

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

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In the Matter of :  
: :  
: : INITIAL DECISION  
JAMES T. PATTEN : December 12, 2005

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APPEARANCES: William Kuehnle, Donald Dowie, and Keshia West for the Division of Enforcement, United States Securities and Exchange Commission

Ira Sorkin and Susan Kalib for James T. Patten

BEFORE: Robert G. Mahony, Administrative Law Judge

**INTRODUCTION**

The Securities and Exchange Commission (Commission) issued an Order Instituting Proceedings (OIP) on February 8, 2005, pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 (Exchange Act) against James T. Patten (Patten). The OIP charged that from at least June 2002 through April 2003 (relevant period), Patten willfully violated and caused violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. The OIP also charged that Patten caused and willfully aided and abetted violations by Martin Fox (Fox) of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, in a fraudulent scheme to manipulate the price of, and bids on, the stock of Initio, Inc. (Initio), which was traded on the National Association of Securities Dealers Automated Quotation system (NASDAQ).

Patten filed his Answer on June 9, 2005. A hearing took place in New York, New York, during September 19-23, 2005. The Division of Enforcement (Division) called seven witnesses and offered one hundred seventeen exhibits. Patten called three witnesses and offered eight exhibits. The parties filed post-hearing briefs on October 25, 2005. The Division and Patten filed reply briefs on November 7, 2005, and November 8, 2005, respectively.<sup>1</sup>

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<sup>1</sup> Citations to the transcript of the hearing will be noted as “(Tr. at \_\_.)” Citations to the Division’s and Patten’s exhibits will be noted as “(Div. Ex. \_\_.)” and “(Resp. Ex. \_\_.)” respectively. Citations to the Division’s prehearing brief will be noted as “(Div. Pre-Hearing Br. at \_\_.)”

## FINDINGS OF FACT

The findings and conclusions herein are based on the entire record. I applied preponderance of the evidence as the standard of proof. See Steadman v. SEC, 450 U.S. 91, 102 (1981). I have considered and rejected all arguments and proposed findings and conclusions that are inconsistent with this Initial Decision.

### A. Background

Patten, age forty-six, began his career in the securities industry in 1981 with Patten Securities.<sup>2</sup> The firm was owned by his brother, and Patten worked there until 1986. He then joined other firms including Phillips Apel and Walden, and Moore Schlei and Cameron. Patten is currently employed by Empire Financial Group. (Tr. at 206-208, 1027.)

Patten acquired Oakmont Capital, the predecessor of Greater Metropolitan Investment Services, Inc. (GMIS), while he was employed by Moore Schlei and Cameron. During the relevant period, Patten was the sole owner of GMIS and owned approximately 24,000 shares of Initio stock. (Tr. at 208-209, 1034.)

In 1998, the NASD suspended Patten for one year as a broker, two years as a principal, and fined him \$175,000, based on three violations including manipulating the closing bid price of stocks. (Tr. at 271-272.)

The orders and trades at issue in this proceeding were placed for three different accounts at GMIS: 1) the GMIS proprietary account (proprietary account), which is used for riskless principal transactions, 2) the J.T. Patten IRA account (Patten IRA account), and 3) Patten's childrens accounts. Patten explained that the firm placed trades for customer accounts and for the firm's own inventory purchases through the GMIS proprietary account. (Tr. at 284, 328.) Patten directed trades for his IRA account and for his childrens accounts. (Tr. at 764-765.)

Fox testified as a witness for the Division.<sup>3</sup> Fox met Patten while he was employed by Patten Securities. (Tr. at 210.) Fox eventually became a client of GMIS. (Tr. at 212.) Generally, when Fox called GMIS he intended to speak to Patten. (Tr. at 486-487.)

In the 1970s, Fox became an officer and director of Initio, a public company since 1969.<sup>4</sup> By 2002, Fox was president and chief executive officer. Fox owned, directly or indirectly, more

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<sup>2</sup> Patten holds a degree in industrial engineering from Rutgers University. (Tr. at 206.)

<sup>3</sup> Fox holds a bachelor's degree in economics from New York University and a law degree from Columbia University. (Tr. at 454-455.) After a federal court clerkship, he joined the law firm of Lee Millberg Weiss & Fox, where he became a partner. (Tr. at 455-456.) Fox testified after receiving a grant of use immunity. (Tr. at 451-452; Div. Ex. 116.)

<sup>4</sup> The ownership of Initio stock was concentrated. (Tr. at 605.)

than one million shares of Initio.<sup>5</sup> (Tr. at 458-462.) In the late 1970s or early 1980s, Initio acquired a catalog business that was subsequently sold in 1999. Thereafter, Initio had no operating business but it had income of a few hundred thousand dollars per year. (Tr. at 469-470, 488-489; Div. Ex. 99.)

Beginning in 2000, the management of Initio considered acquiring or merging the company with another entity. (Tr. at 489.) Sometime prior to July 2002, Fox spoke to Harold Holder (Holder), who was interested in acquiring a controlling interest in Initio.<sup>6</sup> (Tr. at 490-491.) Holder wanted to take one of his casinos public by merging it with a company listed on the New York or American Stock Exchanges, or with a company listed on the NASDAQ with “impeccable reporting records.” (Tr. at 152.) Holder told Fox that the quality of the company and Initio’s NASDAQ listing were important to him. (Tr. at 152, 157, 181-182.) Holder sought a public company because he believed it was a good time for another publicly held casino. He believed public companies had potential for growth and acquisitions. (Tr. at 153.) Holder and Fox began negotiating the merger terms on or about June 12, 2002. (Tr. at 185; Div. Ex. 66.) Fox hoped that a merger “would bring value to the company and the shares would increase in price.” (Tr. at 543.)

Philip Lifschitz (Lifschitz) was called as a witness for the Division. Lifschitz is a licensed broker at Oppenheimer & Company, formerly Fahnstock & Company, Inc. He has been with the same firm, including its predecessors, for twenty-three years. (Tr. at 383.) He is one of the “biggest” brokers at Oppenheimer and has many clients. He owns twenty five stocks in his personal portfolio and his stocks would be the main stocks of his clients. (Tr. at 399, 431.) At the time Lifschitz began to invest in Initio, he believed the company was a public shell without an ongoing business. (Tr. at 386.)

Lifschitz believes that he first contacted Fox regarding Initio sometime after Initio sold the catalog business in 1999.<sup>7</sup> (Tr. at 388, 535-536.) Fox knew Lifschitz was a fairly large Initio stockholder who wanted to see the company “do something” that would increase the stock’s value. (Tr. at 535-537.) Early in their discussions, Lifschitz wanted to know the direction the company was taking and he learned that Initio was seeking to merge with another company, but he had not heard of Holder. (Tr. at 390-391.) Lifschitz believed that most shell companies wanted to merge with another company that had assets. As time passed and this did not occur, Lifschitz expressed his concern to Fox about why the company had not merged. (Tr. at 392.) The NASDAQ listing was also significant to Lifschitz because he believed that a shell company with a NASDAQ listing was more valuable to a company with assets seeking a merger. (Tr. at 393.) Lifschitz did not recall Fox telling him that Initio might be delisted by the NASDAQ and

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<sup>5</sup> Fox held options to purchase Initio at \$.91 and \$1.95. (Tr. at 524-525; Div. Exs. 99, 100.) Only some of the options were exercisable during July through September 2002. (Tr. at 525.)

<sup>6</sup> Holder was called as a witness by the Division. In 1999, after an extensive business career, Holder entered the gaming business in Nevada by purchasing casinos. (Tr. at 148-150.)

<sup>7</sup> Lifschitz only met or spoke to Fox five or six times and he did not know of Patten until this matter was instituted. (Tr. at 435.)

Fox did not tell Lifschitz that he wanted to keep the price of Initio above one dollar per share to comply with the closing-bid-price rule.<sup>8</sup> (Tr. at 389, 396, 436-437.)

Lifschitz traded Initio in the account of his wife, Sandra Lifschitz (S. Lifschitz), at Oppenheimer. (Tr. at 397; Div. Ex. 114.) Initio was on Lifschitz's "hot stock" list and he checked the price daily. Generally, it was a thinly traded stock. (Tr. at 407-408.) At the high point, Lifschitz owned more than 100,000 shares of Initio. (Tr. at 413, 436.) Lifschitz denies ever prearranging trades with Fox or Patten. He never told Fox he was selling and he never talked to Fox about Fox's trades in Initio. (Tr. at 417.) However, on several occasions, Lifschitz participated in sales of Initio that coincided with purchases by Fox or Patten. (Div. Ex. 114.) Lifschitz states that he does not know to whom he is selling because the trades are executed by a computer. His sell orders are automatically routed to a market maker dealing in that stock and the sale appears on his computer screen when it is executed. He did not know who Oppenheimer's market makers were in 2002 and 2003. (Tr. at 424, 427.) He never contacted the traders at his firm to find out where Initio orders were being routed. (Tr. at 436-439.)

Robert Lowry (Lowry) testified as an expert witness for the Division.<sup>9</sup> (Tr. at 565.) Lowry analyzed the order tickets placed by Patten and Fox,<sup>10</sup> the bid and ask prices displayed by the market makers, and the NASDAQ audit trail of all trading activity in Initio stock for the relevant period. (Tr. at 585-597.)

Patten called Stewart Woody (Woody) and Steve Luciano (Luciano) as witnesses.<sup>11</sup> (Tr. at 633, 640.) Both witnesses were Knight Securities (Knight) market makers for Initio stock during the relevant period. (Tr. at 634, 641.) Woody and Luciano maintain that they did not speak to other market makers or with anyone at a broker dealer about Initio. They also maintain that they did not know Patten or of GMIS. (Tr. at 636, 641.) Woody explained that when the firm receives an order the firm's computer systems handle the routing of the order and the order display. (Tr. at 636.) He added that orders received by the firm show the four letter code of the broker-dealer that routed the order and that Knight was required to match buy and sell orders. (Tr. at 637.) Both witnesses maintain that they did not prearrange trades with Patten or anyone at GMIS. (Tr. at 637, 642.)

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<sup>8</sup> Lifschitz testified that he knew a company could lose its NASDAQ listing if the company did not maintain a closing bid price equal to \$1.00 or greater and he normally would have called Fox if the price fell below \$1.00. (Tr. at 394-396.)

<sup>9</sup> Lowry holds a bachelor of arts degree in business management from the University of Maryland. From 1973 to 1995, he was employed by the Commission's Division of Market Regulation. In 1995, he joined the Corporate Compliance Department of Prudential Insurance Co. Since 1996, he has been self-employed as a securities consultant. (Tr. at 566.)

<sup>10</sup> The order ticket analysis prepared by Lowry lists the orders placed by GMIS and Patten, the execution time and price, and the order status (canceled or executed). (Div. Ex. 113.)

<sup>11</sup> Woody worked for Knight Securities from July 1999 through March 2005. (Tr. at 634-635.) Luciano has been with Knight Securities for over six years. (Tr. at 640.)

