prescribed by Rule 204T. But even if this were evidence of industry practice rather than LSC's own experience,[98] we "have repeatedly held that the fact that a practice is common or widespread in an industry does not make such conduct proper or legal."[99]

LSC further contends that it should have received "pre-fail credit" for its customers' purchases of three securities that occurred before Rule 204T(a)'s deadline. Under Rule 204T(e), a broker-dealer could receive "pre-fail credit" for purchases of securities effected before the beginning of regular trading hours on the settlement day following the settlement date to close out an open short position. To claim the credit, the broker or dealer had to demonstrate that the purchases met four conditions.[100] But on appeal LSC addresses only one condition—that LSC's books and records showed a net long or net flat position on the settlement day for which it was seeking to demonstrate that it had purchased shares to close out its open short position. LSC

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sale of a security that a person is deemed to own"); *see also Amendments to Regulation SHO*, 74 Fed. Reg. at 38,277 ("[W]e are expanding the universe of securities to which Rule 204(a)(2) will apply.").

97 *Landgraf v. USI Film Prods.*, 511 U.S. 244, 273–74 (1994) (quotation marks omitted).

98 *See Midas Sec.*, 2012 WL 169138, at *11 (rejecting claim that a practice was consistent with "industry practice" where the testimony was "evidence only that the practice was widespread at the[] particular firms" where the testifying witnesses worked, "not industry-wide").

99 *Ronald Pellegrino*, Exchange Act Release No. 59125, 2008 WL 5328765, at *11 n.30 (Dec. 19, 2008) (quoting *Ko Sec., Inc.*, Exchange Act Release No. 48550, 2003 WL 22233255, at *3 (Sept. 26, 2003)).

100 *See* Rule 204T(e), 17 C.F.R. § 242.204T(e) (2008) (providing the conditions for a clearing agency participant to receive pre-fail credit); *Amendments to Regulation SHO*, 74 Fed. Reg. at 38,275–76 (explaining that final Rule 204(e) "incorporated [these] conditions . . . with some limited modifications" not relevant here); *see also Amendments to Regulation SHO*, Exchange Act Release No. 58773, 2008 WL 4567303 (Oct. 14, 2008), 73 Fed. Reg. 61,706, 61,714–15 (Oct. 17, 2008).

does not attempt to demonstrate that its purchases met Rule 204T(e)'s three other conditions. As a result, we reject LSC's claim that it was entitled to pre-fail credit.[101]

LSC also claims that it is retroactively entitled to pre-fail credit based on a 2013 no-action letter in which the Commission's staff addressed an approach under which credit could be aggregated over multiple days (the "Multi-Day No Action Letter").[102] To the extent LSC claims that the staff's views reflect the appropriate interpretation of the law, LSC has not attempted to establish that the transactions for which it wants pre-fail credit involved the same facts as the letter.[103] In any event, the staff issued the Multi-Day No Action Letter in 2013—years after the purchases for which LSC seeks to claim pre-fail credit—and the staff grants no-action relief "only prospectively, not retroactively."[104] Nothing in the Multi-Day No-Action Letter suggests that it provided relief retroactively.

b. LSC violated Rule 204T(b) by improperly accepting short sales without first pre-borrowing the security.

NYSE found, and we agree, that LSC also violated Rule 204T(b) by improperly accepting short sales without first pre-borrowing the security. Rule 204T(b) put participants who did not close out a fail-to-deliver position in an equity security in accordance with Rule 204T(a) in a so-called "penalty box."[105] Once this occurred, until it closed out the fail-to-deliver position, the participant generally was prohibited from accepting a short sale order in the security from another person (or effecting a short sale order in the security for its own account) unless it first borrowed, or arranged to borrow, the security.[106]

Here, the record shows that LSC violated Rule 204T(b) because, between February 23 and July 7, 2009, LSC had open fail-to-deliver positions in five equity securities—LSC thus was in the "penalty box" for those securities. But while in the penalty box, LSC accepted and effected short sales in those five securities without first pre-borrowing the securities. LSC acknowledges in its opening brief that it committed these violations when it failed to close out positions in violation of Rule 204T(a). But, LSC argues, it did not violate Rule 204T(a) for the

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101 Because we find that LSC has not established compliance with Rule 204T(e), we do not consider NYSE's finding that LSC was ineligible to claim pre-fail credit for customer purchases.

102 *See FINRA*, SEC Staff No-Action Letter, 2013 WL 4782336 (Sept. 6, 2013), http://www.sec.gov/divisions/marketreg/mr-noaction/2013/finra-cboe-c2-090613-201.pdf.

103 *Cf. Informal Guidance Program for Small Entities*, Securities Act Release No. 7407, 62 Fed. Reg. 15,604, 15,606 (Apr. 2, 1997) (recognizing that even the party requesting a no-action letter may rely on the letter "with regard only to the specific facts addressed in the letter").

104 *Dennis Todd Lloyd Gordon*, Exchange Act Release No. 57655, 2008 WL 1697151, at *10 n.52 (Apr. 11, 2008).

105 *See* 17 CFR § 242.204T(b) (2008).

106 *Id*.

reasons discussed above, and it thus should not be found to have violated Rule 204T(b). As we explained in the previous section, however, LSC violated Rule 204T(a) by failing to close out its open fail-to-deliver positions; LSC thus also violated Rule 204T(b) by accepting and effecting short sales while in the "penalty box."

c. LSC violated Rule 204T(c) and 204(c) by not providing required notifications.

NYSE also found, and we agree, that LSC violated Rule 204T(c) and 204(c) by failing to notify broker-dealers for which it cleared and settled transactions at the points in time when LSC had open fail-to-deliver positions. Rules 204T(c) and 204(c) both required participants to notify their broker-dealer customers when an open fail-to-deliver position was not closed out in accordance with Rule 204T(a) or 204(a), respectively.[107]

Although LSC suggests that it provided the notifications required by Rules 204T(c) and 204(c), it provides little evidence of this. The firm was required to preserve in its books and records copies of any such notifications sent under Rules 204T(c) and 204(c).[108] But LSC does not identify any such evidence, and our independent review of the record reveals none. Instead, LSC's President testified simply that, when LSC was in the penalty box, it tried "as much as [it could]" to notify its customers of its open fail-to-deliver positions by calls and instant messages. Beyond that testimony, LSC introduced no evidence that it provided notifications, such as copies of any such instant messages with its customers, which should have been maintained in its books and records. We thus conclude that a preponderance of the evidence shows that LSC did not provide the required notice.

