

INITIAL DECISION RELEASE NO. 304
ADMINISTRATIVE PROCEEDING
FILE NO. 3-11813

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

In the Matter of :
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 MARKETXT, INC., : INITIAL DECISION
 and IRFAN MOHAMMED AMANAT : December 22, 2005
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APPEARANCES: Kathleen Furey, Valerie Szczepanik, and Nancy Brown for the Division
of Enforcement, United States Securities and Exchange Commission

Martin Siegel and David Molton for Irfan Mohammed Amanat

BEFORE: Lillian A. McEwen, Administrative Law Judge

SUMMARY

This Initial Decision concludes that Respondent Irfan Mohammed Amanat (Amanat) did not violate Section 10(b) of the Securities Exchange Act of 1934 (Exchange Act) and Rule 10b-5 thereunder. It further concludes that Amanat did not willfully aid and abet or cause MarketXT, Inc. (MarketXT), to violate Section 15(c)(1)(A) of the Exchange Act. This Initial Decision dismisses all charges against Amanat.

PROCEDURAL HISTORY

The Securities and Exchange Commission (Commission or SEC) issued its Order Instituting Proceedings (OIP) on February 9, 2005, pursuant to Section 15(b) and 21C of the Exchange Act. Amanat filed his Answer on March 21, 2005. Respondent MarketXT submitted an Offer of Settlement, which the Commission accepted on June 17, 2005. MarketXT, Inc.,

Exchange Act Release No. 51864. Thus, this Initial Decision addresses the charges in the OIP related only to Amanat.¹

I held a five-day public hearing in May and June in New York, New York, which ended on June 6, 2005. The Division of Enforcement (Division) called eight witnesses and introduced forty-three exhibits. Amanat testified at the hearing and he called two witnesses and introduced seventeen exhibits. The parties also submitted one joint exhibit (Jt. Ex. 1). The parties filed post-hearing briefs and proposed findings of fact and conclusions of law, the last of which was received August 30, 2005.²

ISSUES PRESENTED

The OIP alleges that Amanat executed thousands of fraudulent wash trades and matched orders over a three-day period in March 2002 in order to improperly qualify MarketXT for a tape revenue rebate program offered by the NASDAQ Stock Market, Inc. (NASDAQ). As a result of the fraudulent wash trades and matched orders, the OIP alleges that Amanat willfully violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and willfully aided and abetted and caused MarketXT's violation of Section 15(c)(1)(A) of the Exchange Act. If I conclude that the allegations in the OIP are true I must then determine what remedial sanctions, if any, are appropriate.

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 for the Division's case. See Steadman v. SEC, 450 U.S. 91, 102 (1981). I have considered and rejected all arguments and proposed findings of fact and conclusions of law that are inconsistent with this Initial Decision.

Irfan Amanat

Amanat, a thirty-four-year-old graduate of Johns Hopkins University, has a degree in biomechanical engineering. He eventually abandoned his PhD studies to assist his brother, Omar Amanat, as a computer programmer in the securities industry, at Cyber Trading and then later at Momentum Securities (Momentum). (Tr. June 6 at 58-64.) Although Amanat holds no securities licenses, he and his team were responsible for several technological innovations that enhanced trading efficiency. (Tr. June 6 at 65-66, 274-75.) He developed, designed, and implemented:

¹ On August 16, 2005, Amanat filed a Motion in Limine to preclude, exclude, or have the undersigned reject the declaration of Stephen Ehrlich, or, in the alternative, to admit the handwritten notes of Amanat dated March 27, 2002. The motion is denied.

² Citations to the transcript of the hearing will be noted as "(Tr. May or June __ at __.)" Citations to the Division's and Amanat's exhibits will be noted as "(Div. Ex. __.)" and "(Resp. Ex. __.)" respectively. Citations to the Division's post-hearing brief will be noted as "(Div. Post-Hr. Br. at __.)" and citations to Amanat's post-hearing brief will be noted as "(Resp. Post-Hr. Br. at __.)"

Cybertrader, Lightspeed (LSPD), and other platforms for decimal arbitrage, electronic trading, and elimination of inefficiencies. (Tr. June 3 at 30-34.) The two brothers formed Tradescape Technologies (Tradescape), a technology firm based in New York City, in May 1997. (Tr. June 3 at 6-14.)