## **B. Trading in the NASDAQ Market**

### **1. How the NASDAQ Market operates**

The NASDAQ market opens at 9:30 a.m. and closes at 4:00 p.m. Eastern Time. (Tr. at 595.) Brokers enter customer orders into the broker-dealer's system and the order is routed to the market maker displaying the best price. (Tr. at 583.) A market maker is any dealer who, with respect to a security, holds himself out (by entering quotations in an inter-dealer communications system or otherwise) as being willing to buy and sell a security for his own account on a regular and continuous basis. 15 U.S.C. § 78c(a)(38).

Market makers have an obligation to make a two-sided market, which means they must be prepared to buy and sell securities as well as publish their quotations in an electronic format.<sup>12</sup> (Tr. at 574.) The bid published by the market maker is the price the market maker is willing to pay to buy a security and the ask is the price at which the market maker will sell the security. (Tr. at 575.) The inside market (inside bid and ask) is created by the quotations of the market makers. The inside bid is the highest unexecuted bid and the inside ask is the lowest unexecuted ask of the market makers. (Tr. at 576.) The customer must buy at the low ask or better or sell at the high bid or better. (Tr. at 576-577.) Under the order handling rules, specifically NASD Rule 2320, when the market maker receives an order it must execute the trade at the best price that is quoted by all market makers. The best execution rule does not apply to trades between market makers. They can trade between the bid and ask. (Tr. at 907-908, 918.) The market maker price movement report (MMPMR) shows the inside market as well as the bid and ask prices displayed by market makers. (Div. Ex. 22A-K.)

Market makers adjust their bid and ask prices according to supply and demand within the market, so they do not accumulate a surplus of stock. (Tr. at 578-579.) The MMPMR, which is a report prepared by the NASDAQ, reflects the routing of the order to the market maker from the change in the market maker's quotation. (Tr. at 590-592.) Market makers for Initio stock included Island, Knight, Herzog (now Merrill Lynch), Fahnestock, Spear Leeds, the Cincinnati Stock Exchange (Cincinnati), and Hill. (Div. Ex. 114.)

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<sup>12</sup> Rule 11Ac1-4(b)(2) of the Exchange Act (Limit Order Display Rule) requires that a NASDAQ market maker, display in the market makers public quote, a customer limit order that is better than the market maker's quote, or represents more than a de minimis increase to the size of the market maker's quote if the market maker's quote is already equal to the National Best Bid Offer amount at the time the customer limit order is received. The National Best Bid and Offer is the inside spread. Under Rule 11Ac1-4(c), the publication requirements of subsection (b) do not apply to orders that are executed upon receipt of the order. Thus, if the order is routed to a market maker and that market maker then fills that order from its inventory or from a matched order, the market maker does not need to display the limit order. In that case, other market makers will not know of the bid entered by that customer.

## 2. Customer Orders

Retail customers can place limit orders to buy or sell a stock with their broker. A limit order to buy shares requires that the trade be executed at the limit order price or less. A limit order to sell must be executed at the limit order price or more. (Tr. at 580-581.) A limit order would be the closing bid if that bid existed at the close of the market. (Tr. at 242-244.)

If a customer places a not-held order, the broker decides when the order is entered, the shares purchased by the order, and the price at which the order is entered. (Tr. at 581, 785.) This allows the broker to enter large orders in small increments to minimize any effect on the stock price. A limit-not-held order gives the broker discretion as to the timing and quantity entered, but the trade must be executed at the limit order price or better. A customer can also choose when the order will expire. A good-until-canceled order remains open until canceled. A day order expires at the close of the trading day that the order is placed. (Tr. at 581-586.)

At GMIS, all orders for NASDAQ-listed stocks were entered on the firm's computer system and the orders are linked to the firm's clearing agent for execution.<sup>13</sup> (Tr. at 235.) Patten had two workstations on his desk that enabled him to monitor stocks. (Tr. at 244.) The first station enabled Patten to monitor a montage of stocks. The second station was a NASDAQ station that showed the market makers, the last transaction in a stock, changes in the inside market, current bids, and current offers. Patten explained that if he entered a bid greater than the inside bid, his bid would become the inside bid. (Tr. at 244-245.)

The NASDAQ also compiles an audit trail for all trades in a stock. The data is compiled from information provided by the seller and the buyer, which includes the execution time of the trade, the quantity, and the price. (Tr. at 589-590.) Trades must be reported in ninety seconds. (Tr. at 590.) The Audit Trail report prepared by Lowry includes the information from the NASDAQ audit trail, the buyer and seller names from the order tickets and the Blue Sheets, and the inside market information from the MMPMR. (Tr. at 594; Div. Ex. 114.)

## 3. Indications of Market Manipulation

Lowry testified that the following are indications of market manipulation:

a. Placing trades at or near the end of the day is a red flag. A buy order at or near the end of the day that is unexecuted may influence the quotes of one or more market makers and it may cause the bid to increase at the end of the day. A sale at or near the end of the day may depress the market. The size of the trade, especially if it is placed late in the day, may have a significant impact on the market.<sup>14</sup> (Tr. at 602-603.)

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<sup>13</sup> In May 2002, GMIS's clearing firm was RBC Dain Rauscher (RBC). (Tr. at 235.) Patten believed that RBC had an agreement with various other firms or market makers to execute the trades. (Tr. at 236-237.)

<sup>14</sup> Lowry testified that, on several days, the limit on orders was increased throughout the day. He observed the increases from the order tickets and the MMPMR. (Tr. at 606.)

b. Activity not based on economic factors may be an indication of market manipulation. (Tr. at 603-604.)

c. Concentration of ownership. Domination and control by one or more individuals, in terms of the overall percentage of trading activity, is an indication of market manipulation. This means the price could be controlled by a few stockholders and not market forces. (Tr. at 604-605.)

d. Low volume of trading can be a factor in manipulating the market. Lowry observed there were many days in the relevant period when the volume of trading was zero. On some days, the MMPMR shows the quotes did not change the entire day. (Tr. at 605.)

### **C. Evidence of Market Manipulation by Fox and Patten**

In its opening brief, the Division states:

During two discrete periods-July 26 through September 6, 2002 and November 26, 2002 through January 6, 2003-the respondent James Patten, a broker, and his long-time customer and friend Martin Fox, conspired to manipulate the closing bid price of Initio Inc. stock, then a NASDAQ traded company. Specifically, the two men traded the stock with a view to maintaining the closing bid price above one dollar, so that Initio would not be in violation of NASDAQ's Closing Bid Price Rule, and would not lose its NASDAQ listing. (Div. Pre-Hearing Br. at 4.)

#### **July 25, 2002, through September 6, 2002**

July 25, 2002

On July 25, Brie Charles (Charles)<sup>15</sup> sent a letter to Fox on behalf of the NASDAQ. (Tr. at 61-62; Div. Ex. 3.) The letter stated that Initio was not in compliance with the "closing bid-price rule." (Tr. at 511; Div. Ex. 3.) The closing bid price for a stock is the inside bid at the close of the trading day. (Tr. at 242, 595-596.) Fox understood this rule requires a company listed on the NASDAQ to maintain a closing bid price of \$1.00 or more. (Tr. at 499.) The deficiency letter explained that during the previous thirty days, the price of Initio stock closed below the \$1.00 minimum required by NASDAQ Rule 4310(c)(4) and that Initio would have 180 calendar days to regain compliance. Compliance required, at a minimum, that the closing bid

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<sup>15</sup> Charles has been employed by the NASDAQ as a lead analyst in the Listing Qualifications Department for the past seven years. (Tr. at 49-50.) In that position, she evaluates companies' compliance with NASDAQ requirements including: 1) closing bid price; 2) stockholders equity; 3) market value of listed securities; 4) corporate governance; and 5) shareholder approval of certain transactions. (Tr. at 50.) On a daily basis, Charles reviews a "hot list", which, among other things, identifies companies that are not in compliance with NASDAQ requirements. (Tr. at 52-54.)

price be \$1.00 or more for ten consecutive trading days during the six month grace period. (Tr. at 60, 466-468; Div. Ex. 3.)

July 26, 2002 (first trading day)

On July 26, Fox entered a limit-day order to buy 5,000 shares of Initio at \$.85 in his Ameritrade account at 10:37:50.<sup>16</sup> (Tr. at 621-624; Div. Ex. 23 at 1.) The order was routed to Island,<sup>17</sup> which raised its bid at 10:37:51 to \$.85, and became the inside bid. (Tr. at 621-623, 651; Div. Ex. 22A at 1.) Fox's order was not executed at \$.85. Therefore, at 2:03:12, Fox raised his limit order to \$1.01. (Tr. at 652; Div. Ex. 23 at 2.) Island then raised its bid to \$1.01 at 2:03:15. (Tr. at 653; Div. Ex. 22A at 3.) Fox purchased 4,000 shares from Island at 3:56:38 to 3:56:49 at \$1.01. (Div. Ex. 114 at 1.) However, 1,000 shares of Fox's 5,000 share order remained unexecuted at 4:00. (Div. Ex. 23 at 2.) This meant that Fox's limit order of \$1.01 closed the market at 4:00. (Div. Exs. 22A at 5, 114 at 1.) The trading records establish that Fox obtained the 4,000 shares from sales by Lifschitz.<sup>18</sup> (Tr. at 653-654; Div. Ex. 114 at 1.) Fox and Lifschitz were the only retail customers trading Initio stock on July 26. (Div. Ex. 114 at 1-2.)

July 27 and 28, 2002 (weekend)

July 29, 2002 (second trading day)

On July 29th, the inside bid opened at \$.84. (Div. Ex. 22B at 1.) Fox had the authority to trade in the Ameritrade accounts of Richard Wong (Wong) and Warren Opal (Opal). (Tr. at 492-493.) At 3:55:12, Fox placed a limit-day order in the Opal Ameritrade account to buy 5,000 shares at \$1.01, which was routed to Island. (Tr. at 662-663; Div. Ex. 24.) At 3:55:12, the inside bid increased to \$1.01 when Island reported the bid; it was executed at 3:57. (Tr. at 663; Div. Exs. 22B at 3; 114 at 2.) The closing inside bid was \$1.01, which was posted by Spear Leeds at 3:58:46. (Div. Ex. 22B at 6.)

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<sup>16</sup> Ameritrade account records are normally reported in Central Time. However, in this proceeding all other orders and transactions are reported in Eastern Time. (Tr. at 622.) For consistency, therefore, the orders placed through Ameritrade are stated in Eastern Time.

<sup>17</sup> Lowry testified that Island is a matching system where buyers and sellers come together and the orders are matched. He explained that it is different from a market maker, which decides the price based on different criteria. (Tr. at 614-615.)

