

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION  
October 21, 2004

ADMINISTRATIVE PROCEEDING  
File No. 3-11716

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In the Matter of

THOMAS J. DONOVAN,

Respondent.

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: **ORDER INSTITUTING PUBLIC**  
: **ADMINISTRATIVE PROCEEDINGS**  
: **PURSUANT TO SECTION 15(b) OF**  
: **THE SECURITIES EXCHANGE ACT**  
: **OF 1934**  
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**I.**

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b)(6) of the Securities Exchange Act of 1934 ("Exchange Act") against Thomas J. Donovan ("Donovan" or "Respondent").

**II.**

After an investigation, the Division of Enforcement alleges that:

**A. Background**

1. Respondent was an equities trader at Knight Securities, L.P. ("Knight") from 1996 until he resigned in September 2001. At all relevant times, he held a Series 7 general securities license. After leaving Knight, Donovan worked as a registered representative for Andover Brokerage, L.L.C. from November 2001 through February 2002. Donovan is not currently associated with any regulated entity.

2. Knight Securities, L.P. is a registered broker-dealer headquartered in Jersey City, New Jersey. Knight is a subsidiary of Knight Trading Group, Inc., a Delaware corporation headquartered in Jersey City, New Jersey. The common stock of Knight Trading Group, Inc. is registered with the Commission pursuant to Exchange Act Section 12(g) and trades on the Nasdaq National Market.

**B. Default Judgment Entered Against Donovan**

3. On September 8, 2003, the Commission filed a civil action in the United States District Court for the District of New Jersey charging Donovan and others with violating Section 17(a) of the Securities Act of 1933 (the "Securities Act"), Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. *SEC v. Brian P. Delaney, et al.*, No. 2:03 CV 4206 (JWB). The Commission's Complaint alleged that from approximately September 2001 through March 2002, Donovan and two other defendants, Brian Delaney and Nicole Shkedi, engaged in a fraudulent trading scheme in which they knowingly and intentionally executed stock trades from Knight proprietary accounts they controlled at prices guaranteed to generate profits in private brokerage accounts that they also controlled, thereby defrauding Knight of approximately \$1.4 million.

4. The Complaint alleged, among other things, that Donovan and his Co-defendants were all employed by Knight as equity traders responsible for making markets in specific equity securities. As equity traders, the three defendants had discretionary trading authority over Knight trading accounts maintained for the purpose of carrying out Knight's business as a market maker in these specific stocks. The Complaint alleged that on or about March 5, 2001, Co-defendant Delaney caused a friend and business partner to open a brokerage account at E\*TRADE Securities LLC ("E\*TRADE"), an on-line retail brokerage firm that directs the vast majority of its customer orders to Knight for execution. Delaney's friend nominally owned the E\*TRADE account, but Delaney and Donovan placed all of the trades in the account and otherwise exercised control over it. The Complaint also alleged that shortly after the E\*TRADE account was opened, Delaney and Donovan began placing orders in the E\*TRADE account to purchase and sell specific thinly-traded securities for which Delaney and Donovan were responsible for executing trades in Knight's proprietary accounts. Delaney and Donovan typically used electronic means, such as a Palm Pilot, to place the orders in the E\*TRADE account in order to avoid detection of the fraud. As equity traders for Knight in those securities, Delaney and Donovan knew that the orders they placed in the E\*TRADE account would be routed for execution to Knight, and specifically to either Delaney or Donovan.

5. The Complaint further alleged that Delaney and Donovan knowingly and intentionally caused Knight to repeatedly purchase and sell securities to the E\*TRADE account at artificial prices that guaranteed profits for the E\*TRADE account at Knight's expense. For example, Delaney and Donovan sold securities from Knight's proprietary accounts to the E\*TRADE account at prices that were less than their fair market value and, shortly thereafter, repurchased the same securities from the E\*TRADE account into Knight's proprietary accounts at prices that were higher than their fair market value. Likewise, Delaney and Donovan engaged in trades without regard to the spread between the bid and the ask prices of a security. They sold from Knight's account at the bid amount (lowest quoted price of the day) and sold back to Knight at the ask price (the highest price quoted for the day). The Complaint also alleged that between March 2001 and October 2001, Delaney and Donovan executed at least 17 fraudulent trades with the E\*TRADE Account, resulting in an average profit per trade to the E\*TRADE account of \$30,383.67 and a total of \$516,522.40 in illegal profits.

6. The Complaint alleged that in September 2001, before the trading scheme became known to Knight, Donovan resigned from Knight. At or around that time, Delaney recruited his girlfriend and fellow trader, Co-defendant Shkedi, to participate in the fraudulent scheme. In furtherance of the scheme, Donovan opened two E\*TRADE accounts in his own name in October 2001 and January 2002. Thereafter, Delaney and Shkedi electronically placed orders in Donovan's accounts, which were then routed to Delaney and Shkedi, the two Knight employees responsible for executing orders in the securities at issue. Delaney and Shkedi then executed the orders at prices highly favorable to Donovan's account, at Knight's expense.

7. Finally, the Complaint alleged that between October 2001 and February 2002, Delaney and Shkedi executed at least 87 fraudulent trades with Donovan's two E\*TRADE accounts, resulting in an average profit per trade to Donovan's accounts of \$10,212.15 and a total of \$888,457.00 in illegal profits.

8. After the Commission commenced this action on September 8, 2003 by filing the Complaint against Donovan and his Co-defendants, the Commission served process upon Donovan on January 20, 2004. Donovan never filed an answer in this matter.

9. On September 3, 2004, the Commission filed a Motion for Default Judgment in the District Court for the District of New Jersey. A Motion Hearing was set for September 27, 2004 in front of the Honorable John W. Bissell.

10. On September 27, 2004, the United States District Court for the District of New Jersey granted the Commission's Motion for Default Judgment and entered Final Judgment for Default against Donovan with no opposition. The Final Judgment enjoined Respondent from violating Section 17(a) of the Securities Act of 1933, Section 10(b) of the Exchange Act and Exchange Act Rule 10b-5 and awarded civil penalties of \$90,000.00.

### **III.**

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate in the public interest that public administrative proceedings be instituted pursuant to Section 15(b)(6) of the Exchange Act to determine:

A. Whether the allegations set forth in Section II are true and, in connection therewith, to afford Respondent an opportunity to establish any defenses to such allegations; and

B. What, if any, remedial action is appropriate and in the public interest pursuant to Section 15(b)(6) of the Exchange Act.

### **IV.**

IT IS ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a place and time to be fixed

and before an administrative law judge to be designated by further order, as provided by Rule 110 of the Commission's Rules of Practice, 17 C.F.R. § 201.110; and

IT IS FURTHER ORDERED that Respondent shall file an Answer to the allegations contained in this Order within twenty (20) days after service of this Order, as provided by Rule 220 of the Commission's Rules of Practice, 17 C.F.R. § 201.220.

If Respondent fails to file the directed answer, or fails to appear at a hearing after being duly notified, the Respondent may be deemed in default and the proceedings may be determined against him upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f) and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.220(f), 221(f) and 201.310.

This order shall be served forthwith upon Respondent personally or by certified mail.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 210 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice.

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceedings will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 533 delaying the effective date of any final Commission action.

For the Commission, by its Secretary, pursuant to delegated authority.

Jonathan G. Katz  
Secretary