Rules 204T(c)(2) and 204(c)(2) also both required participants to notify their broker-dealer customers when a purchase made by the participant to resolve an open fail-to-deliver position cleared and settled.[109] Although NYSE found that LSC did not provide such notifications, the record evidence establishes that LSC did not purchase securities to resolve its customers' open fail-to-deliver positions; indeed, its failure to do so contributed to the Rule 204T(a) and 204(a) violations discussed above. Because LSC did not purchase securities to resolve its customers' open fail-to-deliver positions, there were no relevant purchases requiring LSC to notify its customers under Rules 204T(c)(2) and 204(c)(2).

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107 *See* 17 C.F.R. § 242.204T(c)(1) (2008); 17 C.F.R. § 202(c)(1) (2009); *see also Amendments to Regulation SHO*, 73 Fed. Reg. at 61,724.

108 *See* 17 C.F.R. § 240.17a-4(b)(4) (requiring national securities exchange member firms to preserve "copies of all communications sent . . . by the member . . . relating to its business as such").

109 *See* 17 C.F.R. § 242.204T(c)(2) (2008); 17 C.F.R. § 202(c)(2) (2009).

d. Rules 204T and 204 are, and were applied in a manner, consistent with the purposes of the Exchange Act.

We also find, and it is undisputed, that Rules 204T and 204 were, and were applied in a manner, consistent with the Exchange Act's purposes. In adopting Regulation SHO, we found that the locate and delivery requirements would discourage potentially abusive naked short selling.[110] In promulgating temporary Rule 204T and final Rule 204, we observed that the close-out requirement in subsection (a) would "promote the prompt clearance and settlement of securities transactions."[111] The close-out requirement thus would reduce the risk that persistent fails to deliver would disrupt markets in equity securities, reduce investor confidence, and cause prices to "decline below the price level that would have resulted from the normal price discovery process."[112] Imposing liability on LSC for failing to abide by its Rule 204T(a) and 204(a) close-out obligations is consistent with these purposes and promotes the public interest by reducing the likelihood of persistent fail-to-deliver positions and the potential threat they pose to the markets.

We find that Rule 204T(b) also was, and was applied in a manner, consistent with the purposes of the Exchange Act. In adopting Rule 204T(b)'s pre-borrow requirement, we explained that the requirement was designed to "ensure that shares will be available for delivery on the short sale by settlement date and, thereby, help to avoid additional fails to deliver occurring in the security."[113] We find, and LSC does not dispute, that NYSE applied Rule 204T(b) in a manner consistent with the Exchange Act's purposes of promoting market liquidity and pricing efficiency.

We further find that Rules 204T(c) and 204(c) were, and were applied in a manner, consistent with the Exchange Act's purposes. In promulgating Rule 204T, we observed that the purpose of its notification requirement in subsection (c) was to ensure that "broker-dealers that submit trades for clearance and settlement to a participant" would have "notice that short sales in that security . . . will be subject to the borrow requirements of temporary Rule 204T(b) until the fail to deliver position has been closed out."[114] These notifications apprised broker-dealers submitting trades for clearance and settlement of their own obligations to comply with Rule 204T(b)'s pre-borrow requirement. In turn, this notice encouraged compliance with the rule as well as the underlying "goal of limiting fails to deliver and addressing abusive 'naked' short

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110 *See Short Sales*, 69 Fed. Reg. at 48,009; *see also Amendments to Regulation SHO*, 74 Fed. Reg. at 38,281 (explaining that the close-out requirements of Rule 204T and Rule 204 "will further our goals of reducing fails to deliver," thereby "addressing potentially abusive 'naked' short selling," promoting investor confidence "that trading can be conducted without the influence of illegal manipulation," and "helping to maintain fair and orderly markets").

111 *Amendments to Regulation SHO*, 73 Fed. Reg. at 61,728; *see also Amendments to Regulation SHO*, 74 Fed. Reg. at 38,281.

112 *Amendments to Regulation SHO*, 73 Fed. Reg. at 61,728.

113 *Id.* at 61,714.

114 *Id.*

selling by promoting the prompt and accurate clearance and settlement of securities transactions."[115] Imposing liability on LSC for failing to close out its fail-to-deliver positions and for failing to notify customers about such positions is likewise consistent with this purpose, in that it promotes the public interest by reducing the likelihood of persistent fails to deliver and the threat they pose to market stability.

2. We affirm NYSE's imposition of a censure and a $50,000 fine for LSC's Primary Violations of Regulation SHO.

NYSE censured LSC and imposed a $50,000 fine for its Primary Violations of Rules 204T and 204 of Regulation SHO. LSC does not challenge the censure or the amount of the fine. Instead, in arguing that the sanctions are punitive, LSC repeats its merits defenses and argues that sanctioning the firm "serves no remedial purpose." To the extent LSC contends that its merits defenses demonstrate that the sanctions are punitive, we disagree. We rejected those arguments above and, for the same reasons, do not find them mitigating for sanctions purposes. We also find that the censure and $50,000 fine are neither excessive nor oppressive, and that the sanctions serve an appropriate remedial purpose of ensuring that LSC will take more seriously its obligation to comply with the requirements of Commission regulations and rules.[116]

3. We affirm NYSE's finding that LSC committed Supervisory Violations relating to Regulation SHO.

NYSE found, and we agree, that LSC violated NYSE Rule 342 by not having adequate supervisory procedures and controls with respect to effecting short sales in violation of Rules 204T and 204 of Regulation SHO. Between October 2008 and July 2009, LSC allowed fail-to-deliver positions to remain outstanding beyond the deadlines prescribed in the rules. Although LSC was aware of these open fails because it received daily notifications from NSCC, its employees ignored those notifications and allowed the fail-to-deliver positions to continue. As reflected in LSC's trade data, LSC regularly waited for fail-to-deliver positions to be closed out by customer purchases—even if that meant a fail-to-deliver position remained open long after the deadline to close. We thus agree with NYSE that LSC failed "to reasonably supervise and implement adequate controls, including a separate system of follow-up and review, designed to achieve compliance with" Rules 204T and 204.[117]

As explained above, Rule 342 is consistent with the Exchange Act's purposes.[118] We further find that applying Rule 342 to LSC's lack of an adequate supervisory system to prevent

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115 *Id*.

116 *Cf.* FINRA Sanctions Guidelines 49 (2024) (establishing as guidelines for short sale violations of Regulation SHO and FINRA Rule 2010 fines of up to $155,000 for small firms and $200,000 for midsize or large firms).

117 *See Lek Sec. Corp.*, 2018 WL 1602630, at *6–7.

118 *See supra* note 15.

short sales in violation of Rules 204T and 204 of Regulation SHO was consistent with those purposes. For these and the other Supervisory Violations, NYSE imposed the Unitary Supervisory Sanction, which we discuss below.

E. LSC engaged in Blue Line trading without prior approval, falsely represented that it had stopped Blue Line trading, and did not reasonably supervise its Blue Line trading business.