<sup>18</sup> Lifschitz sold 1,000 shares to Spear Leeds at 3:56:29. Spear Leeds then sold 1,000 shares to Island at 3:56:41 and Island sold 1,000 shares to Fox at 3:56:43. Lifschitz then sold 2,500 shares to Spear Leeds at 3:56:37. This was followed by Spear Leeds's sale of 2,500 shares to Island at 3:56:37 and Island's sale of 2,500 shares to Fox at 3:56:38. Finally, Lifschitz sold 500 shares to Spear Leeds at 3:56:42 and Spear Leeds sold 500 shares to Island at 3:56:48. Then, Island sold 500 shares to Fox at 3:56:49. All of the sales were at \$1.01. Lifschitz also sold an additional 8,000 shares to Spear Leeds through 1,000 share increments from 3:58:44 to 3:59:53 at \$1.01. (Tr. at 657-658; Div. Exs. 23, 114 at 1-2.)



Lowry testified that on July 29 Spear Leeds sold the shares it purchased at the close on July 26, from S. Lifschitz, to M. Lifschitz and Fox. (Tr. at 658.) Spear Leeds sold 1,000 shares at \$1.03 at 3:56:52 and 1,500 shares at \$1.03 at 3:57:02 to Fahnestock for M. Lifschitz. (Tr. at 659; Div. Ex. 114 at 2.) Lowry notes that Lifschitz sold the shares on July 26 at \$1.01, but purchased those shares back at \$1.03. (Tr. at 659-661.) Spear Leeds sold 5,000 shares at \$1.01 to Island at 3:57:14 and Island sold those shares to the Fox Trust in the Ameritrade account at \$1.01 at the same time. (Tr. at 659; Div. Ex. 114 at 2.)

Lowry agrees that the closing inside bid price on July 26 and July 29 was \$1.01 and that Patten did not trade Initio stock either day. (Tr. at 780-781.) Therefore, Patten did not influence the closing inside bid price on these days.

July 30 through August 1, 2002 (third-fifth trading days)

The closing inside bid on July 30 was \$1.05; on July 31 it was \$1.00. (Div. Ex. 114 at 4.) Neither Fox nor Patten placed orders on these days. (Div. Ex. 113; Resp. Exs. 7, 8.) On August 1, Fox purchased an additional 5,000 shares for \$1.00 in the Wong account with Ameritrade. The closing inside bid on August 1 was \$1.00. (Tr. at 521; Div. Exs. 33 at 2, 114 at 4.) As Patten did not enter orders on these days, he did not influence the closing inside bid on these dates. (Tr. at 782-784.)

August 2, 2002 (sixth trading day)

On this date, Fox placed the first of his three orders with GMIS. All were placed during August. Fox's August 2 order was for 5,000 shares at \$1.01 at 3:52:16. (Tr. at 670; Div. Ex. 45 at 515.) GMIS entered the order and it was routed to Knight, which raised its bid to \$1.01. (Div. Exs. 22C, 45.) This caused the inside bid to increase from \$.99 to \$1.01, which was the closing inside bid because the trade was not executed. (Tr. at 784-792; Div. Exs. 22C at 1, 45 at 515.)

Patten told Fox on two occasions that he was not comfortable entering orders late in the day. He may have discussed the issue with Fox on August 2.<sup>19</sup> (Tr. at 270-274.) Patten was particularly concerned about placing trades late in the day because he was previously sanctioned by the NASD for marking the closing bid price. However, he did not question why Fox placed the orders late in the day. (Tr. at 270-274.)

August 3, and 4, 2002 (weekend)

August 5, and 6, 2002 (seventh and eighth trading days)

The closing inside bid on August 5 and August 6 was \$1.03. (Tr. at 792-793; Div. Ex. 114 at 5.) Patten did not place buy orders on either day. (Div. Ex. 113; Resp. Exs. 7, 8.)

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<sup>19</sup> On July 22, three days before receiving the first deficiency letter, Fox placed a day order with GMIS to purchase 5,000 shares of Initio. (Tr. at 257-258; Div. Ex. 35.) Patten has no recollection of talking to Fox about the order. (Tr. at 267.) This order was not executed because it was entered after 4:00. Patten noted this on the order ticket. (Tr. at 257-259; Div. Ex. 35.)

August 7, 2002 (ninth trading day)

On August 7, Fox placed a limit-not-held order with GMIS for 10,000 shares. (Div. Ex. 47.) In an effort to fill Fox's 10,000 share order, GMIS entered an order at 2:19:56 for 3,000 shares at \$1.01. GMIS routed the order to Knight. GMIS entered a second order at 2:20:46 for an additional 3,000 shares also at \$1.01. GMIS routed this order to Herzog. (Div. Ex. 45 at 516-517.) Knight raised its bid to \$1.01 at 2:19:55 and Herzog raised its bid to \$1.01 at 2:20:46. (Div. Ex. 22D at 4.) Neither order was executed.<sup>20</sup> (Div. Ex. 45 at 516-517.)

The closing inside bid for August 7 was \$1.05, which was the bid entered by Spear Leeds. (Tr. at 798; Div. Ex. 22D at 6.) Because the bids in the market were greater than Patten's bid of \$1.01, his order was not executed. (Tr. at 798-799.)

August 8, 2002 (tenth trading day)

On August 8, GMIS continued its effort to fill Fox's 10,000 share order. GMIS entered two 3,000 share limit orders for Fox, both for \$1.01, at 3:28:28 and 3:29:10 with Knight and Herzog, respectively. Neither order was executed. (Div. Ex. 45 at 516-517.) The closing inside bid was \$1.01. (Div. Ex. 114 at 7.) Therefore, Initio's closing inside bid for the ten consecutive trading days from July 26 to August 8 ranged from \$1.00 to \$1.05. (Tr. at 780-801; Div. Ex. 114 at 1-7.)

After August 8, Charles noticed Initio's name on her "hot list" as having a closing bid price of \$1.00 or more for a minimum of ten consecutive trading days. (Tr. at 63.) Charles explained that she looked into Initio's compliance further because it was borderline. She notes that the closing bids were "barely above the dollar" mark and the price of the stock rose "right after" Fox received the deficiency letter. (Tr. at 63-64.) She explained that compliance is borderline when the closing bid prices are at or slightly above \$1.00. (Tr. at 88.) She added that the NASDAQ wanted to see a closing bid price of at least \$1.05 or \$1.10. (Tr. at 67.) She also considered this immediate rise in the bid to be a "red flag." (Tr. at 63-64.)

Charles continued to review the trading in Initio to determine whether there was a true market and actual compliance. She reviewed the bids and the market maker montage, which is a chart that shows the bids of the market makers on different days and at various times. She also looked at closing bid prices each day, but her system did not show the time of day the bid was entered. (Tr. at 64-66, 82.) Charles and her manager noticed that two market makers placed bids at the end of the day for more than \$1.00 but the majority of the market makers bid less than \$1.00. (Tr. at 66-67.)

Although some of the orders during the ten day period were entered by GMIS, there is no evidence that Patten knew that the NASDAQ sent Fox a letter threatening to delist Initio unless the bid price was raised to at least one dollar for ten consecutive days. (Tr. at 85-86, 1035; Div. Exs. 3, 5.) There is also no evidence that Patten knew of the Ameritrade orders. (Tr. at 1029.)

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<sup>20</sup> Lowry observed that Fox was the primary retail purchaser from July 26 through August 7 and Lifschitz was the primary retail seller. (Tr. at 687.)

August 9, 2002

On August 9, in an attempt to fill the 10,000 share order, GMIS entered two 3,000 share orders at \$1.01. GMIS routed the first order to Knight at 10:11:56 and the second to Herzog at 10:12:35. Neither order was executed. (Div. Ex. 45 at 516-517.) Lowry opined that the August 8 and 9 orders caused Herzog and Knight to raise their bids to \$1.01. (Tr. at 683; Div. Ex. 22D at 4.) The closing inside bid for August 9 was \$1.01. (Div. Ex. 114 at 7.)

August 12, 2002

GMIS again entered two smaller orders in an attempt to fill the 10,000 share order. The first order for 3,000 shares at \$1.01 was entered at 9:29:47 and routed to Herzog. GMIS purchased the 3,000 shares at \$1.01 at 4:00:06. (Div. Ex. 47.) The second order for 2,000 shares at \$1.01 was entered at 9:29:04 and routed to Knight. This order was not executed. (Div. Ex. 45 at 518.) The closing inside bid on August 12 was \$1.01. (Div. Ex. 114 at 8.)

August 13, 2002

Fox's 10,000 share order was completed on August 13. This was accomplished when GMIS purchased 7,000 shares in two orders both at \$1.01. The first order for 2,000 shares was routed to Knight and the second order for 5,000 shares was routed to Herzog. (Div. Ex. 114 at 9.) Less than two minutes after the final purchase for the 10,000 share order, at 2:47:20, Fox placed a limit-not-held order for 40,000 shares at \$1.01. (Div. Ex. 113 at 1; Resp. Exs. 7, 8.) Fox could not recall any new public or economic information about the company at the time. (Tr. at 523.)

Beginning on August 13 and continuing until August 30, a total of twelve trading days, GMIS entered orders to buy Initio in 2,000 to 5,000 share increments in an effort to fill Fox's 40,000 share order. (Div. Ex. 45 at 519-522.) Patten maintains that he placed orders with two different market makers because he believed he would find a seller through one of these market makers. (Tr. at 295-296.) During this period, the bid and ask prices were \$1.00 or greater. (Div. Ex. 114 at 8-10.)

August 14, 2002, through August 20, 2002.

On August 14, 15, and 16, GMIS entered, on each day, a limit-buy order for 3,000 shares at \$1.01, which was routed to Herzog, and a limit-buy order for 2,000 shares at \$1.01, which was routed to Knight. (Div. Ex. 45 at 519-520.) None of these orders was executed or became the closing inside bid for these days. (Div. Ex. 114 at 9.) August 17 and 18 were weekend days. Patten did not enter orders on August 19 or 20. (Div. Ex. 113; Resp. Exs. 7, 8.) The closing inside bid was \$1.14 during August 14-20. (Div. Ex. 114 at 9.)

August 21, 2002, through August 30, 2002

On each trading day between August 21 and August 30, GMIS entered a day order for Fox for 5,000 shares at \$1.01, which were routed to Knight. (Div. Ex. 45 at 521-522.) The closing inside bid on each of these days varied from \$1.03 to \$1.06. (Div. Ex. 114 at 9-10.) None of Fox's orders was executed and they expired at the close of the trading day. (Div. Ex. 45 at 521-522.)

The closing inside bid during August 13 through August 30 ranged from \$1.03 to \$1.15. (Div. Ex. 114 at 8-10.) The orders GMIS routed to Knight and Herzog for \$1.01 from August 14-16, and routed to Knight from August 21-30, were also unexecuted at the close of these trading days. (Div. Ex. 45 at 519-522.) Thus, at least one other market maker entered a bid above \$1.00 during this date range that remained unexecuted at the close of these trading days. Lowry maintains that three market makers maintained a bid above \$1.00 from August 8, 2002, through September 6, 2002: Spear Leeds (with its own bid), and Knight and Herzog (with Fox's bids from GMIS). (Tr. at 691-692.)