At Tradescape, they soon developed smart order routing technology (SORT) to “hunt and seek and find the best price,” through the market, without a market maker. (Tr. June 3 at 15.) Tradescape Corporation is the parent company of several entities including: Momentum, MarketXT, and Tradescape Technology Holdings (the parent of Tradescape) (collectively, Related Entities). (Tr. June 2 at 85-86; Tr. June 3 at 22.) Omar Amanat was the chief executive officer of all the Related Entities and Tradescape Corporation. (Tr. June 2 at 85; Div. Exs. 36, 37.) Both Tradescape and Momentum used programs written in C++ and Visual Basic. They were both affiliated with MarketXT, whose system was written in Java. (Tr. May 25 at 32.) Amanat was paid by Tradescape, and in 2002, he made \$225,000 per year and was a director of Tradescape Corporation. (Tr. June 6 at 74-76.) Amanat was not responsible for raising money for Momentum or MarketXT. (Tr. June 6 at 76.)

In 1999, Tradescape acquired Momentum, an on-line broker-dealer with thirty branch offices. (Tr. May 25 at 31, Tr. June 3 at 19-22.) Momentum customers were unlicensed investors trading in their own accounts on the computer system set up in the Momentum office in Houston, Texas. (Tr. June 2 at 358.) James H. Lee (Lee) and Jay Earnest started the firm in 1994. (Tr. June 2 at 359.) Initially, Momentum’s retail customers entered orders via one of the eight licensed brokers on site, but eventually were able to place their own trades. Their orders were entered on a NASDAQ level-two station. (Tr. June 2 at 360.) After being acquired by Tradescape, much of the old small-order execution system (SOES) had changed and become extinct. (Tr. June 2 at 361-62.)

MarketXT, Inc.

In 2000, Tradescape acquired MarketXT a broker-dealer in New York City, which eventually became an Electronic Communications Network (ECN). (Tr. June 2 at 364; Tr. June 3 at 19-21, 83-84.) An ECN is an electronic communications network that matches buyers and sellers for electronic securities trading in securities in the marketplace. (Tr. June 1 at 228.) A broker-dealer achieves ECN status by filing a registration with the SEC Division of Market Regulation, which is responsible for Self-Regulatory Organizations’ Rule compliance. No-action letters are then issued to the ECN. (Tr. June 1 at 228-30; Div. Ex. 11.) MarketXT was the first ECN to become a member of NASDAQ’s execution system in NASDAQ securities, Super SOES. (Tr. June 1 at 233-34.)

Pursuant to the December 1999 request of MarketXT, the Commission issued a no-action letter in January 2000 that allowed MarketXT to operate as an ECN. (Div. Ex. 11.) MarketXT then could operate an “electronic system that widely disseminates to third parties orders entered therein by an exchange market maker or over the counter (OTC) market maker, and permits such orders to be executed in whole or in part.” (Div. Ex. 11.) Participants could enter orders into the system electronically through a dedicated line. The system disseminated those orders to all other participants, any of which might effect executions against displayed orders. Participants

included at least one registered NASDAQ market maker. Orders displayed in the system were available to be executed in whole or in part by all participants.

As an ECN, MarketXT had many special obligations. It was obligated to comply with the requirements under the ECN Display Alternative set forth in the ECN Amendment with respect to NASDAQ securities for which linkage between MarketXT and the NASDAQ system would be operational. MarketXT had sufficient capacity to handle the volume of trading reasonably anticipated in its system. Such capacity would be ensured through periodic review and testing to: (1) ensure future capacity; (2) identify potential weaknesses; and (3) reduce the risks of system failures and threats to system integrity. Trading information entered into MarketXT must be kept confidential by those employees of MarketXT having access to it, and the operation of the system must be kept separate from the other business of MarketXT. (Div. Ex. 11.)

The ECN Amendment provides, among other things, that a priced order entered by an exchange specialist or OTC market maker into an ECN that widely disseminates such orders is a bid or offer under the Quote Rule to be communicated by the specialist or market maker to its exchange or association. The ECN Display Alternative, however, provides that an exchange specialist or OTC market maker has complied with the ECN Amendment if the ECN it uses: (1) provides to a self-regulatory organization for inclusion into the public quotation system the prices and sizes of such orders at the highest buy price and lowest sell price for the security; and (2) provides to any broker or dealer the ability to effect transactions with such orders that is equivalent to the ability of any broker or dealer to effect a transaction with an exchange specialist or OTC market maker pursuant to the rules of the self-regulatory organization receiving the prices from the ECN for inclusion in the public quotation system. (Div. Ex. 11 at 1-2.)