1. We affirm NYSE's finding that LSC committed Primary Violations relating to Blue Line trading.

a. LSC violated NYSE Rule 70.40 by not obtaining the necessary approvals related to Blue Line trading.

NYSE found, and we agree, that LSC violated NYSE Rule 70.40. That rule authorizes an NYSE member to use its floor booth premises to conduct the same business for customers that it could conduct from its off-floor location, including initiating orders and routing orders to NYSE systems and other markets.[119] The practice of using the floor booth to access other markets is known as "Blue Line trading."[120] As relevant here, NYSE Rule 70.40 requires that, before beginning Blue Line trading, NYSE members (1) obtain approval to conduct such trading; and (2) adopt and implement WSPs for Blue Line trading and obtain approval for those procedures.

Despite these requirements, LSC admitted that it engaged in Blue Line trading "every month between June 2007 and October 2009" without obtaining prior approval to do so. In fact, NYSE sent LSC a cease-and-desist letter on July 17, 2009, after learning that LSC was engaged in Blue Line trading. In response, on July 27, 2009, LSC falsely represented that it had stopped engaging in Blue Line trading, even as it continued to engage in Blue Line trading through October 2009. On the same date, LSC also stated that it was "in the process of developing specific" WSPs, which it did not submit for approval until September 2009—thereby effectively acknowledging that it had not received advance approval for WSPs related to Blue Line trading.

LSC contends that it was not required to obtain advance approval for its Blue Line trading or WSPs, asserting that Rule 70.40 required only that WSPs about floor operations be

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[119] NYSE Rule 70.40; *see also Notice of Filing and Immediate Effectiveness of Proposed Rule Change Relating to Rules 54 ("Dealings on Floor—Persons") and 70 ("Bids and Offers")*, Exchange Act Release No. 55908, 2007 WL 2031606 (June 14, 2007), 72 Fed. Reg. 34,056 (June 20, 2007). NYSE adopted Rule 70.40 in response to the Commission's 2005 adoption of Regulation NMS, which requires broker-dealers, among other things, to route customer orders to the market center that displays the best price with automated quotations. *Regulation NMS*, Exchange Act Release No. 51808, 2005 WL 1364545 (June 9, 2005), 70 Fed. Reg. 37,496, 37,501 (June 29, 2005).

[120] Blue Line trading refers to an actual blue line on NYSE's floor that demarcates the space for floor brokers' booths from the space for the specialists' posts.

segregated "in a separate document" provided to NYSE and maintained "in that manner going forward." But this is incorrect. Rule 70.40 expressly required NYSE members like LSC to obtain prior approval for their Blue Line trading and WSPs.[121]

LSC next contends that it was not required to obtain advance approval for its Blue Line trading or WSPs because it was already an NASD member. LSC cites NYSE Information Memo 07-77 ("IM 07-77"), which stated that dual members of NYSE and NASD "already [met] the requirements" to engage in Blue Line trading subject to the requirements in the memorandum, including detailed WSPs.[122] LSC's argument is incorrect. Although IM 07-77 provided different instructions for the contents of WSPs based on whether a firm had to obtain new registrations and licenses, nothing in IM 07-77 provided that dual NYSE and NASD members like LSC were exempt from obtaining prior approval of their WSPs before conducting Blue Line trading. To the contrary, the document extensively detailed firms' obligation to submit and obtain prior approval for WSPs.

LSC also argues that requiring it to obtain preapproval of Blue Line trading is inconsistent with the firm's best-execution obligations, pursuant to which a broker-dealer must seek to obtain for its customer order execution "at the best reasonably available price." This best-execution obligation, LSC contends, may require NYSE member firms like LSC to route orders to competing markets that provide the best terms.[123] Requiring Blue Line trading preapproval, according to LSC, would burden its ability to obtain best execution for its customers because, until its application is approved, LSC would have to stop its floor brokers from routing orders to competing markets and instead route the orders to the firm's "upstairs operation for further routing" to other markets. But the Commission took best-execution duties into account when approving Rule 70.40, concluding that preapproval balanced floor brokers' best-execution obligations with the need for procedures to protect investors and the public interest.[124] Rule 70.40's text requires all NYSE members to obtain prior approval of Blue Line trading operations and related WSPs.[125]

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121 NYSE Rule 70.40(1), (6), (7).

122 NYSE Information Memorandum 07-77, *Requirements for Conducting "Upstairs" Operations from a Member Organization's Booth Premises*, 2007 WL 2200563, at *4 (July 30, 2007).

123 *Regulation NMS*, 70 Fed. Reg. at 37,538 (explaining that in "periodically assess[ing] the quality of competing markets" and "examin[ing] their procedures for seeking to obtain best execution, . . . broker-dealers must take into account price improvement opportunities, and whether different markets may be more suitable for different types of orders or particular securities").

124 *See NYSE Rules 54 and 70*, 72 Fed. Reg. at 34,056–57.

125 *See* NYSE 70.40(1) (providing that a member may engage in Blue Line trading "*provided that the member organization has obtained prior approval* from the Exchange's regulatory staff

(*continued . . .*)

LSC further argues that requiring preapproval for its Blue Line trading would ratify NYSE's decision to hold it "hostage" because, as of briefing in this matter, LSC's application for Blue Line trading had been pending since 2009. But the merits of LSC's application, and NYSE's consideration of it, do not change that, for two years, LSC repeatedly violated Rule 70.40 by engaging in Blue Line trading before submitting an application to do so.

LSC also contends that Rule 70.40 is inconsistent with certain Exchange Act regulations that address off-exchange trading.[126] Specifically, LSC cites regulations limiting the reach of exchange rules that generally prohibited NYSE members and their affiliates from effecting transactions in NYSE-listed securities on other exchanges or in the over-the-counter markets.[127] But LSC does not explain why or how these regulations should be interpreted as prohibiting NYSE from requiring members to obtain preapproval of Blue Line trading, and we can find no basis for doing so.

Lastly, LSC contends that Rule 70.40 is "unenforceable" as an "illegal restraint on trade." The Commission expressly rejected this assertion when it concluded that the rule was not such a restraint in approving Rule 70.40,[128] and LSC does not provide any compelling reasons to reconsider that conclusion.

Having found that LSC violated Rule 70.40, we find that the rule is, and was applied in a manner, consistent with the Exchange Act's purposes. We have explained that Rule 70.40 furthers several objectives of the Exchange Act, including the goal of "remov[ing] impediments to and perfect[ing] the mechanism of a free and open market and a national market system."[129] Rule 70.40 also protects investors and the public interest by requiring members to provide "detailed information regarding the proposed systems and order handling process, proof that all personnel are appropriately registered, proof of independent compliance personnel and proof of

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to operate its booth premise in said manner") (emphasis added); NYSE IM 07-77, 2007 WL 2200563, at *4 ("*Assuming* a member organization has developed written policies and procedures that meet the above-described requirements, the level of trading activity that a member organization can conduct in away markets from its booth premises will depend on whether the firm has the requisite registrations and qualifications.") (emphasis added).