On August 29, Charles wrote to Fox and advised that Initio regained compliance with the closing bid price requirement. (Tr. at 531; Div. Ex. 4.)

Maureen Seiss (Seiss)<sup>21</sup> is an associate director at NASD Market Regulation. Seiss testified that on or about August 30 the NASDAQ Listing Qualifications Department referred the Initio matter to her department due to potential manipulation of the market in connection with the minimum bid requirements. (Tr. at 109-110.) Seiss had analysts in her department review internal trading records to determine who was trading Initio stock after the NASDAQ sent the July 25 letter to Fox. (Tr. at 111.) Thereafter, the analysts sent letters to the market makers, clearing firms, and broker-dealers who traded Initio stock to determine who ultimately purchased or sold the stock. (Tr. at 112; Div. Exs. 9-12, 14-18.)

Seiss explained that the market maker and clearing firm records, for trades not placed in Ameritrade accounts, showed the name of the brokerage firm that placed the trade. (Tr. at 120.) The NASD would then need to request information from the broker-dealer to learn the identity of the ultimate buyer or seller. (Tr. at 124.)

Seiss testified that investigations are kept confidential and parties not involved in the matter are not informed about the investigation. (Tr. at 130-131.) However, there is nothing to prevent parties from discussing the matter with each other or with uninvolved persons. (Tr. at 131.) Seiss believes that in December 2002 the matter was referred to the Commission for investigation. (Tr. at 118.)

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<sup>21</sup> Seiss oversees the fraud surveillance section at the NASD. (Tr. at 108-109.)

September 4, 2002, through September 5, 2002

On September 4, NASD Regulation sent a letter to Advanced Clearing, Inc., requesting a transaction summary for any and all accounts that bought or sold Initio stock during the period July 26, 2002, through September 3, 2002. (Div. Ex. 9.) On September 4 and 5, the closing inside bid price was \$1.04. (Tr. at 841; Div. Ex. 114 at 10.)

September 6, 2002

On September 6, NASD Regulation sent a document request to Spear Leeds, via fax at 10:19, requesting information for all orders and trades involving Initio during the period of July 25, 2002, through August 5, 2002.<sup>22</sup> (Tr. at 114-115; Div. Ex. 10.)

Also on September 6, GMIS continued in its attempt to fill Fox's order for 40,000 shares at \$1.01 by entering three orders for 19,000 shares of which 18,100 shares were purchased. GMIS entered an order at \$1.01 for 9,000 shares at 3:21:10. GMIS bought 8,100 shares of this order at 3:33. (Div. Exs. 48, 113 at 2.) GMIS entered the second order for 5,000 shares at \$1.01 at 3:21:20, which was filled at 3:28 through a purchase from Knight. (Div. Exs. 48, 113 at 2, 114 at 10.) A third order for 5,000 shares was entered at 3:27:50 at \$1.01, which was filled by 3:33 through a purchase from Herzog. (Div. Exs. 48, 113 at 2, 114 at 10.) GMIS also entered a day order for 6,000 shares at \$1.01 at 3:35:51 with Herzog, but it was canceled at 4:00:15. (Div. Exs. 45 at 523, 113.) That bid became the closing inside bid for the day at \$1.01. (Div. Ex. 22E at 4.)

Fox purchased 18,100 shares on September 6 and canceled 21,900 shares of his 40,000 share order at the end of the day. (Tr. at 851; Div. Ex. 113; Resp. Exs. 7, 8.) Lowry opined that GMIS purchased the 12,000 shares Lifschitz sold between 3:32:53 and 3:33:28. (Tr. at 851-859; Div. Ex. 114 at 10.) Lifschitz chose to sell his shares at \$1.01 although he could have sold them during the previous two weeks when the closing inside bid ranged from \$1.03 to \$1.14. (Div. Ex. 114 at 9-10.) Lowry notes that GMIS's purchases for Fox and Lifschitz's sales took place within the same 35 seconds and were responsible for the \$1.01 closing price. (Tr. at 716-717, 899, 922.) Therefore, Lowry contends the trades were prearranged. (Tr. at 716-718.)

As Lowry testified, these trades allowed Fox and Patten to control the price of the stock and give the appearance of genuine market activity. (Tr. at 716-718.) Lowry further opines that Patten placed bids with Knight and Herzog for \$1.01 to ensure the closing inside bid would not

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<sup>22</sup> Specifically, the NASD requested a transaction summary for "any and all accounts that bought or sold INTO [Initio stock symbol] during the period July 25, 2002 through August 5, 2002, including customer name, account number, quantity and price of shares traded, and trade date." The NASD also requested a "trade history reflecting all orders and trades executed by REDI involving INTO during the period July 25, 2002 through August 5, 2002, including the identity of all brokerage firms executing orders of INTO through REDI and executing trades through the REDI system." (Div. Ex. 10.) Spear Leeds owns an electronic clearing network called REDI. (Tr. at 658.)

drop below \$1.00 even if market makers dropped out of the market. (Tr. at 926-927; Div. Ex. 22E.)

**September 7, 2002, through November 25, 2002**

Patten did not enter any orders for Fox or his own accounts between September 7 and November 25. During this period, Fox traded in the Wong Ameritrade account on September 11 and in the Fox Trust Ameritrade account on September 27. (Div. Exs. 113, 114.) Fox could not recall if there was new public information that prompted his purchases of Initio in July through September. (Tr. at 523.)

On September 23, Patten received a document request from the NASD seeking information about trading in Initio. This letter was the NASD's first contact with Patten or GMIS about this matter. Patten responded to the letter on September 26, and provided the requested documents. (Tr. at 129-130; Div. Exs. 14, 19.) He testified that did not know the NASD had made earlier requests for information about Initio trading. (Tr. at 321.)

On October 23, the NASDAQ sent Fox a second letter, via fax, stating that the Initio stock price had closed below the minimum \$1.00 per share and that the company would have 180 days, or until April 21, 2003, to regain compliance. (Div. Ex. 5.)

During this period, Initio's inside bid price ranged from \$.79 to \$1.01 and the volume declined. (Div. Ex. 114 at 10-35.) Lowry testified that the price was approximately \$.85. Lowry also notes that when Patten and Fox were in the market, the closing inside bid price was higher. Lowry opined that these facts indicate market manipulation. (Tr. at 720-721.)

**November 26, 2002, through January 6, 2003**

**November 26, 2002**

On November 20 and 26, Fox and Holder spoke by telephone about the Initio merger. (Div. Exs. 70, 71.) Also on November 26, at 10:28:35, when the inside bid-ask spread was \$.87-.89, Patten entered a limit order at \$1.01 for 5,000 shares, which was routed to Knight. (Div. Exs. 49, 113, 114 at 35.) Knight sold Patten 500 shares at \$.89 at 10:28:35, 100 shares at \$.92 at 10:28:57, and 4,400 shares at \$.97 at 10:29:03 for the Patten IRA account. (Div. Exs. 49, 114 at 35.) Knight filled the order from inventory so the bid was not displayed. (Tr. at 734; Div. Ex. 22F at 5.) Telephone records on November 26, show that someone from Initio called GMIS at 10:09 and that someone from GMIS called Initio at 10:21 and 10:28. (Div. Ex. 110 at 6.) There is no evidence of who participated in these calls or what was said.

Patten maintains that he placed the limit order at \$1.01 early in the morning to avoid multiple ticket charges because the clearing firm charges per order ticket. According to Patten, placing the limit order at an amount slightly higher than the probable completion price would result in only one ticket charge. (Tr. at 1042-1043.)

At 10:42:51, GMIS entered a second order for the GMIS proprietary account for 6,500 shares at \$1.01. This order was also routed to Knight. Knight sold Patten 500 shares at \$.97 at 10:42:48, 400 at \$.97 at 10:43:13, and 5,600 at \$.98 at 10:43:19. (Div. Exs. 49, 114 at 35-36.) Knight filled these orders from its own inventory because it had the lowest price for both orders, so the bid was not displayed. (Tr. at 736; Div. Ex. 22F at 5-6.)

At 10:45:08, Patten entered his third buy order for 5,000 shares at \$.95, which was routed to Knight. (Tr. at 1043; Div. Exs. 22F at 6, 45 at 525.) Cincinnati entered a bid for \$.96 at 10:45:17. (Tr. at 1045; Div. Ex. 22F at 7.) Patten raised his bid to \$.97 at 10:45:48. (Tr. at 1045; Div. Ex. 22F at 8.) Thereafter, Cincinnati raised its bid to \$.98 at 10:48:16. (Tr. at 1045; Div. Ex. 22F at 9.) Cincinnati raised its bid again to \$1.01 at 11:47:20. (Div. Ex. 22F at 14.) Patten increased his bid to \$1.01 at 3:58:43.<sup>23</sup> (Tr. at 1047-1049.) As a result, Knight raised its bid to \$1.01 at 3:59:27. (Div. Ex. 22F at 21-22.) The order was not executed and became the closing inside bid.<sup>24</sup> (Div. Exs. 22F at 21-22, 45 at 525.) Patten testified that he raised his bid to buy more shares because he was originally outbid by others in the market, but not to close the market. (Tr. at 1047-1048.) Patten maintains that he did not have any conversation with anyone at Cincinnati and he did not know Lifschitz was a seller of Initio stock that day.<sup>25</sup> (Tr. at 1046, 1065.)

Patten believed that Initio was a good buy any time the price was less than \$1.00. (Tr. at 336-337.) Nevertheless, other than to suggest that he might not have had the money, he could not explain why he did not purchase the stock when the price was below \$1.00 between September 6 and November 25. (Tr. at 331-337.) Nor could he explain why he began purchasing Initio on November 26. (Tr. at 331.) Patten did not learn new information about Initio in late November and he did not recommend Initio to his customers in November or December. (Tr. at 1051-1053.) On November 26, except for a purchase of 399 shares by another person, Patten and Fox were the only retail buyers and Lifschitz was the only retail seller. (Div. Ex. 114 at 35-37.)

Lowry opined that Patten's trades on November 26 caused the inside bid and ask to increase. Knight did not publish the limit prices for the two initial orders because it filled those orders from its own inventory. However, Knight raised its ask price to \$1.25 after the orders

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<sup>23</sup> Patten testified that he raised his bid because Cincinnati raised its bid and he observed other trades were executed at \$1.01 throughout that afternoon. (Tr. at 1046-1047.)

<sup>24</sup> Lowry explained that the Limit Order Display Rule requires that the market maker to whom the order is routed display the bid if the bid is inside the market. (Tr. at 655-656.)