Pursuant to negotiations with NASDAQ, on or about January 11, 2000, MarketXT provided to NASDAQ, over an operative electronic linkage, the requisite data concerning best prices and sizes that exchange specialists, OTC market makers, and non-market maker participants (who so request) had entered in securities quoted on NASDAQ. MarketXT allowed broker-dealers the ability to effect transactions with orders in MarketXT via SelectNet linkage or through a telephone desk staffed by employees who met applicable NASD qualification standards. MarketXT provided access to broker-dealers via either SelectNet or the telephone for a charge of no more than the then-current highest rate charged to a substantial proportion of the active broker-dealer participants in the system, and in any event, no more than \$0.015 per share, plus any fees charged to MarketXT by NASDAQ for SelectNet trades and any applicable transaction fee payable pursuant to Section 31 of the Exchange Act. Finally, MarketXT was obligated, as an ECN, to provide response times for orders entered into MarketXT through SelectNet access no slower than the response time MarketXT offered to subscribers who entered orders directly into the system, and in any event not more than a few seconds. (Div. Ex. 11 at 1-2.)

MarketXT, whose sixty traders and staff were originally located in the World Trade Center, was shut down for some period after September 11, 2001. By early 2002, the office had reorganized and relocated to 57th Street in Manhattan. (Tr. June 3 at 25-26.) MarketXT generated income by charging fees to traders, per share traded. (Tr. May 25 at 68-69.)

MarketXT competed with other ECNs, which operated to match orders; they provide “exchange-like services” to enable consolidation of market data and publication of “a national best bid and offer.” (Tr. May 25 at 69-71.) By March 15, 2002, MarketXT had executed over 140 million shares, 90% of the volume of Island, the largest ECN. At the time, NASDAQ volume was down 60% for the year. (Tr. June 3 at 159.)

MarketXT collected 91% of its receivables in 2001, with the usual sixty-to-ninety-day collection time. (Tr. June 3 at 139-42.) Like other ECNs since 1967, however, MarketXT was embroiled in controversy among market participants over charging access fees. (Tr. June 3 at 142.) Division Exhibit 39, the termination notice from NASDAQ, indicates that MarketXT owed NASDAQ \$275,000 in fees. However, MarketXT, NASDAQ’s largest customer, contended that NASDAQ owed them money because MarketXT should be compensated in the same way that market makers were rewarded, in the form of rebates by NASDAQ. (Tr. June 3 at 165-66.) On July 29, 2002, the NASD ordered MarketXT to cease operating because it had failed to maintain required net capital. (OIP at 9; Jt. Ex. 1 at 2.) On that same day MarketXT notified the Commission that it was unable to prove compliance with its net capital obligations under Rule 15c3-1 of the Exchange Act. (Jt. Ex. 1 at 2.) MarketXT’s ECN No-action letter was revoked by the Commission on August 8, 2002. (Jt. Ex. 1 at 3.) By August 2002, MarketXT was evicted from its office space. The corporation brought a civil suit against E*Trade shortly thereafter. (Tr. June 6 at 32-33.) MarketXT is currently in bankruptcy. (Tr. June 3 at 80.)

NASDAQ’s Tape Rebate Program

In March 1999, the tape rebate program had been proposed by NASDAQ to the Commission pursuant to a proposed rule change. (Div. Ex. 9.) The program was approved and then extended in January 2002. (Div. Ex. 10.) NASDAQ’s Third Market is a quotation, communication, and execution system which allows NASD members to trade stocks listed on the New York Stock Exchange (NYSE) and the American Stock Exchange (AMEX). The Third Market competes with regional exchanges like the Chicago Stock Exchange (CHX) and the Cincinnati Stock Exchange (CSE) for retail order flow in stocks listed on the NYSE and AMEX. The NASD collects quotations from broker-dealers that trade these securities over-the-counter and provides such quotations to the Consolidated Quotation System for dissemination. Additionally, the NASD collects trade reports from these broker-dealers trading such securities in the over-the-counter market and provides the trade reports to the Consolidated Tape Association (CTA/CQA) for inclusion in the Consolidated Tape. As a participant in the CTA and CQA, the NASD earns a share of those organizations’ revenue from trades that it reports in NYSE-listed securities (Tape A) and in AMEX-listed securities (Tape B). It is from the NASD’s share of these revenues that NASDAQ created credit pools for qualified members. Both CHX and CSE established similar programs. To remain competitive with these markets, the NASD must evaluate programs designed to effectively respond to other market’s approaches to trading the same securities.