126 *See* Exchange Act Rule 19c-1, 17 C.F.R. § 240.19c-1 (prohibiting restrictions on off-board trades in exchange-listed securities as an agent); Exchange Act Rule 19c-3, 17 C.F.R. § 240.19c-3 (limiting reach of exchange rules prohibiting members from engaging in off-board transactions for their own account, to those securities listed on the exchange on April 26, 1979).

127 *See Order Approving Proposed Rule Change to Rescind Exchange Rule 390*, Exchange Act Release No. 42758 (May 5, 2000), 65 Fed. Reg. 30,175 (May 10, 2000).

128 *See NYSE Rules 54 and 70*, 72 Fed. Reg. at 34,058 (finding that the rule "will [not] impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the [Exchange] Act.").

129 *Id.*

adequate supervisory controls."[130] NYSE's application of Rule 70.40 to LSC's conduct is consistent with these stated purposes of the Exchange Act because LSC bypassed the preapproval process necessary to protect investors and other market participants.

b. LSC violated NYSE Rule 2010 by falsely representing to NYSE that it had stopped Blue Line trading.

NYSE also found, and we agree, that LSC violated NYSE Rule 2010 when, after receiving a cease-and-desist order from NYSE, it falsely represented that it had stopped engaging in Blue Line trading. Rule 2010 requires a NYSE member, "in the conduct of its business, [to] observe high standards of commercial honor and just and equitable principles of trade."[131] As noted above, NYSE sent LSC a cease-and-desist letter in July 2009 requiring the firm to stop all unapproved Blue Line trading immediately. LSC responded that "all such activity has ceased . . . as of the afternoon of July 17," but in fact it continued to route hundreds of orders from its NYSE floor booth to other markets through October 19, 2009. NYSE correctly found, and LSC does not dispute, that such conduct is contrary to high standards of commercial honor and inconsistent with just and equitable principles of trade.[132]

We also find that Rule 2010 is, and was applied in a manner, consistent with the purposes of the Exchange Act. We have explained that Rule 2010 "is used to protect market participants from dishonest and unfair practices."[133] Applying Rule 2010 here furthered those purposes.

2. We affirm NYSE's imposition of a censure and $100,000 fine for LSC's Primary Violations relating to Blue Line trading.

NYSE censured LSC and imposed a $100,000 fine for its violations of NYSE Rules 70.40 and 2010 with respect to Blue Line trading. In arguing the sanctions are punitive, LSC repeats its merits defenses. We rejected these arguments above and, for the same reasons, do not find them mitigating for sanctions purposes.[134] We also find that the censure and $100,000 fine are neither excessive nor oppressive and serve an appropriate remedial purpose of ensuring that LSC will comply with its obligations to follow directions from regulators and to be candid and truthful in its responses to regulatory investigations.[135]

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130 *Id.* at 34,057.

131 NYSE Rule 2010.

132 *See, e.g., Brian L. Gibbons*, Exchange Act Release No. 37170, 1996 WL 254664, at *3 (May 8, 1996) (finding that "[p]roviding misleading and inaccurate information" to an SRO was inconsistent with just and equitable principles of trade).

133 *Notice of Filing of Proposed Rule Change*, 74 Fed. Reg. at 15,565.

134 *See supra* text accompanying notes 121–132.

135 *Cf. Michael A. Rooms*, Exchange Act Release No. 51467, 2005 WL 742738, at *5 (Apr. 1, 2005) (sustaining bar imposed against individual who engaged in efforts to impede an SRO's

(*continued . . .*)

3. We affirm NYSE's finding that LSC committed Supervisory Violations relating to Blue Line trading.

NYSE found, and we agree, that LSC violated Rule 342 because its supervision of its Blue Line trading business was not reasonable. As discussed above, LSC conducted Blue Line trading for more than two years without seeking the necessary approval under Rule 70.40. LSC also falsely represented to NYSE that its Blue Line trading had stopped after receiving a cease-and-desist letter. LSC could have, for example, confirmed whether its floor brokers had stopped engaging in Blue Line trading as LSC represented to NYSE. Indeed, LSC does not dispute that this conduct violated Rule 342 beyond its contention that that its underlying conduct did not violate Rule 70.40 and therefore could not have been a failure to supervise. As explained above, Rule 342 is consistent with the Exchange Act's purposes.[136] And NYSE's application of Rule 342 to LSC's inadequate supervision of its Blue Line trading business was also consistent with those purposes. We accordingly sustain NYSE's finding of violation. For these and the other Supervisory Violations, NYSE imposed the Unitary Supervisory Sanction, which we discuss below.

F. LSC lacked an adequate supervisory system reasonably designed to supervise and monitor for spoofing, wash trading, and marking the close.

NYSE found that LSC failed to reasonably supervise and monitor its electronic order flow for spoofing, wash trading, and marking the close. Before getting to the substance of these findings, we note that LSC argues that Dimension's supervisory obligations as an introducing broker relieved LSC of its own obligations. According to LSC, Dimension and LSC entered into a clearing agreement that allocated supervisory responsibilities to Dimension.[137] But the Commission has long held that a contractual agreement allocating functions between introducing and carrying organizations does not "relieve either organization from their respective responsibilities under the federal securities laws and applicable SRO rules."[138] Thus, regardless of Dimension's obligations under the agreement, LSC retained its own obligation to ensure a reasonable supervisory and monitoring system for the electronic order flow it was effecting on

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investigation and thereby violated high standards of commercial honor and just and equitable principles of trade).

136 *See supra* note 15.

137 The clearing agreement provided that it was Dimension's responsibility "in connection with the . . . monitoring of accounts . . . to review orders and/or accounts, [and] to supervise orders and/or accounts."

138 *Order Approving Proposed Rule Change*, Exchange Act Release No. 18497 (Feb. 19, 1982), 47 Fed. Reg. 8284, 8284 n.2 (Feb. 25, 1982); *see*, *e.g.*, *Del Mar Fin. Servs.*, 2003 WL 22425516, at *2 n.6 (same). We explained in another proceeding that this policy prevented LSC from relying on its clearing agreement with Dimension to relieve it from its own obligations under NASD and FINRA rules to investigate potentially suspicious transactions consistent with the Bank Secrecy Act. *Lek Sec. Corp.*, 2018 WL 1602630, at *7.