<sup>25</sup> Lifschitz made his first sale of the day to Knight at 10:43:19 for 5,600 shares at \$.98 and 300 shares for \$.98 at 10:43:22. (Div. Ex. 114 at 36.) The inside spread was \$.87-.98. (Div. Ex. 114 at 36.) Lifschitz made his second sale of the day to Goldman Sachs at 11:24:40 for 1,000 shares at \$1.25. (Div. Ex. 114 at 36.) The inside spread was \$.98-1.25. (Div. Ex. 114 at 36.) Lifschitz made his third sale to Knight of 1,000 shares at \$1.01 at 12:31:23, 2,500 shares for \$1.01 at 12:31:44, and 5,000 shares between 12:32:53 and 1:43:34. (Div. Ex. 114 at 36.) When Lifschitz finished his sales, the inside bid was \$1.01 and the inside ask was \$1.20. (Div. Ex. 114 at 36.)

were filled. (Tr. at 734-737; Div. Ex. 22F at 6.) Lowry explained that the bid price can never be higher than the ask price. Thus, as the ask price increases, the bid price can also increase. (Tr. at 734-737.) According to Lowry, after Patten's trades increased the bid and ask prices, Patten placed a bid late in the day for \$1.01, which closed the market. (Tr. at 736-737; Div. Ex. 109 at 10.)

November 27, 2002

On November 27, Fox sent Holder a letter proposing the terms for the merger.<sup>26</sup> (Tr. at 161-162; Div. Ex. 71.) Fox's proposal included the number of shares to be exchanged for Holder's casino and put options for Fox and a business associate to sell two million shares at \$1.75 to Holder. (Tr. at 161-162; Div. Ex. 71.)

a. Orders entered by GMIS

Patten entered a limit order at 1:25:04 to buy 500 shares, which was changed to 1,500 shares at 1:36:13, for \$1.01 on behalf of the GMIS proprietary account. (Tr. at 1048; Div. Exs. 22F at 49; 49.) At 1:59:48, GMIS bought 1,000 shares from Knight at \$1.01. At 2:00:05, GMIS bought 500 shares from Knight at \$1.01. (Div. Ex. 114 at 37.) At 2:01:36, the inside market was \$.90-1.03. (Div. Ex. 114 at 37.)

GMIS then entered a limit order at 2:01:39 to buy 2,500 shares at \$.90. The order was not executed. (Div. Ex. 45 at 527; Resp. Exs. 7, 8.) At 3:12:13, GMIS entered a limit order to buy 2,000 shares at \$.95. The limit was changed to \$1.01 at 3:55:40 and routed to Knight, but the order was not executed. (Div. Ex. 113 at 2; Resp. Exs. 6, 7.) At 3:31:59, the inside market was \$.98-1.01. (Div. Ex. 114 at 37.)

At 3:32:02, GMIS entered a limit order for 1,500 shares at \$.98. The limit was changed to \$1.02 at 3:57:33. The order was not executed. (Div. Ex. 45 at 526; Resp. Ex. 6.) GMIS entered a limit order at 3:48:50<sup>27</sup> for 1,000 shares at \$1.01, which was routed to Knight. Knight sold GMIS 500 shares at 3:48:55. The order for the remaining 500 shares was not executed.<sup>28</sup> (Tr. at 1048; Div. Ex. 49; Resp. Exs. 7, 8.) Patten's orders gradually increased the inside bid and the unexecuted orders eventually became the closing inside bid for the day. The inside bid

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<sup>26</sup> Fox and his associate at Initio, Danny DeStefano, met with Holder in Reno, Nevada, around the Thanksgiving Holiday of 2002. (Tr. at 162-163.)

<sup>27</sup> The order ticket analysis shows the order for 1,000 shares was entered at 3:42:50. (Div. Ex. 113 at 2.)

<sup>28</sup> Respondent's exhibits show that Patten purchased 2,500 shares on November 27. (Resp. Exs. 7, 8.) However, the audit trail and the order ticket analysis show that Patten purchased a total of 2,000 shares on this day. (Div. Exs. 113, 114.)



increased to \$1.01 at 3:48:48 and remained at that price for the remainder of the day.<sup>29</sup> (Div. Ex. 114 at 37.) The inside ask closed at \$1.03. (Div. Ex. 114 at 37.)

For the period of November 26, 2002, through January 6, 2003, Lowry testified that the orders were routed primarily to Knight and the bids for those orders caused the closing inside bid to equal \$1.01 or greater. He notes that on several occasions Patten changed the limit to \$1.01 after 3:00. (Tr. at 740.)

b. Lifschitz trades

The sell orders entered by Lifschitz matched the buy orders placed by Patten. At 1:59:48, Lifschitz sold Knight 1,000 shares at \$1.01 and Knight sold 1,000 shares to GMIS for \$1.01. At 2:00:05, Lifschitz sold Knight 500 shares at \$1.01 and Knight sold 500 shares to GMIS for \$1.01. (Div. Ex. 114 at 37.) At 3:48, Lifschitz sold 500 shares to Knight who then sold 500 shares to GMIS for the 1,000 share order. (Div. Ex. 114 at 37.) Again, Patten was the only retail buyer and Lifschitz was the only retail seller on this day. (Div. Ex. 114 at 37.) Lowry opines that GMIS purchased the shares that Lifschitz sold to Knight and that these sales caused the inside market to increase. (Div. Ex. 109 at 12.)

Patten testified that he entered bids early in the day at lower prices and then later increased those bids because no sellers accepted his bid for less than \$1.01. (Tr. at 1049.) Patten testified that he was not aware on November 26 or 27 that Initio was in danger of being delisted. (Tr. at 1035-1036.)

November 29, 2002, through December 4, 2002

On November 29 at 9:47:38, GMIS entered one bid for 500 shares at \$1.01 that was routed to Knight, but it was not executed. (Div. Exs. 45 at 528, 113 at 2.) On December 2, GMIS placed an initial bid of \$.92, which was executed. (Div. Ex. 49.) GMIS placed a second order at 12:45:46 for \$.95, but raised the bid to \$.98 at 3:36:21. (Div. Ex. 45 at 529.) Thereafter, Cincinnati placed a bid at 3:43:13 at \$1.01. (Div. Ex. 22G at 5.) At 3:51:14, GMIS raised its limit order price to \$1.01. At 3:54, GMIS canceled the order. (Div. Ex. 45 at 529.) The bid entered by Cincinnati for \$1.01 remained unexecuted at the close of the day. (Div. Ex. 22G at 7.) On December 3, GMIS entered an initial order at 2:55:43, but changed the limit price to \$.98 at 3:21:37, and again to \$1.01 at 3:40:29. The order was not executed at the close of the day. (Div. Exs. 45 at 531, 113; Resp. Exs. 7, 8.) On December 4, GMIS placed an initial day order to purchase at \$.98 and a final order for \$1.02 at 3:56:12, which were not executed. (Div. Exs. 45 at 532, 113 at 3.)

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<sup>29</sup> Although the order ticket, the order ticket analysis, and Respondent's chronologies show that GMIS entered a bid entered at 3:57:33 for \$1.02 that was not executed at the end of the day, the audit trail indicates the closing inside bid on November 27 was \$1.01. (Div. Exs. 45 at 526, 113 at 2, 114 at 37; Resp. Exs. 7, 8.)

On December 2, Cincinnati entered the closing inside bid. However, GMIS's final bids on November 29, December 3, and December 4 equaled the closing inside bid. (Div. Ex. 114 at 38-39.) On December 2 and 3, GMIS also placed one order on each day to sell 2,400 shares at \$1.08. Patten maintains that he wanted to buy shares low and sell high. (Tr. at 949, 966-967.)

December 5, 2002, through December 15, 2002

Neither Patten nor GMIS traded during the seven trading days in this period.

December 16, 2002, through December 18, 2002

On December 16, the inside bid at the beginning of the day was \$.87. (Div. Ex. 114 at 40.) Patten entered a limit order at 3:30:30 to buy 1,200 shares at \$.89. He increased the limit to \$.95 at 3:38:32. The order was executed at 3:38:42. (Div. Exs. 50, 113 at 3; Resp. Exs. 7, 8.) GMIS then placed three other orders. The first was at 3:41:07 for 1,500 shares at \$.91 of which 1,000 shares were immediately purchased. The order for the remaining 500 shares was not executed. (Div. Exs. 50, 113 at 3, 114 at 40-42.) GMIS placed a second order for 500 shares at 3:54:43 for \$.98, which was executed at 3:54:50. (Div. Exs. 50, 113 at 3, 114 at 42.) GMIS placed a final order at 3:57:05 for 1,000 shares at \$.98, which was filled at 3:58:39. (Div. Exs. 50, 113 at 3, 114 at 42.) The inside closing bid price was \$.96. (Div. Ex. 114 at 39.) There were no orders entered on December 17, 2002. (Div. Ex. 113; Resp. Exs. 7, 8.)

December 18, GMIS placed three buy orders before the market closed. The first order was placed at 1:51:08 for 1,000 shares at \$.97 and routed to Knight. GMIS purchased 400 shares at \$.97. GMIS then raised the limit to \$1.02 for the remaining 600 shares, which was executed at 3:49. (Div. Exs. 51, 113 at 3, 114 at 42.) GMIS placed a second order for 5,000 shares at 1:53:47 at \$.98. GMIS purchased only 500 shares of this order at 2:00:09. (Div. Exs. 51, 113 at 3, 114 at 42-43.) GMIS placed a third order for 1,500 shares at \$1.01 at 3:50:50, which remained unexecuted at the close of the day. (Div. Exs. 51, 113 at 3; Resp. Exs. 7, 8.) The closing inside bid price was \$1.01. (Div. Ex. 114 at 43.)

December 19, 2002, through December 24, 2002

On December 19, GMIS entered an initial bid for \$.99<sup>30</sup> at 9:28:22 and raised the bid to \$1.01 at 1:30:42. The order was not executed. (Div. Exs. 45 at 534, 113 at 3; Resp. Exs. 7, 8.) On December 20, GMIS entered a limit order to buy at \$.99 and then changed the limit to \$1.00 at 10:42:24, and again to \$1.01 at 2:00:33, but the order was not executed.<sup>31</sup> The closing inside bid price was \$1.01. (Div. Ex. 114 at 44; Resp. Exs. 6, 7, 8.) On December 23, Patten entered

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<sup>30</sup> Division Exhibit 113 shows Patten's initial order was entered for \$.98 at 9:28:22. (Div. Ex. 113 at 3.)

<sup>31</sup> Respondent Exhibit 6 includes a copy of this order ticket. However, Division Exhibit 113 does not indicate that GMIS or Patten entered buy orders on December 20. (Div. Ex. 113 at 3.)

an initial order at \$.97 at 1:21:39, and changed the limit price to \$1.01 at 3:25, but it was not executed. (Div. Exs. 45 at 535, 113 at 3; Resp. Exs. 7, 8.) On December 24, Patten entered one order at 8:55:39 at \$1.01, which was not executed.<sup>32</sup> (Div. Ex. 45 at 535; Resp. Exs. 7, 8.) The final bids by Patten equaled the closing inside bid on December 18, 19, 20, 23, and 24. (Div. Exs. 113, 114.)