The rebate program provided a transaction credit to NASD members who exceeded certain levels of trading activity in exchange-listed securities. The NASD had determined to establish a program regarding these transaction credits to assist in finding ways to lower investor costs associated with trading and to respond to steps taken by other exchanges that compete for

investor order flow in these securities. The NASD established the program as a limited period pilot program to develop experience with assisting NASD members trading in exchange-listed securities and to learn how best to lower the cost of these securities. (Div. Ex. 9 at 2.)

Pursuant to the tape rebate program, NASDAQ first calculated two separate pools of revenue from which credits could be earned – one represented 40% of the gross revenues received from the CTA for providing trade reports in NYSE-listed securities executed in the Third Market for dissemination by CTA (Tape A). The other represented 40% of the gross revenue received from the CTA for reporting AMEX trades (Tape B). To earn a credit from either of these pools, a NASD member must have reached a minimum trading level in that market segment, 500 average daily executions in Tape A or 500 average daily executions for Tape B. Only NASD members who both exceeded this 500 average daily execution threshold and continued to average either 500 or more Tape A or 500 more Tape B daily executions during the term of the pilot would be eligible for transaction credits. NASD members became part of the pilot's control group and, thus, would be eligible to receive a pro-rata portion of the 40% revenue calculation during the term of the pilot.

The NASD chose to establish the threshold for qualification at 500 trades per day because such number represents a clear example of a member's commitment to operating in the Third Market and competing for order flow. It also is being used as a rough, temporary measure to balance the credit program incentives against NASDAQ's costs in operating facilities that facilitate Third Market trading. A qualifying NASD member's transaction credit under the calculation is determined by taking its percentage of total Third Market Transactions during the applicable calculation period and providing an equivalent percentage from the appropriate Tape A or Tape B calculation pools. Thus, for each calendar quarter, NASD measures qualified member's trade reported activity for that calendar quarter in each Tape A or Tape B and creates a credit for the member based upon such activity. For example, should a qualifying NASD member's transactions represent 10% of the NASD's Tape A transactions, that member would receive a 10% share of the Tape A 40% calculation pool. The rebate program, thus, is intended to both lower costs for Third Market Makers and for their customers, who execute trades in exchange-listed stocks through NASD members and NASD facilities. The NASD believes that lowering the cost of trading increases competition among market centers trading listed securities. The program will allow NASDAQ to evaluate the efficacy of this revenue sharing model and more effectively compete for the retention of Third Market participants with other regional exchanges who have adopted similar revenue distribution methodologies.

Putting the Automated Tape Rebate Program in Place

The tape rebate program is administered through the CTA. The CTA is “made up of the nine United States Stock Exchanges to consolidate and redisseminate market data pursuant to the Commission's regulations.” (Tr. June 1 at 65.) From the Securities Industry Automation Corporation (SIAC), a technology house owned jointly by the NYSE and AMEX, the consolidated data is sent to vendors such as Reuters and Bloomberg and from them it is sent to end users such as broker-dealers and individual investors. (Tr. June 1 at 66-69.) SIAC splits the data into Tape A and Tape B. (Tr. June 1 at 68-69.) CTA collects monthly fees from vendors for accessing the data and from end users for viewing the data. (Tr. June 1 at 69.) In turn, fees go to

the Tape A Administrator and Tape B Administrator. (Tr. June 1 at 70-71.) The CTA operating committee meets quarterly, with exchanges rotating host duties.

At the end of each quarter, after deduction of CTA costs, the revenues are split between Tape A and Tape B. The Tape B administrator, Kerry Baker-Relf (Baker-Relf), in turn divides and disperses the revenue to the nine exchanges after receiving the trade reports, based on “which percentage of trading each market did.” (Tr. June 1 at 75-77.) Thus, the CTA plan requires that revenue share be based on “number of trades.” (Tr. June 1 at 86-87.) Tape B, which includes AMEX and other exchanges, has historically had higher number of shares reported onto the consolidated tape (or print value) than Tape A, which includes only the NYSE. (Tr. June 1 at 90-92.) In 2002, the Tape A print value for the first quarter was \$0.37, whereas the value for Tape B was \$4.02. (Tr. June 1 at 92.) If “illegitimate trades are reported by one of the exchanges . . . one market would end up getting more revenue than they should have.” (Tr. June 1 at 92-93.)