NYSE on behalf of Dimension and Dimension's customers, the substance of which we address below.

1. LSC lacked an adequate system reasonably designed to supervise and monitor for spoofing.

NYSE found, and we agree, that LSC violated NYSE Rule 342 by failing to reasonably supervise and monitor for potential "spoofing" in connection with the firm's electronic order flow transmitted on customers' behalf. Spoofing is a form of market manipulation that occurs when an entity places "non-bona fide orders that are intended to trigger some type of market movement or response from other market participants, which the market manipulator is able to take advantage of by placing orders on the opposite side of the market."[139] It can involve the entry of small orders—*e.g.*, for fewer than 10,000 shares—that are canceled before the market opening.

LSC did not have an adequate supervisory or monitoring system designed to detect and prevent spoofing involving pre-market cancellations between June 2009 and March 2010.[140] Indeed, before October 2009, LSC had no system to surveil for spoofing. This is best demonstrated by LSC's response to a series of letters that NYSE sent to LSC about specific pre-open cancellations and LSC's controls regarding these cancellations between June and October 2009. The cancellations at issue involved as few as 100 shares and as many as 100,000 shares.

According to that response, LSC had to contact Dimension, which had introduced the customers that entered the cancellations, to obtain information to respond to NYSE's inquiries. In particular, LSC asked Dimension about several of the pre-open cancellations referenced in one of NYSE's inquiries. LSC informed NYSE that Dimension had responded "that the orders were not appropriate and that [Dimension] had instructed the responsible [Dimension customers] to immediately cease such trading behavior." But the pattern of trading still continued through October 2009.

Furthermore, in a letter dated October 7, 2009, NYSE asked LSC to identify its WSPs pertaining to, and the systems and controls it had in place for, the detection, identification, and prevention of potentially manipulative activity by customers who had direct market access through LSC's ROX platform. On October 19, 2009, LSC admitted to NYSE that it did "not have any controls in place to prohibit a customer who enters a pre-market order from canceling it

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[139] *Notice of Filing and Immediate Effectiveness of a Proposed Rule Change to Provide a Process for an Expedited Proceeding and Adopt a Rule to Prohibit Disruptive Quoting and Trading Activity*, Exchange Act Release No. 79361 (Nov. 21, 2016), 81 Fed. Reg. 85,650, 85,651 n.12 (Nov. 28, 2016).

[140] The record contains evidence of potentially manipulative trades, which LSC argues were not in fact manipulative. We need not decide whether spoofing in fact occurred through LSC's ROX platform, because our inquiry here is only whether LSC had a system reasonably designed to monitor for potentially manipulative activity.

before the market opens," claimed that it lacked "the authority to force a customer to enter into a securities transaction that he does not want," and explained that it had developed an exception report to identify "all large pre-market cancel orders routed to the Exchange."

To that end, LSC implemented an exception report sometime around October 2009 to identify "orders of 10,000 shares or more in aggregate in a symbol that were cance[l]ed prior to the opening." This control was not effective. Even above this threshold, as NYSE found, the exception report "did not always function as intended." For example, on April 13, 2010, the report did not capture when a 16,800 share buy order of securities issued by CatchMark Timber Trust, Inc. ("CTT") was canceled before the open. Moreover, by relying solely on this exception report, LSC effectively exempted other types of activity from monitoring for spoofing, such as pre-market cancellations of orders for fewer than 10,000 shares in aggregate in a symbol, even though, in its correspondence with LSC in 2009, NYSE had flagged 33 pre-market cancellations of orders fewer than 10,000 shares that it believed may have impacted the price of securities at market opening.

LSC's supervisory procedures and controls also did not require LSC to follow up with customers regarding transactions flagged by the exception report as suspicious trades, and LSC did not consistently do so. In response to NYSE's inquiry, for instance, LSC represented that it had "developed an exception report" and that, for all "orders that have come under review," it was working with Dimension by "reaching out to specific traders . . . to determine whether or not the intention of the customer is to manipulate the market." LSC followed up with some customers to investigate cancellations identified on its exception report—including by sending Dimension the report and asking it to follow up with customers to eliminate or minimize the number of orders and cancellations sent to LSC before the open. Although LSC represented to NYSE that it was working with Dimension to assess traders' intent, LSC did not always contact Dimension to follow up. And LSC did not (and could not) follow up with customers about cancellations that the exception report did not detect, such as the April 13, 2010 order and cancellation in CTT.

LSC argues that NYSE Regulation failed to satisfy its burden of proof regarding the spoofing-related claim. In particular, LSC faults NYSE Regulation's failure to introduce testimony from market makers whose complaints allegedly prompted NYSE's initial inquiries in June 2009, and with a lack of evidence of manipulative trades. But the spoofing-related claim against LSC is not related to the market maker complaints that prompted NYSE's initial inquiry in June 2009; the claim instead arises from the supervisory failures that NYSE found after beginning its inquiry. An underlying primary violation is not required to establish a violation of Rule 342, which required that LSC have a supervisory system reasonably designed to detect potentially manipulative transactions. As discussed above, LSC had no system to surveil for spoofing until October 2009, and even after LSC adopted an exception report that identified pre-open cancellations of more than 10,000 shares, the report did not identify all transactions that it should have. LSC also failed to follow up on all flagged trades, even though it could not assess traders' intent without such follow up. Consequently, LSC did not reasonably supervise and implement adequate controls designed to achieve compliance with NYSE rules pertaining to spoofing.

Applying Rule 342 to LSC's conduct was consistent with the purposes of the Exchange Act. Rule 342's requirement that NYSE members have supervisory systems reasonably designed to identify trades that may violated the Exchange Act served the Exchange Act purposes of helping "to prevent fraudulent and manipulative acts and practices" while also "protect[ing] investors and the public interest."[141] LSC's failure to establish a system reasonably designed to identify spoofing created the risk of harm to investors and the public by unscrupulous traders using LSC's ROX platform to manipulate the market. Thus, we sustain NYSE's finding that, between June 2009 and March 2010, LSC violated Rule 342 by not having a supervisory system reasonably designed to detect possible spoofing.

2. LSC lacked an adequate system reasonably designed to supervise and monitor for wash trading.

NYSE found, and we agree, that LSC also violated Rule 342 by not having an adequate supervisory system reasonably designed to detect wash trading until August 2009. During the relevant time, NYSE Rule 476(a)(8) prohibited wash trading—entering buy and sell orders that would have no change in beneficial ownership.[142] It is undisputed that LSC did not have an exception report to detect wash trades until August 14, 2009.

LSC contends that its supervisory systems were adequate during this period, noting that it had an "automated exception report" that detected "the indicia of potential manipulation," as well as "technology-assisted manual review." But LSC's reference in its briefs to a mix of manual and automated surveillance before August 2009 is vague and not supported by citations to record evidence. And our independent review of the record has not found evidence that LSC monitored for wash sales before August 2009.