Patten entered an order to sell 1,800 shares on December 20 at \$1.02, which was executed at \$1.02.<sup>33</sup> (Div. Exs. 52, 114 at 44.) On December 24, he entered an order to sell 4,400 shares at \$1.08, which was not executed. (Div. Ex. 45 at 536.)

On December 23, Fox sent Holder a letter listing the number of market makers and shareholders and stated that he would send Holder a list of the items that remained open. Holder was concerned about the number of market makers and the support for the stock. (Tr. at 163-164; Div. Ex. 73.) Although he could not recall Fox's request for this information, Patten admits that the fax number on that document shows that it was faxed from GMIS. (Tr. at 352-354; Div. Ex. 73.)

December 26, 2002, through December 31, 2002

On December 26, Patten entered a limit order for 1,100 shares at \$1.01 at 8:28:21 for his IRA account, which was executed at 12:33:10. He initially entered a second limit order to buy 1,200 shares at \$.97, but the limit price was increased to \$1.01 at 3:16. The order was not executed. (Div. Exs. 45 at 537, 52.) On December 26, Lifschitz sold 1,500 shares at \$1.01 at 12:33:09 to Knight. At 12:33:10, Knight sold GMIS 1,100 shares at \$1.01 to fill the order Patten placed at 8:28:21 for his IRA account. (Div. Ex. 114 at 44.)

On December 27, 30, and 31, Patten entered initial buy orders between \$.89 and \$.99 for the Patten IRA account. Thereafter, Patten gradually increased the bid to \$1.01, except for December 31, when his last bid was for \$1.03. On these three days, Patten entered a bid of \$1.01 per share or higher after 3:00.<sup>34</sup> (Div. Ex. 45 at 538-541.) His final bids remained unexecuted and equaled the closing inside bid for the day. (Div. Exs. 45 at 538-541; 114.) On December 27 at 1:09:44, Patten bought 1,200 shares at \$1.00 for the Patten IRA account and Lifschitz sold 2,000 shares at \$1.00. (Div. Ex. 114 at 45.) Patten placed an order to sell 5,500 shares at \$1.07 for the Patten IRA account, which remained unexecuted. (Div. Ex. 45 at 539.)

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<sup>32</sup> Division Exhibit 113 shows that an order was entered for the Patten IRA account with a limit of \$.99. However, the order ticket indicates the order was entered for \$1.01. (Div. Ex. 45 at 535.)

<sup>33</sup> The order tickets show that 1,800 shares were sold at \$1.02. (Div. Ex. 52.) Division Exhibit 113 does not show the orders for a total of 1,800 shares were executed. Respondent Exhibits 7 and 8 indicate that 3,000 were sold.

<sup>34</sup> Lowry notes that there were several days when Patten entered an order before the market opened and that bid remained unexecuted for the entire day and equaled the closing inside bid. (Tr. at 983.) Lowry also notes that Patten's bid above \$1.00 closed the market on most days that he entered bids. (Tr. at 983-984.)

Post-December 2002

GMIS placed a limit order at \$1.01 for 1,800 shares on January 3, 2003, at 2:43. The order remained open and marked the close. It was filled on January 6. On January 7, Fox was contacted by the Commission staff and thereafter orders for Initio through GMIS ceased for the remainder of January. (Tr. at 542-543; Div. Ex. 113 at 4.) The closing bid price fell to \$.87 on January 7 and remained between \$.85 and \$.87 for the remainder of the month. (Div. Ex. 114 at 48-49.)

Patten maintains that he was not aware of the Commission investigation into this matter until he received a phone call and a document request from the Commission. He learned later that Fox was also called by the Commission. (Tr. at 357-359.)

Because the company did not regain compliance with the ten day bid requirement within 180 days, as required by the October 23 letter, the NASDAQ sent a letter to Fox, dated April 24, 2003, stating Initio stock would be delisted from the NASDAQ Small Cap Market. (Div. Ex. 7.) The letter also explained that Initio would not be given an additional 180 days to comply because Initio did not meet the initial inclusion requirements under NASDAQ Rule 4310(c)(2)(A) and the company failed to pay its annual fees in the amount of \$15,000. (Div. Ex. 7.) The letter also stated that Initio could appeal the delisting determination to the Listing Qualifications Panel, but Initio did not appeal the decision. (Tr. at 78; Div. Ex. 7.) The stock was delisted. The merger with Holder was never completed. (Tr. at 197.)

## CONCLUSIONS OF LAW

The OIP charges that Patten violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, by manipulating the bids for and price of Initio stock. He is also charged with aiding and abetting Fox's violations of Section 10(b) and Rule 10b-5 for the same conduct. This section and rule proscribe fraudulent conduct in connection with the purchase and sale of securities. To establish a violation, the Division must prove: (1) misrepresentations or omissions of material facts or other fraudulent devices; (2) made in connection with the offer, sale, or purchase of securities; and (3) that the respondent acted with scienter. Aaron v. SEC, 446 U.S. 680, 697 (1980); Pinker v. Roche Holdings Ltd., 292 F.3d 361 (3d Cir. 2002).

A fact is material if there is a substantial likelihood that a reasonable investor would consider it important in making an investment decision and would view disclosure of the omitted fact as having significantly altered the total mix of information made available. Basic Inc. v. Levinson, 485 U.S. 224, 231-32 (1988); TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976). Materiality is a mixed question of law and fact. TSC Indus., 426 U.S. at 450.

Courts have interpreted broadly the requirement of Exchange Act Section 10(b) and Rule 10b-5 that violations must occur "in connection with" the purchase or sale of a security. See SEC v. Zandford, 535 U.S. 813, 819-825 (2002); Superintendent of Ins. v. Bankers Life & Cas. Co., 404 U.S. 6, 12 (1971); In re Ames Dep't Stores, Inc., Stock Litig., 991 F.2d 953, 964-965 (2d Cir. 1993). "Any statement that is reasonably calculated to influence the average investor satisfies the

‘in connection with’ requirement of Rule 10b-5.” SEC v. Hasho, 784 F.Supp. 1059, 1106 (S.D.N.Y. 1992).

Scienter is defined as “a mental state embracing intent to deceive, manipulate or defraud.” Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 n.12 (1976). The scienter requirement may be satisfied by a showing of recklessness. Hollinger v. Titan Capital Corp., 914 F.2d 1564, 1568-1569 (9th Cir. 1990); David Disner, 52 S.E.C. 1217, 1222 & n.20 (1997). Recklessness is defined as “an extreme departure from the standards of ordinary care . . . present[ing] a danger of misleading buyers or sellers that is either known to the [respondent] or is so obvious that the [respondent] must have been aware of it.” Sundstrand Corp. v. Sun Chem. Corp., 553 F.2d 1033, 1044-1045 (7th Cir. 1977). Proof of scienter can be demonstrated by circumstantial evidence. Herman & MacLean v. Huddleston, 459 U.S. 375, 390 n.30 (1983).

The jurisdictional clauses under the antifraud provisions are given broad interpretation and are satisfied by intrastate telephone calls, incidental use of the mails, or by use of any national securities exchange. See 15 U.S.C § 78(j); McDaniel v. United States, 343 F.2d 785, 787-88 (5th Cir. 1965); see also Reube v. Pharmacodynamics, Inc., 348 F. Supp. 900, 912 (E.D. Pa. 1972); Ingraffia v. Belle Meade Hosp., Inc., 319 F. Supp. 537, 538 (E.D. La. 1970).

#### **A. Patten aided and abetted Fox’s violations of Section 10(b) and Rule 10b-5**

Patten is alleged to have aided and abetted a primary violation by Fox during the period July 26-September 6, 2002. Three principal elements are required to establish liability for aiding and abetting a violation of Section 10(b) and Rule 10b-5: (1) that a principal committed a primary violation; (2) that the aider and abettor provided substantial assistance to the primary violator; and (3) that the aider and abettor rendered such assistance knowingly or recklessly. Graham v. SEC, 222 F.3d 994 (D.C. Cir. 2000).

The Division argues that Fox violated Section 10(b) and Rule 10b-5 by manipulating the inside bids for and price of Initio stock. Specifically, the Division contends that Fox, the president and CEO of Initio, orchestrated a scheme to elevate the closing inside bid of Initio stock to \$1.00 or more in order to prevent the delisting of Initio stock from the NASDAQ Small Cap Market.

#### **1. Fox manipulated the price of Initio stock in violation of Section 10(b) and Rule 10b-5 during the period July 26 to September 6, 2002.**

Fox received a letter from the NASDAQ on July 25, stating that Initio stock was in danger of being delisted because the closing bid price for the stock had been less than \$1.00 per share for thirty consecutive trading days. The letter advised Fox that, among other things, the closing bid price had to be \$1.00 or more for ten consecutive days before January 23, 2003, or the NASDAQ would provide written notification of delisting. The next day, July 26, Fox bought 4,000 shares of Initio stock for \$1.01 in his Ameritrade account. Fox continued to place orders on July 29 and August 1 at \$1.01 and \$1.00 per share, respectively, in the Ameritrade account. A few weeks earlier, in June, Fox began discussions with Holder about the possibility of merging

Initio with one of his casinos. Holder wanted to merge with an exchange listed company. Therefore, it was especially important for Fox to keep the NASDAQ listing.

In furtherance of the scheme, Fox intentionally placed large limit orders in August, as a mechanism for Patten to manipulate the closing bids of Initio stock in order to retain the NASDAQ listing. On August 2, Fox placed his first limit order with GMIS for 5,000 shares of Initio stock at \$1.01. Fox's bid was the closing inside bid for the day because it was the highest unexecuted bid at the close of the market. On August 7, Fox placed a second order for 10,000 shares at \$1.01 per share. GMIS placed a series of small orders ranging from 2,000 shares to 5,000 shares on August 7 through August 13 to fill the 10,000 share order. At the close of the trading day on August 7, the order entered by GMIS for \$1.01 per share remained unexecuted and the closing inside bid was \$1.05. GMIS also entered orders on August 8, 9, 12, and 13 for \$1.01 to fill this order. The bid of \$1.01 equaled the closing inside bid on August 8, 9, and 12.

As of August 8, Initio achieved ten consecutive days where the closing inside bid was \$1.00 or greater. However, Initio did not, as yet, satisfy the NASDAQ requirements for listing. Charles explained that even if an issuer under review achieves a stock price of \$1.00 or more for ten consecutive trading days, the NASDAQ can continue to review activity in that stock if the issuer's compliance is borderline. Under such circumstances, the NASDAQ would review the number of market makers, the closing inside bid price, and the market activity in the stock.