The number of trades reported to the tapes determines the allocation of revenue from the fees. (Tr. June 1 at 110-11.) Each participating market reports its trades to SIAC. “SIAC counts up those trades and sends a report to each administrator at the end of each month.” (Tr. June 1 at 111.) The SIAC report is thus a monthly report of trades reported. (Tr. June 1 at 110-11.) Baker-Relf uses the SIAC report to divide each market’s number to arrive at “the proportional allocations” for each quarter to two decimal places. (Tr. June 1 at 110-11.)

General crucial steps in the implementation of the new automated program were performed by the SIAC. It was engaged “to serve as the processor of last sale price information reported to it for inclusion in the consolidated tape.” (Resp. Ex. 4 at 20.) The primary functions of the processor include: to maintain and operate computer equipment; to maintain and publish technical specifications for reporting of last sale price information over “high speed line facilities”; and to maintain last sale price information for use by participants. (Reps. Ex. 4 at 20-21.) Contracts with the processor authorize “the processor to process all last sale price information furnished to it, to validate the information, to sequence reports of last sale prices received on the basis of the time received by the processor . . . and to transmit such consolidated information.” (Resp. Ex. 4 at 21-22.)

The processor makes last sale price information available by means of the high speed line: (a) to the vendors and other persons, (b) at the premises of the processor, (c) in the sequence in which it receives the prices, and (d) insofar as such prices have not been rejected by the validation process. Technical specifications describing the reporting formats for both computer-to-computer and manual reporting of last sale price information to the processor were developed by technical representatives of the participants of the processor, and have been furnished to the SEC for its information. (Resp. Ex. 4 at 22-26.)

The Related Entities Employees and Work Leading up to the Automated Trading Program

The transformation of MarketXT into an ECN required the combined expertise of many talented people and presented a great challenge for the broker-dealer. Brian Nigito (Nigito), a 2001 graduate of Stevens Institute of Technology, began working at Tradescape while he was still a senior in college. (Tr. May 25 at 28.) As Tradescape’s senior Java developer, Nigito

worked on SORT for MarketXT, where customer buy and sell orders were matched, prices were set, and execution reports were sent to customers by computer. (Tr. May 25 at 33-34.) Nigito also oversaw quality assurance for the matching engine, although he reported to Amanat, the chief technology officer at Tradescape. (Tr. May 25 at 34-35.) Nigito was hired by Tradescape to develop Java technologies for MarketXT. During his tenure at Tradescape, Nigito was given substantial raises and management responsibility. (Tr. May 25 at 42.) When Nigito joined MarketXT in 2001, he was paid \$110,000 per year. By the time he quit on March 25, 2002, he was making \$175,000 per year. (Tr. May 25 at 211-12, Tr. June 2 at 12.)

Amanat could not code Java or C++. Amanat did not code, but he was responsible for overall coordination. (Tr. June 6 at 73.) The programming management team at MarketXT, consisting of Amanat, Robert Chaffey, and Sohail Khalid, determined priorities and had input into which programmers received raises and promotions. (Tr. May 25 at 39-42.) Amanat was head developer with responsibility for all programming and coding for end users. (Tr. June 2 at 165.)

Mike Bundy (Bundy), in Houston, was responsible for M-trade, the Momentum trading platform. (Tr. June 2 at 363.) Bundy was not an employee of Momentum; he was a member of the technical staff section of Tradescape, and a vice president who reported to Amanat. (Tr. June 2 at 6-7, 32-35, 76.) When Tradescape acquired Momentum in 1999, Bundy, with one year of college education, was paid \$300,000 per year. However, in late 2001, Bundy received a 25% pay cut. (Tr. June 2 at 77-78.) Bundy knew Nigito as the “principal developer of the core MarketXT system.” (Tr. June 2 at 10-11.)

Bundy programmed order-routing systems, developed systems, and managed employees. Amanat, as chief technology officer, was responsible for technology development. (Tr. June 2 at 6-7, 32-35.) Amanat solved programming problems. Bundy developed and maintained most of the components of the MarketXT system that communicated with external systems, such as stock exchanges. (Tr. June 2 at 8, 79-80.)