Applying Rule 342 to LSC's conduct was consistent with the purposes of the Exchange Act for the same reasons as discussed above with respect to LSC's lack of a system to monitor for spoofing. As a result, we sustain NYSE's finding that LSC did not have an adequate system reasonably designed to supervise and implement controls in compliance with NYSE rules pertaining to wash trading until August 2009.

3. LSC lacked an adequate system reasonably designed to supervise and monitor for marking the close.

NYSE found, and we agree, that LSC violated Rule 342 because it lacked an adequate supervisory system reasonably designed to detect transactions that "mark the close." Marking the close is the practice of "'attempting to influence the closing price of a stock by executing

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141 15 U.S.C. § 78f(b)(5); *see also supra* note 15.

142 *See* NYSE Rule 476(a)(8).

purchase or sale orders at or near the close of the market.'"[143] During the relevant period, LSC's WSPs prohibited marking the close, and directed supervisors to review "patterns of orders that are potentially manipulative (*i.e.*, orders at the close)." But LSC did not implement an exception report to detect marking the close until March 2010. Before then, LSC relied on a "rapid succession order report" that could not flag orders entered at the end of the day that involved fewer than 25,000 sequential orders (not shares) from a single customer.[144]

LSC asserts that its surveillance for a large number of orders was reasonable because trading at the end of the day is permitted, and LSC had no reason to be concerned about that practice. However, even a small number of orders effected at or near the close of the market can constitute marking the close, depending on type and volume of shares traded in the order.[145] LSC's supervisory system could not detect situations in which a customer marked the close by entering fewer than 25,000 orders in rapid succession at the end of the day. For example, the system would not detect 24,000 orders of 100 shares each, let alone an attempt to mark the close with a handful of orders at the end of the day. The system thus was not reasonably designed to monitor for and detect a smaller number of orders entered with a manipulative purpose. Indeed, Lek himself suggested that the system was not designed to detect marking the close, as he testified that the rapid succession order report was primarily designed to alert for "some runaway black box [that] may get into a loop and start sending order after order after order after order," with the result of "all kind [sic] of unintended orders reach[ing] the market in error."[146]

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143 *Donald L. Koch*, Exchange Act Release No. 72179, 2014 WL 1998524, at *9 (May 16, 2014) (quoting *Thomas C. Kocherhans*, Exchange Act Release No. 36556, 1995 WL 723989, at *2 (Dec. 6, 1995)), *petition denied in relevant part*, 793 F.3d 147 (D.C. Cir. 2015).

144 LSC characterizes the report as "flagg[ing] orders *over a certain size* within one minute of each other." But the record contradicts this characterization: LSC's response to an NYSE inquiry explained that this report "screen[s] our customers' electronically transmitted orders and triggers an alert, which appears on the computer monitors of our networking department when the number of *orders* per minute in a particular security crosses a threshold of 25,000. The alert will read: '*High Message rate alarm* – messages per minute.'" (emphasis added).

145 *See Richard D. Chema*, Exchange Act Release No. 40719, 1998 WL 820658, at *2, *4 (Nov. 30, 1998) (finding that respondent marked the close over a five month period by making 69 purchases "during the final 10 minutes of the trading day," of which "54 were the last trade of the day and 47 were executed on an uptick," for purposes that included manipulating "the closing price [used] to assess margin"); *Kocherhans*, 1995 WL 723989, at *1–2 (finding that respondent marked the close 47 times over a six month period by effecting a transaction "within 15 minutes of the market close," of which 35 caused the security "to close . . . at a price higher than the previously reported trade" to avoid "margin maintenance calls" in the account); *see also Koch*, 2014 WL 1998524, at *17 (rejecting respondents' contention that they did not engage in a scheme to mark the close because they "used limit orders" and made "small executions").

146 Lek's testimony is consistent with LSC's characterization of the report in its correspondence with NYSE. *See supra* note 144.

LSC also argues that there is no evidence it executed any manipulative trades. As noted above, an underlying primary violation is not required to establish a violation of Rule 342, which required that LSC have a supervisory system reasonably designed to detect transactions intended to mark the close. The rapid succession order report was not so designed, and thus LSC did not reasonably supervise and implement adequate controls designed to achieve compliance with NYSE rules pertaining to marking-the-close transactions.

Applying Rule 342 to LSC's conduct was consistent with the purposes of the Exchange Act for the same reasons as discussed above with respect to LSC's lack of a system to monitor for spoofing. We therefore sustain NYSE's finding that LSC violated Rule 342 with respect to marking the close.

4. We affirm NYSE's imposition of the Unitary Supervisory Sanction.

For all of the Supervisory Violations, NYSE imposed the $300,000 Unitary Supervisory Sanction. As discussed elsewhere in this opinion, we are sustaining NYSE's findings of Supervisory Violations, and we address LSC's arguments related to those specific violations in those sections.[147] Beyond its challenges to those findings, LSC also argues that the cumulative $575,000 in fines—which includes the $300,000 Unitary Supervisory Sanction—are excessive and improperly punitive under the circumstances, rather than remedial.

We find, taking into account the public interest and protection of investors, that the Unitary Supervisory Sanction serves a remedial, not punitive, purpose and is not excessive or oppressive. As detailed throughout this opinion, LSC's supervisory system and controls suffered from deficiencies in eight distinct areas. Many of these deficiencies resulted in Primary Violations. For example, the deficiencies in LSC's supervisory system allowed LSC to, among other things, improperly cancel orders in violation of NYSE 123C,[148] effect odd-lot limit orders in a pattern of day trading in violation of NYSE Information Memo 94-14 and Rules 401, 405(1) and 476(a)(6),[149] and effect short sales in violation of a Commission emergency order issued under Section 12(k).[150] Moreover, that so many aspects of LSC's supervisory system were deficient suggests that LSC did not take its Rule 342 obligations seriously. A $300,000 cumulative fine, while significant, is not excessive or oppressive in light of the number of deficiencies in LSC's supervisory system, and effectively works out to a fine of $37,500 per area of deficiency.[151] Nor does the Unitary Supervisory Sanction become punitive when considered

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147 *See supra* Section III.A, III.B.4, III.C.4, III.D.3, III.E.3, and III.F.1–3.

148 *See supra* Section III.A.

149 *See supra* Section III.B.1.

150 *See supra* Section III.C.1.