On August 13, within minutes of filling the 10,000 share order, Fox placed a limit-not-held order for 40,000 shares at \$1.01. Given the time that it took to execute the 10,000 share order (five trading days) and the fact that Initio was a thinly traded stock, Fox knew or was reckless in not knowing that it could take many days to fill the 40,000 share order. To fill this order, GMIS entered small orders at \$1.01 for 2,000 to 5,000 shares for twelve trading days from August 13 through August 30. From August 13 through August 30, the inside closing bid ranged from \$1.03 to \$1.14. During this twelve day period, the inside closing bid would have been at least \$1.01 as long as the bids placed by GMIS remained unexecuted. Therefore, this pattern of entering buy orders at \$1.01 was manipulative in that it established an artificial floor price for the closing inside bid of Initio stock.

On August 29, the NASDAQ advised Fox that Initio met the ten day bid requirement. He placed no other orders with GMIS after this date. In addition, Fox cancelled 21,900 shares of the 40,000 share order on September 6. The cancellation of most of the order establishes that it was only a manipulative device to allow Patten to place a series of orders at \$1.01 in order to provide a artificial floor for Initio's closing bid price and to give the appearance of active trading for Initio stock.

As further evidence of manipulating the market, on July 26, and September 6, the purchases made by or for Fox, were matched by Lifschitz's sales. On July 26, Fox purchased 4,000 shares that Lifschitz sold into the market. Fox and Lifschitz were the only retail customers in the market that day. On September 6, GMIS purchased 12,000 shares that Lifschitz sold into the market. GMIS's purchases for Fox and Lifschitz sales took place within the same 35 seconds. Although I credit the testimony of the Knight traders that they did not prearrange

trades, the dates, times, and amounts in the trading records persuade me that the trades were prearranged.

## **2. Patten provided substantial assistance by entering Fox's orders.**

Patten provided substantial assistance to Fox's scheme by entering smaller orders on eighteen trading days in August and one trading day in September. It was these orders that provided an artificial floor bid for Initio stock in the event that another market maker withdrew its bid. He also provided substantial assistance by routing these orders to two market makers in order to create the appearance of market demand for the stock.

## **3. Patten aided and abetted Fox's scheme with the requisite scienter.**

Patten was sanctioned by the NASD in 1998 for marking the closing bid price of stock. Therefore, he knew that companies listed on the NASDAQ are required to maintain a closing bid price of \$1.00 or more. Patten also knew Fox was the president of Initio and they had a long term broker-client relationship. I infer that Patten, who had many years of experience in the securities industry, knew that the NASDAQ would contact Fox if Initio was not in compliance with the closing bid requirement.

Although possessing this knowledge and experience, Patten did not question Fox about these large orders, all at \$1.01, for a thinly traded stock. Patten also did not exhibit any concern that it could take many days or even several weeks to fill these orders in an inactive stock. Nevertheless, Patten or another trader at GMIS who worked for Patten, placed orders to purchase Initio stock at \$1.01 on sixteen trading days from August 7 through August 30. This time frame included two periods when Patten entered orders at \$1.01 on eight consecutive trading days (August 7 through August 16, and August 21 through August 30). An order at \$1.01 remained outstanding at the close all of these trading days. This trading pattern continued into September until a few days after the NASDAQ sent the compliance letter on August 29, 2002, advising that the ten day minimum had been met. Under these circumstances, Patten was reckless in not questioning that the president of the issuer was using him and his firm to place orders at \$1.01, which Patten knew could take many days to fill.

Although a broker is required to place orders for a client, it cannot be done with a blind eye to the circumstances surrounding the orders. As the Commission has stated:

The importance of a broker-dealer's responsibility to use diligence where there are any unusual factors is highlighted by the fact that violations of the antifraud and other provisions of the securities laws frequently depend for their consummation . . . on the activities of broker-dealers who fail to make diligent inquiry to obtain sufficient information to justify their activity in the security.

In the Matter of Alessandrini & Co., 45 S.E.C. 399, 406 (1973). See also, Graham v. SEC, 222 F.3d 994 (D.C. Cir. 2000) (stating that "a registered representative can always refuse to execute a trade she [or he] knows may constitute a securities violation"); Hanly v. SEC, 415 F.2d 589, 595 (2d Cir. 1969) (explaining that registered representatives are under a duty to

investigate); Frederick H. Joseph, 51 S.E.C. 431, 438 (1993) (“red flags and suggestions of irregularities demand inquiry as well as adequate follow-up and review”).

Further, Patten created the appearance of demand for Initio stock when he placed orders with two different market makers on August 13 through August 16. Patten immediately attempted to fill the 40,000 share order by entering bids at \$1.01 for 3,000 shares with Herzog and 2,000 shares with Knight, from August 13 through August 16. The closing bids placed by Knight and Herzog equaled \$1.01. On August 21 through August 30, GMIS entered an order on each trading day for 5,000 shares at \$1.01 with Knight. The inside closing bid from August 13 through August 30 ranged from \$1.03 to \$1.14. Therefore, I infer that at least one other market maker posted a bid greater than \$1.01 on those dates.<sup>35</sup> There were at least three Initio market makers on August 13 through August 16 (Knight, Herzog, and High Bidding Market Maker), and at least two market makers on August 21 through August 30 (Knight and High Bidding Market Maker), who entered bids above \$1.00.

Patten knew or was reckless in not knowing that entering a series of smaller buy orders over an extended period, at \$1.01, with two different market makers, facilitated Fox’s manipulation of the Initio stock price. Therefore, I conclude that Fox engaged in a primary violation of Section 10(b) and Rule 10b-5 and Patten aided and abetted this scheme.

#### **B. Patten Violated Section 10(b) and Rule 10b-5**

Patten violated Section 10(b) and Rule 10b-5 when he manipulated the bids for and price of Initio stock from November 26, 2002, through January 6, 2003. Again, to establish a violation, the Division must prove: (1) misrepresentations or omissions of material facts or other fraudulent devices; (2) made in connection with the offer, sale, or purchase of securities; and (3) that the respondent acted with scienter. Aaron v. SEC, 446 U.S. 680, 697 (1980); Pinker v. Roche Holdings Ltd., 292 F.3d 361 (3d Cir. 2002).

Proof of market manipulation depends on inferences drawn from a mass of factual detail. The trier of fact looks at patterns of behavior, apparent irregularities, and trading data. Pagel, Inc., 48 S.E.C. 223, 226 (1985). The circumstances surrounding the trading data establish that Patten knew or was reckless in not knowing that the orders he placed for Initio stock on many days equaled or set the closing the bid price at or above \$1.00. This pattern of trading was done to manipulate the market in Initio.

On October 23, the NASDAQ sent Fox a letter stating that Initio stock was again in danger of being delisted from trading because the bid price had been less than \$1.00 for thirty consecutive days. This time, the letter explained that the bid price had to close at \$1.00 or more for a minimum of ten consecutive trading days before April 21, 2003, to comply with the minimum closing bid price rule.

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<sup>35</sup> Lowry testified that Spear Leeds maintained the high bid from August 8 through September 6, 2002. However, no MMPMR reports were entered into evidence to confirm which market maker posted the closing inside bid during this date range.



Even though Initio had not complied with the closing bid-price rule, on November 20 and 26, 2002, Fox and Holder began negotiating the terms of the merger. These negotiations continued into December 2002 and January 2003. In a letter to Holder, dated November 27, Fox memorialized the terms of the merger. The letter stated that Fox and a business associate would receive put options on Initio stock through the merger.

### **1. Patten manipulated the market activity.**

On November 26 and 27, Patten entered numerous orders to buy substantial amounts of Initio stock. Lowry opined that Patten's trades on these days raised the inside bid and marked the closing inside bid for both days. Placing bids at increasingly higher prices throughout the trading day is an indication of market manipulation. See SEC v. Resch-Cassin & Co., 362 F. Supp. 964, 976 (S.D.N.Y. 1973).

On the following trading days, Patten entered a bid price early in the day and a final bid price after 3:00: November 26 and 27, December 2, 3, 4, 16, 18, 23, 26, 27, 30, and 31. GMIS's bids equaled the inside closing bid of \$1.01 or greater per share on November 26, 27, and 29, and December 3, 4, 18, 19, 20, 23, 24, 26, 27, 30, and 31, and on January 3, 2003. December 2 and 16 were the only days in which GMIS's final bid did not equal the closing inside bid.

The orders placed by GMIS on December 2 and 16, increased the inside bid at the end of the day. On December 2, GMIS raised its bid to \$.98 at 3:36:21, and Cincinnati raised its bid to \$1.01 at 3:43. At 3:51, GMIS raised its bid to \$1.01, but then canceled the bid at 3:54, shortly before the market closed. Cincinnati's bid remained unexecuted at the close of the day and became the closing inside bid. On December 16 at 3:30:29, the inside bid was \$.89. GMIS entered its first order at 3:30:31 for \$.89. GMIS placed two other orders for \$.91 and \$.98. By 3:54:50, the inside bid was \$.91. GMIS then placed its final order for \$.98. Although this order was filled by 3:59:01 and was not the closing inside bid, Lowry testified that these orders caused the inside bid to close at \$.96.

Entering orders or trading late in the day to mark the closing inside bid price constitutes market manipulation. See T.H.C., Inc. v. Fortune Petroleum Corp., U.S. Dist. LEXIS 4039, No. 96 Civ. 2690 (S.D.N.Y. Mar. 31, 1999.) In or about August 2002, Patten warned Fox that he did not want to enter orders late in the day because he had been sanctioned by the NASD in the past for marking the close. Despite this warning, Patten proceeded to place orders or change the limit order price for several orders after 3:00. Specifically, he entered orders for \$1.01 per share or greater after 3:00 on November 26 and 27, as well as December 2, 3, 4, 18, 23, 26, 27, 30, and 31. A day order entered later in the day has less time to be executed and is therefore more likely to remain unexecuted at the close of the trading day. Lowry also explained that placing trades late in the day affects the price of the stock at the end of the trading day.

Further, Patten again entered matched orders with Lifschitz on several trading days in the November-January period. Matched orders are "orders for the purchase/sale of a security that are entered with the knowledge that orders of substantially the same size, at substantially the same price, have been or will be entered by the same or different persons for the sale/purchase of such security." Ernst & Ernst v. Hochfelder, 425 U.S. 185, 205 n.25 (1976). On November 27,

December 26, and December 27, Patten bought stock and Lifschitz sold stock at the same time and through the same market maker. Accordingly, I conclude these trades were matched to create the appearance of real activity in the market. Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 476-77 (1977) (“[Manipulation] refers generally to practices, such as wash sales, matched orders, or rigged prices, that are intended to mislead investors by artificially affecting market activity”).

Finally, domination and control of the trading in a security is an indication of market manipulation. See J.H. Goddard & Co., Inc., 42 S.E.C. 638 (1965). A party who is manipulating the market has domination and control where that party is responsible for a large percentage of the trading volume over a period of time. See SEC v. Resch-Cassin & Co., 362 F. Supp. 964, 976 (S.D.N.Y. 1973). Patten purchased a significant portion of the shares sold during this period. Almost all of the trades during the November-January period involved Patten, Fox, or Lifschitz.