Elisabeth Cummins (Cummins), with Series 7, 63, and 24 licenses, and based in Houston, wrote procedures for the entire firm and was the compliance officer at Momentum. Dan Connell (Connell) was her counterpart in New York and was the chief operating officer at Momentum. (Tr. June 2 at 123, 315-20, 365-66.) Cummins had no role in MarketXT operations or compliance. (Tr. June 2 at 315-20.) Her highest annual salary was \$150,000. In the first quarter of 2002, Cummins was working from home and at the time of the hearing Cummins was not employed. (Tr. June 2 at 367-68.) Pursuant to the merger agreement with Momentum, most of the daily operations in Houston were performed by Lee, with a staff of seventy-five people. (Tr. June 3 at 23-24.) For Momentum, compliance issues were handled by Connell, Lee, and Cummins. For MarketXT, in New York City, Robert Zaofi, Dan Ryan, and Ketroa Smith handled compliance. (Tr. June 6 at 88-89.)

Scott Ignall (Ignall), a graduate of the University of Pennsylvania with a degree in urban and environmental design, became a “trader” in 1996 and in 1997; he was employed at CS Block, which then became a part of Tradescape. (Tr. June 2 at 163-65.) Scott Ignall (Ignall) was in charge of LSPD, which used C++. (Tr. June 6 at 72-73.) By 1997, Ignall held series 7, 63, and

24 licenses, but he has no background in compliance, and he is not an attorney. (Tr. June 2 at 164, 266.) In the first quarter of 2002, as vice president of technology at Momentum Securities, Ignall reported to Amanat among others.³ (Tr. June 2 at 165.)

In March 2002, Brian Ignatowitz (Ignatowitz) was manager of the purchase and sales department at Momentum, in New York City. He was responsible for reconciling trades internally and with a clearing firm, and he handled problems with the traders and computer programmers. (Tr. June 2 at 82-84.) Ignatowitz has Series 7 and 63 licenses. (Tr. June 2 at 122.) He reported to Connell, but he spoke to Amanat daily about the traders, the market, and technical matters. (Tr. June 2 at 84-85.) Through e-mails and personal visits to his office, Ignatowitz communicated with Omar Amanat several times a week. (Tr. June 2 at 86.)

In late 2001, MarketXT began using Super SOES Technology. SOES was the small order execution system that enabled a retail trader to send orders to market makers to be executed. Super SOES lifted many restrictions and allowed professional traders and market makers to “use it to execute against both market makers and ECNs . . . to be able to hit the best bid/offers out there.” (Tr. June 6 at 78.) MarketXT was the first ECN to integrate Super SOES. The problem with implementation was that if you “post a quote on NASDAQ on Super SOES you are required to fill it. You get 100% execution any time you get a market order.” (Tr. June 6 at 78.) Because MarketXT was faster than NASDAQ technology “a trader would cancel the order and then later on we would get the execution. We basically were doubling our exposure” to market risk. (Tr. June 6 at 78.) NASDAQ actively assisted MarketXT efforts to become integrated into Super SOES. (Tr. June 6 at 78-79.) Amanat built interfaces to NASDAQ from Momentum. Because the interfaces were built in Java code, Amanat supervised Nigito. (Tr. June 6 at 79.) MarketXT, thus, was working closely with NASDAQ in 2002.

The NASDAQ Super SOES order-routing technology does not allow an ECN to choose whether it wants to accept the order that its price display has generated. MarketXT became an ECN that used Super SOES in spite of possible liability. Now simultaneous limit orders could be expressed to the majority of liquidity available in the marketplace. (Tr. June 3 at 60-61.) By March 11, 2002, in 120 stocks, using its LSPD technology, MarketXT was the “first ECN to accept Super SOES executions in NASDAQ securities. Prior to MarketXT’s move none of the ECNs chose to accept Super SOES executions due to the potential for dual liability.” (Resp. Ex. 13.) MarketXT took the risk “to quickly build its market share.” (Resp. Ex. 13.)

During the first quarter of 2002, Amanat was working on twenty-five different projects involving code, with Super SOES interface given the highest priority; four or five strategies for automated trading were being coded and developed. (Tr. June 6 at 94-95.) The first automated trading program that Amanat wrote involved “a basic form of index arbitrage.” (Tr. June 6 at 96.) Amanat had also written day-trading software in Visual Basic for Windows applications. (Tr. May 25 at 35-38.) Major programming efforts at MarketXT had been devoted to integrating

³ In late 2002, E*Trade bought out Momentum securities. Bundy and Amanat then commenced employment at E*Trade. (Tr. June 2 at 24-25.) In January 2003, Amanat was fired from E*Trade. (Tr. June 6 at 261-62.) On the date of the hearing, Ignall was employed at E*Trade Capital Markets. (Tr. June 2 at 163-64.)

trading with NASDAQ's Super SOES, that enabled "small investors to receive automatic electronic executions without market maker intervention." (Tr. May 25 at 44.)