151 *See Meyers Assocs., L.P.*, Exchange Act Release No. 86497, 2019 WL 3387091, at *16 (July 26, 2019) (sustaining $500,000 sanction for "systemic supervisory failures"); *cf. Wedbush Sec., Inc.*, Exchange Act Release No. 78568, 2016 WL 4258143, at *15 (Aug. 12, 2016) (imposing $100,000 fine against firm for its supervisory violations in a single area of activity).

in aggregate with the fines for the Primary Violations that we have sustained, which total $200,000 and are not themselves punitive.[152]

LSC argues that mitigating factors render the sanctions excessively punitive. Specifically, LSC contends that "much of the sanctioned conduct could not happen again" because several of the provisions that LSC violated no longer exist and because it no longer conducts Blue Line trading, and it has improved its systems. We acknowledge that several of the provisions that LSC violated are no longer in effect and that LSC has ceased Blue Line trading; however, LSC violated those rules while they were in effect, and subsequent rule changes and LSC's own cessation of activity do not eliminate or render less serious LSC's violations. We thus remain concerned about LSC's repeated disregard for its obligations under the federal securities laws and regulations and NYSE rules.

LSC also seeks mitigation by arguing, without elaboration, that it "improved its systems as technology advanced" and claiming, without support, that it eventually developed automated exception reports to monitor for wash trading, marking the close, and pre-market cancelations and other unspecified exception reports related to its electronic order flow. Even accepting as true that LSC improved its systems by adopting such exception reports, we do not find that such actions mitigate the firm's Supervisory Violations. LSC's adoption of the specified exception reports was necessary for it to stop committing Supervisory Violations related to spoofing, wash trading, and marking the close. But complying with the securities laws and a member firm's duties is not mitigating.[153] And although LSC may also have implemented exception reports that allow its supervisory system to monitor for certain types of potentially manipulative trading, this does not mitigate that, as a result of its prior lack of such reports, LSC's supervisory system had not been reasonably designed to monitor for spoofing, wash trading, and marking the close.[154]

Finally, LSC argues that the cumulative fines are punitive because it is "a very small firm." LSC seems to imply that the fines are disproportionate to the firm's size, but LSC does not elaborate on this argument or provide any supporting record or legal citations. With respect to the fines that we are sustaining, we find that LSC has not established that the cumulative fines

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[152] *See Meyers Assocs.*, 2019 WL 3387091, at *16 (sustaining $500,000 unitary sanction for pervasive supervisory failures that caused violations of other SRO rules); *see also supra* Sections III.B.3, III.D.2, III.E.2. As discussed above, the sanctions, including the $75,000 fine, for the Primary Violations relating to the 2008 Emergency Order are being remanded; we express no view about the appropriate sanctions on remand. *See supra* Section III.C.3.

[153] *See Siegel v. SEC*, 592 F.3d 147, 157 (D.C. Cir. 2010) (affirming the Commission's view that compliance with the securities laws is not mitigating because a securities professional "should not be rewarded" for satisfying his legal obligations); *Lek Sec. Corp.*, 2018 WL 1602630, at *12 & n.47 (declining to apply any mitigative weight to "subsequent corrective measures" where member firm engaged in "serious, prolonged, and reckless . . . misconduct").

[154] *Cf. KJM Sec., Inc.*, Exchange Act Release No. 94059, 2022 WL 215647, at *5 (Jan. 25, 2022) (holding that a firm's belated filing of a report required to be filed under the Exchange Act and a related rule "does not mitigate its violation").

are excessive or oppressive and therefore conclude that there is no basis for us to cancel or reduce the fines that NYSE imposed.[155]

IV. LSC'S EXPERT WITNESS CLAIM

LSC contends that NYSE improperly excluded LSC's proposed expert testimony on certain industry standards and practices. LSC's claims that it was prejudiced by this decision and that the NYSE decision should therefore be reversed. Hearing officers have broad discretion to admit or to exclude expert testimony.[156] The Hearing Officer's decision to exclude LSC's proffered expert testimony, which NYSE affirmed, is reviewed for abuse of discretion,[157] and we do not find that the Hearing Officer or NYSE abused its discretion in excluding this testimony.

LSC sought to introduce testimony from two experts: Raymond Aronson, former Senior Counsel for Bear Stearns & Co. Inc., on "industry custom and practice, including compliance and supervisory controls and systems, and the reasonableness of Lek's controls and procedures," and Stewart Mayhew, former Deputy Chief Economist with the Commission, on "trading practices, market impact, and the Exchange's regulations involving the trading and order activity" at issue, as well as "market structure and interpretation of regulations," including Regulation SHO. The Hearing Officer determined that LSC had not met its burden to establish that the proffered expert testimony would be helpful to the Hearing Panel. The Hearing Officer found that the reasonableness of LSC's controls and procedures and interpretations of regulations including Regulation SHO were not proper subjects for expert testimony because they related to legal issues and ultimate legal conclusions. The Hearing Officer found that LSC also had not shown that the remaining proffered testimony would be helpful in light of the two industry panelists' familiarity with industry custom and practice, which LSC acknowledged in a filing.

With respect to the proffered testimony regarding legal issues, the Hearing Officer reasonably concluded that such issues were not the proper subject of expert testimony. The reasonableness of LSC's controls and procedures and the proper interpretation of regulations including Regulation SHO were legal issues within the Hearing Panel's role to adjudicate. An expert may not usurp the adjudicator's role of determining legal rules and the ultimate legal

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155 *See* 15 U.S.C. § 78s(e)(2). As discussed above, the sanctions, including the $75,000 fine, for the Primary Violations relating to the 2008 Emergency Order are being remanded; we express no view about whether any fine that NYSE might impose following remand for those violations would be excessive or oppressive. *See supra* Section III.C.3.

156 *See Pagel, Inc.*, Exchange Act Release No. 22280, 1985 WL 548387, at *5 (Aug. 1, 1985) (finding no abuse of discretion in declining to admit expert testimony, because the law judge was "sophisticated in securities matters with many years of experience in determining issues under the securities laws, [and] clearly had the necessary expertise to determine from the evidence whether or not respondents" had violated the securities laws), *aff'd*, 803 F.2d 942 (8th Cir. 1986).

157 *Cf. id.* (applying abuse of discretion standard to law judge's decision to admit or exclude expert testimony).

conclusions based on the rules' application to the facts.[158] Any legal arguments LSC sought to introduce could have been incorporated into LSC's briefs below or in this appeal.[159]

With respect to the remaining proffered expert testimony, LSC has not shown that the Hearing Officer abused her discretion by excluding the testimony. The Hearing Officer concluded that LSC had "not demonstrated that the proposed testimony of either [purported expert] would be helpful to adjudicators who also have industry experience." The Hearing Panel, comprised of the Hearing Officer and two practitioners in the securities industry,[160] concluded that it was familiar with the relevant industry custom. LSC conceded as much in an unrelated motion two weeks earlier, explaining that the Hearing Panel included member firm representatives who were "familiar with industry custom and practice." Under the circumstances, the Hearing Officer could properly conclude that testimony on industry custom was not necessary to assist the panel as the finder of fact.