## **2. Patten knew or was reckless in not knowing that he manipulated the market for Initio stock.**

To establish a primary violation of Section 10(b) and Rule 10b-5, it must also be shown that Patten acted with scienter. The scienter requirement may be satisfied by a showing of recklessness. Hollinger v. Titan Capital Corp., 914 F.2d 1564, 1568-1569 (9th Cir. 1990); David Disner, 52 S.E.C. 1217, 1222 & n.20 (1997). The scienter element can be established by the trading patterns and the circumstances surrounding the trading. See Pagel, Inc., 48 S.E.C. 223, 226 (1985). A purpose may be presumed upon a showing of a course of conduct that has the effect of manipulating the securities market for certain stocks. SEC v. Lorin, 877 F. Supp. 192, 196 (S.D.N.Y. 1995). A pattern can be established from as little as three of four bids, purchases, or sales. Kidder Peabody & Co., 18 S.E.C. 559, 568 (1945).

On November 26, Fox and Holder continued merger negotiations. On the same day, Patten began entering bids for Initio stock more than two months after not placing any orders in this stock. Patten entered increasingly higher bids throughout the day and eventually entered the closing inside bid. Patten could not explain why he entered the market after a long hiatus or why he didn't enter the market just few weeks earlier when the price of Initio stock was lower.

On November 27, Fox sent a document to Holder memorializing the terms of the merger at that point. Patten again entered increasing higher bids throughout the day and his final bid equaled the closing inside bid of the day.

On eleven trading days, from November 26, 2002, through January 3, 2003, Patten entered orders, after 3:00, for Initio shares at \$1.01, which set or equaled the closing inside bid on most of those days. Patten argues that the one cannot infer from the trading pattern that he intended keep the closing bid price of Initio stock at \$1.00 or greater for ten consecutive trading days, which the NASDAQ required for Initio to regain compliance. Although there is no evidence that Patten knew that Initio again needed to meet the minimum ten day requirement, he did know that Initio stock needed a closing bid price of at least \$1.00 to maintain a NASDAQ listing. He also knew that it was a violation of securities law to mark the closing bid price. Further, a scheme to maintain the closing bid price at \$1.00 or greater did not need to be successful to establish that Patten acted with

the requisite scienter. See SEC v. Todt, No. 98 Civ. 3980 (JGK), 2000 U.S. Dist. LEXIS 2087, at \*31 (S.D.N.Y. Feb. 25, 2000), aff'd, 2001 U.S. App. LEXIS 6042, No. 00-6101 (2d Cir. Apr. 5, 2001) (Rule 10b-5 prohibits actions that would operate as a fraud if successful, it does not matter that these attempts were unsuccessful).

Lastly, when there is no a persuasive reason for a consistent trading pattern, market manipulation may be indicated. See Reddy v. CFTC, 191 F.3d 109, 117-119 & n.7 (2d Cir. 1999.) Patten maintains that he traded from November 26, 2002, through January 3, 2003, to earn a profit buying and selling the stock. However, there was little profit to be made from buying shares at approximately \$.89-1.01 and selling at \$1.01-1.08, in low volume. Patten stood to gain a much larger profit on his almost 24,000 shares of Initio, if Holder, a successful businessman, gained a controlling interest in the company and increased the company's value.

## SANCTIONS

### A. Cease-and-Desist Order and Associational Bar

Section 21C(a) of the Exchange Act authorizes the Commission to impose a cease-and-desist order on any person who "is violating, has violated, or is about to violate" any provision of the Securities Act of 1933 (Securities Act), the Exchange Act, or the rules and regulations thereunder.

In pertinent part, Section 15(b)(6) of the Exchange Act permits the Commission to sanction persons associated with a broker or dealer if it finds that the sanction is in the public interest and such persons have willfully violated the Securities Act, the Exchange Act, or the rules and regulations thereunder. Specifically, the Commission may censure a broker or associated person, place limitations on the activities or functions of such person, suspend such person for a period not exceeding twelve months, or bar such person from being associated with a broker or dealer.

I have already concluded that Patten willfully violated Section 10(b) of the Exchange Act and Rule 10b-5 and aided and abetted Fox's violation of the same section and rule. Therefore, I must now determine whether a cease-and-desist order and sanctions under Section 15(b)(6) of the Exchange Act are appropriate.

In making this determination, the Commission considers the following factors:

[T]he egregiousness of the respondent's actions; the isolated or recurrent nature of the infraction; the degree of scienter involved; the sincerity of the respondent's assurances against future violations; the respondent's recognition of the wrongful nature of his conduct; and the likelihood that the respondent's occupation will present opportunities for future violations.

Steadman v. SEC, 603 F.2d 1126, 1140 (5th Cir. 1979), aff'd on other grounds, 450 U.S. 91 (1981). No one factor controls. See SEC v. Fehn, 97 F.3d 1276, 1295-1296 (9th Cir. 1996).

In addition to the Steadman factors discussed above, in determining whether to impose a cease-and-desist order, the Commission considers whether there is a risk of future violations, whether the violation is recent, the degree of harm to investors or the marketplace resulting from the violation, and the remedial function to be served by the cease-and-desist order in the context of any other sanctions being sought in the same proceedings. KPMG Peat Marwick LLP, 54 S.E.C. 1135 (2001). The Commission explained that the Division must show some risk of future violations. However, it also ruled that such a showing should be “significantly less than that required for an injunction, and that, “absent evidence to the contrary,” a single past violation ordinarily suffices to raise a significant risk of future violations. Id. at 1185, 1191.

Patten’s explanation of his conduct persuades me that he does not understand the wrongfulness of his actions. Patten denies that the trades he placed during the relevant period were entered to manipulate the price of Initio stock. Further, he maintains that, as Fox’s broker, he was required to enter trades for Fox in August and September 2002, and that it was not necessary to question the fact that the president and director of the issuer placed several large trades, for \$1.01 per share, in a short period of time, for a thinly traded stock. Patten’s actions were egregious. They occurred over an extended period of time and involved a high degree of scienter.

Patten’s age and occupation pose the risk that he may commit future violations of the securities laws. As Patten is forty-six years old, he could have many more years to work in the securities industry. He has previously been sanctioned by the NASD for the same conduct. Further, he is currently employed by Empire Financial Group, which could enable him to participate in the same type of conduct in the future.

Viewing the Steadman and KPMG factors in their entirety, I conclude that a cease-and-desist order and a bar from association with any broker or dealer are appropriate in the public interest. There are no mitigating circumstances in this case to warrant lesser sanctions.

## **B. Civil Penalty**

Under Section 21B(a) of the Exchange Act, the Commission may impose a civil monetary penalty if a respondent has willfully violated any provision of the Securities Act, the Exchange Act, or the rules and regulations thereunder. It must also find that such a penalty is in the public interest. In considering whether a penalty is in the public interest, the Commission may consider the following six factors: (1) fraud; (2) harm to others; (3) unjust enrichment; (4) prior violations; (5) need for deterrence; and (6) such other matters as justice may require. See Section 21B(c) of the Exchange Act.

Section 21B(b) of the Exchange Act specifies a three-tier system for determining the maximum amount of a penalty. For each “act or omission” by a natural person, the maximum amount of a penalty is \$5,000 in the first tier; \$50,000 in the second tier; and \$100,000 in the third

tier.<sup>36</sup> A second-tier penalty is permissible if the act or omission involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement.

A third-tier penalty is permissible for an act or omission that not only must have involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement, but also must have “directly or indirectly resulted in substantial losses or created a significant risk of substantial losses to other persons or resulted in substantial pecuniary gain to the person who committed the act or omission.”

In this matter the Division asks for a second-tier penalty of \$60,000 for each of the thirty-four separate trading days in which Patten entered manipulative buy orders. Patten did not derive a substantial financial benefit from the fraudulent scheme. The manipulative orders and trading during the relevant period constitute one scheme. Thus, a total penalty of \$60,000, along with the other sanctions, is sufficient in the public interest to deter future violations of the securities laws.

### **CERTIFICATION OF THE RECORD**

Pursuant to Rule 351(b) of the Commission’s Rules of Practice, 17 C.F.R. § 201.351(b), I hereby certify that the record includes the items set forth in the record index issued by the Secretary of the Commission on November 23, 2005.

### **ORDER**

Based on the findings and conclusions set forth above:

IT IS ORDERED THAT, pursuant to Section 21C of the Securities Exchange Act of 1934, James T. Patten shall cease and desist from committing or causing any violations or future violations of Section 10(b) of the Securities Exchange Act of 1934, and Rule 10b-5 thereunder;

IT IS FURTHER ORDERED THAT, pursuant to Section 21C of the Securities Exchange Act of 1934, James T. Patten shall cease and desist from aiding and abetting any violations or future violations of Section 10(b) of the Securities Exchange Act of 1934, and Rule 10b-5 thereunder;

IT IS FURTHER ORDERED THAT, pursuant to Section 21B of the Securities Exchange Act of 1934, James T. Patten shall pay a civil penalty in the amount of \$60,000;

IT IS FURTHER ORDERED THAT, pursuant to Section 15(b)(6) of the Securities Exchange Act of 1934, James T. Patten is barred from association with any broker or dealer.

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<sup>36</sup> As required by the Debt Collection Improvement Act of 1996, the Commission increased the maximum penalty amounts for violations occurring after December 9, 1996, and, again for violations occurring after February 2, 2001. 17 C.F.R. §§ 201.1001, .1002. For a natural person, the adjusted maximum penalty amounts for each violation occurring after February 2, 2001 were \$6,500 (tier one), \$60,000 (tier two), and \$120,000 (tier three). 17 C.F.R. § 201.1002.

Payment of the civil penalty shall be made on the first day following the day this initial decision becomes final. Payment shall be made by certified check, United States Postal money order, bank cashier's check, or bank money order, payable to the U.S. Securities and Exchange Commission. The payment, and a cover letter identifying the Respondent and the proceeding designation, shall be delivered to the Comptroller, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, Virginia 22312. A copy of the cover letter and the instrument of payment shall be sent to the Commission's Division of Enforcement, directed to the attention of counsel of record.

This Initial Decision shall become effective in accordance with and subject to the provisions of Rule 360 of the Commission's Rules of Practice, 17 C.F.R. § 201.360. Pursuant to that Rule, a party may file a petition for review of this Initial Decision within twenty-one days after service of the Initial Decision. A party may also file a motion to correct a manifest error of fact within ten days of the Initial Decision, pursuant to Rule 111 of the Commission's Rules of Practice, 17 C.F.R. § 201.111. If a motion to correct a manifest error of fact is filed by a party, then that party shall have twenty-one days to file a petition for review from the date of the undersigned's order resolving such motion. The Initial Decision will not become final until the Commission enters an order of finality. The Commission will enter an order of finality unless a party files a petition for review or a motion to correct a manifest error of fact, or the Commission determines on its own initiative to review the Initial Decision as to a party. If any of these events occur, the Initial Decision shall not become final as to that party.

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Robert G. Mahony  
Administrative Law Judge