Amanat regularly contacted NASDAQ for assistance with technical interfaces, business ventures, and coding. (Tr. June 6 at 81.) Because Momentum could calculate in milliseconds (thousandths of a second), its system could respond, execute, and cancel orders faster than NASDAQ could. A market order on MarketXT could be executed in 15 milliseconds. (Tr. June 6 at 83.) Specifications for the NASDAQ interface were generated by NASDAQ and delivered to MarketXT in large binders. Amanat helped to supervise the technology that enabled MarketXT to become the first ECN to use Super SOES. (Tr. June 6 at 84.) The NASDAQ technical specifications also included compliance data imbedded in them. Of course, even a typographical error in the technical specifications might cause the programming to fail in its first applications. (Tr. June 6 at 87.)

By early 2002, mirroring was in MarketXT technology to add liquidity to the marketplace by enabling a search for placement of best price to occur simultaneously on multiple market centers. (Tr. June 3 at 34-35.) Trades at computer terminals accounted for 99.9% of Momentum trading by then. (Tr. June 3 at 37.) The newest technology being tested by Amanat in early 2002 was automated of the kind at issue in the instant case, where a software program executed a trading strategy without further manual input. (Tr. June 3 at 37-38.)

During February and March 2002, Omar Amanat, who holds Series 7 and 24 licenses, was actively involved in, and obsessed with, auctioning off Momentum and some parts of Tradescape. (Tr. June 3 at 80.) In the first quarter of 2002, Tradescape conducted 164,000 trades per day via Momentum, making it the largest trade volume on-line brokerage in the United States. (Tr. June 3 at 40-44.) Prospective buyers "wanted to replace their older aging technology with our new systems." (Tr. June 3 at 43.)

A significant source of income for Momentum came in the form of liquidity rebates. Momentum and MarketXT profited from the spread between fees for buying and selling securities, but these profits depended on high volumes of trading. The goal was to receive more rebates than they paid in fees. (Tr. June 6 at 106-07.) By January, Amanat "was already successfully doing arbitrage trading between Island and MarketXT and other ECNs." (Tr. June 6 at 110.) When Island began offering a market data rebate for each trade by Momentum on Island, Island was earning \$9 million in market data rebates. (Tr. June 6 at 111.)

For the first three months of 2002, MarketXT was testing new technology with NASDAQ. Problems with the interface resulted in development costs, double executions, and overfills. (Tr. June 3 at 71-72.) In early 2002, fierce competition from firms like Island resulted from the increased MarketXT trading volume, which it had taken away from Island. Ultimately, through the hiring of highly trained talent, like Nigito, from MarketXT, and through the loss of intellectual property, MarketXT was effectively put out of business. (Tr. June 3 at 52-54.)

The Automated Trading Program

In December 2001, Amanat learned about market data rebates at “a conference sponsored by NASDAQ.” (Tr. June 6 at 98.) Amanat met Erich Buckenmaier (Buckenmaier), the head of NASDAQ listed trading. Buckenmaier discussed the intermarket trading system/computer automated execution system (ITS/CAES), an order-routing system from NASDAQ to route orders to exchanges and market makers for listed securities. Buckenmaier told Amanat that NASDAQ’s market data rebate program was a promotion to increase their volume. (Tr. June 6 at 113-14.) Amanat and two other Momentum employees had patented SORT to take and send a trader’s order to the best place to fill it. (Tr. June 6 at 98-99.) The SORT system sped up routing by eliminating the need for a broker between crucial stages of the order. Best execution might be determined in less than 50 milliseconds. (Tr. June 6 at 101.) Buckenmaier encouraged Amanat to move MarketXT to the ITS/CAES, and briefly mentioned market rebates. (Tr. June 6 at 102.) Buckenmaier had encouraged increased trading volumes on ITS/CAES. (Tr. June 6 at 162-65; Resp. Ex. 15.) Amanat knew that the SEC had approved the tape rebate program. (Tr. June 6 at 186-87; Resp. Ex. 17.)

Nigito discussed the possibility of market data revenue rebates with NASDAQ representatives from the intermarket tape system. (Tr. May 25 at 61-62.) Among trading strategies that Nigito discussed with Amanat, market data revenue emerged as an incentive where rebates of the charges might lower transaction costs of trades. (Tr. May 25 at 48-49.) Nigito also discussed the rebate program with Amanat in late February 2002 as a component of the Tradescape trading strategy in exchange traded funds (ETFs). (Tr. May 25 at 63-64.) By the first week of March 2002, however, Nigito had given notice to Tradescape that he was departing to work for Island, a competitor. (Tr. May 25 at 63-64.)