LSC cites *SEC v. Geon Industries, Inc.*[161] to argue that industry custom is relevant to whether LSC acted reasonably. *Geon Industries* recognized that, in a civil case before a district court, evidence of industry practice can be relevant to the adequacy of a firm's supervision and that the absence of such evidence may weigh in favor of the firm, but that an absence of such evidence is not "conclusive" as industry practices may have "lagged."[162] *Geon Industries* did not, however, hold that expert testimony on industry custom was required,[163] particularly where,

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158 *See Weston v. Wash. Metro. Area Transit Auth.*, 78 F.3d 682, 684 n.4 (D.C. Cir. 1996) ("An expert witness may not deliver legal conclusions on domestic law, for legal principles are outside the witness' area of expertise . . . ."), *opinion amended on reh'g*, 86 F.3d 216 (D.C. Cir. 1996); *United States v. Bilzerian*, 926 F.2d 1285, 1294 (2d Cir. 1991) (explaining that while an expert "may opine on an issue of fact within the jury's province, he may not give testimony stating ultimate legal conclusions based on those facts"); *William H. Murphy & Co.*, Exchange Act Release No. 90759, 2020 WL 7496228, at *16 (Dec. 21, 2020).

159 *See William H. Murphy & Co.*, 2020 WL 7496228, at *16 (affirming Hearing Panel's refusal to permit testimony by attorneys on legal issues and noting that "[n]othing prevented Applicants from incorporating the legal arguments of these three lawyers into their briefs before FINRA and, indeed, in this appeal").

160 The two other Hearing Panelists were Joan Caridi, "formerly associated with Credit Suisse," and Joseph Fenton, "associated with Janney Montgomery Scott, LLC."

161 531 F.2d 39 (2d Cir. 1976).

162 *Id.* at 52.

163 LSC's motion to admit the expert testimony noted our previous conclusion that "testimony regarding industry practice [can be] helpful in resolving enforcement and self-regulatory actions," but we did not hold in that case that such testimony was required. *Stephen Michael Sohmer*, Exchange Act Release No. 49052, 2004 WL 51681, at *8 (Jan. 12, 2004).

as here and unlike in *Geon Industries*, the triers of fact were familiar with industry custom.[164] *Geon Industries* does not suggest that a hearing panel familiar with industry practice abuses its discretion by excluding testimony on such practices.

LSC also contends that, because the Hearing Officer had earlier "acknowledged" that LSC could introduce expert testimony, the Hearing Officer's subsequent order excluding that testimony prevented LSC from "formulat[ing] a defense." This argument misunderstands the posture of the earlier ruling. Before the entire Hearing Board was convened, LSC sought from NYSE discovery about odd-lot limit orders that other firms effected. The Hearing Officer rejected this request, stating that, "[t]o the extent that Respondent is arguing that its odd-lot orders were consistent with widely accepted industry standards, such standards would be well-known in the securities industry and the subject of expert testimony." But at the time, the other Hearing panelists had not yet been appointed, and the Hearing Officer did not know their familiarity with industry standards. Once the Hearing Officer consulted with the industry panelists, she denied the motion on the ground that LSC had not established that the expert testimony "would be helpful" under the circumstances. We find nothing improperly inconsistent or contradictory with this finding.

For these reasons, we find no basis to reverse the NYSE's decision based on the Hearing Officer's denial of LSC's motion for leave to offer expert testimony at the hearing.

An appropriate order will issue.[165]

By the Commission (Acting Chairman UYEDA and Commissioners PEIRCE and CRENSHAW).

Vanessa A. Countryman
Secretary

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164 *See Richard G. Cody*, Exchange Act Release No. 64565, 2011 WL 2098202, at *17 (May 27, 2011), *aff'd*, 693 F.3d 251 (1st Cir. 2012) (holding that, "[i]n determining whether securities law violations have occurred, neither we [the Commission] nor [an SRO] is hindered by the lack of, or is bound by, expert testimony" (internal quotation marks omitted)); *cf. Dearlove v. SEC*, 573 F.3d 801, 804 (D.C. Cir. 2009) (concluding that "the SEC need not have received expert testimony to establish the standard of care or to determine whether [the respondent's] conduct was unreasonable").

165 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
Release No. 102533 / March 6, 2025

Admin. Proc. File No. 3-16424

In the Matter of the Application of

LEK SECURITIES CORPORATION

For Review of Disciplinary Action Taken by the

NEW YORK STOCK EXCHANGE, INC.

ORDER SUSTAINING REVIEW PROCEEDING IN PART, SETTING ASIDE REVIEW PROCEEDING IN PART, AND REMANDING REVIEW PROCEEDING IN PART

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

ORDERED that NYSE's finding that Lek Securities Corp. violated NYSE Rule 123C with respect to improper cancellation of market-on-close and limit-on-close orders is sustained; and it is further

ORDERED that NYSE's finding that Lek Securities Corp. violated NYSE Rules 401, 405, and 476(a)(6) with respect to effecting odd-lot limit orders in a pattern of day trading is sustained; and it is further

ORDERED that NYSE's finding that Lek Securities Corp. violated Exchange Act Section 12(k)(4) and NYSE Rule 401 with respect to effecting short sales prohibited by the 2008 Emergency Order is sustained, except as to those trades effected on behalf of three alleged options market maker customers, as to which NYSE's finding of violation is set aside; and it is further

ORDERED that NYSE's finding that Lek Securities Corp. violated temporary Rule 204T(a), (b), and (c) and final Rule 204(a) and (c) of Regulation SHO is sustained; and it is further

ORDERED that NYSE's finding that Lek Securities Corp. violated NYSE Rules 70.40 and 2010 with respect to routing orders from the exchange floor to away markets without prior approval is sustained; and it is further

ORDERED that NYSE's findings that Lek Securities Corp. violated NYSE Rule 342 by failing to have reasonable and adequate supervisory systems and procedures are sustained; and it is further

ORDERED that the sanctions imposed by NYSE for the violations of NYSE Rules 70.40, 123C, 342, 405, 476(a)(6), and 2010, and for the violations of NYSE Rule 401 related to odd-lot limit orders are sustained; and it is further ORDERED that the proceeding is remanded to NYSE for reconsideration of the sanctions based on violations of Exchange Act Section 12(k)(4) and the violations of NYSE Rule 401 related to Lek Securities Corp.'s effecting short sales, otherwise prohibited by the 2008 Emergency Order, on behalf of alleged options market maker customers.

By the Commission.

Vanessa A. Countryman
Secretary