At the end of 2001, Connell told Amanat to work on automated trading systems. By March 2002, Amanat had been working on the automated system for a little over two months. (Tr. June 6 at 89.) Amanat was also exploring arbitrage at this time. Automated trading could exploit price differences of smaller than one penny quotes for a profit, if you “automatically put in quotes and automatically cover an execution.” Automated trading is based on “limits pricing between markets.” (Tr. June 6 at 93.)

MarketXT programs enabled trades to four decimal places in ETFs “like the QQQ,” where “the public quote was typically to two decimal places.” (Tr. May 25 at 51-52.) The resulting “matching or mirroring” strategy could result in the ability to purchase “near instantaneously” a derivative at \$35.03 and see it at \$35.035. Because the transaction on the sell side was “reported to the tape” the transaction generated market data revenue for MarketXT. (Tr. May 25 at 51-52.) The programming also allowed a statistical arbitrage strategy that exploited the relationship or spread between the NASDAQ 100 QQQ and the price of Microsoft stock. (Tr. May 25 at 53.) Amanat had already begun profitable arbitrage trading in ETFs in January 2002 because the national best bid offer in them was not well known, and because ETFs could be shorted under some circumstances. (Tr. June 6 at 178-81.)

Several unrelated companies provide “matching services” for the same product. As a result of this competition a stock like Cisco, for example, could trade on up to nine different matching engines and orders to buy or to sell “often times are different” on each one. (Tr. May 25 at 54.) In the seventies, a national market system was designed and implemented to link the

regional exchanges with NASDAQ so that orders could be routed back and forth among all exchanges. (Tr. May 25 at 55.) ETFs soon became popular. These derivatives, or funds, included: Spiders, the S&P 500; Diamonds, the Dow Jones industrial average; SMH, semiconductor holders; OIH oil services; and Q&L, the NASDAQ 100. (Tr. May 25 at 55.)

During late 2001 and early 2002, Amanat was doing the coding and programming for MarketXT trading. Rebates for market data revenue sharing provided an incentive to trade at that time. (Tr. May 25 at 56-57.) For ETFs, the rebates might be substantial. For trades on NYSE, the intermarket trading system generally lowered transaction costs. (Tr. May 25 at 57.) Amanat had an automated trading system in place before March 2002. The earlier system was used to “add liquidity rebates that ECNs would pay out.” (Tr. June 2 at 125-26.) It entered limit orders on both sides of the market and would “try to add liquidity in order to get the rebates.” (Tr. June 2 at 126.) On March 5, 2002, Ignatowitz sent an e-mail requesting Amanat’s assistance in generating a spreadsheet that showed profitability with ECN fees. The NASDAQ tape rebate program was also a factor in determining whether the firm would make money from the automated trading program. (Tr. June 2 at 145-48; Resp. Exs. 3, 11.)

On March 11, 2002, a series of e-mails referring to automated trading in a hedge fund involved Amanat, Ignall, and Connell. (Tr. June 2 at 279-82; Resp. Ex. 12) Amanat observed that the system could not handle more than 1,000 orders per second. (Tr. June 2 at 282.) Tradescape charged Ignall \$10.99 per trade every time Ignall tested a program for Tradescape by trading in his own personal account. A large part of Ignall’s job consisted of testing systems daily and, by March 2002, he no longer wanted to pay charges. (Tr. June 2 at 287-88; Resp. Ex. 12.)

Amanat implemented a spread trading program “to get market data rebates.” (Tr. June 6 at 115.) By mid-March 2002, he had learned from Buckenmaier what the qualifications for the data rebates were. (Tr. June 6 at 115-25; Resp. Exs. 1, 15.) Amanat did not involve Nigito because Nigito was leaving to work for a competitor after a year of training at Momentum. (Tr. June 6 at 170.) Crossed and internalized trades received credit for the rebates. (Tr. June 6 at 126-27.) Amanat attempted to clarify the qualifications in a series of e-mails with NASDAQ, but he did not even know then what “CTA” meant. (Tr. June 6 at 130.) The Application Programming Interface Guide contained the specifications for the NASDAQ interface that was required for qualification for the data rebates. (Tr. June 6 at 130-36; Resp. Ex. 1.) NASDAQ rules were also integrated into the new automated data rebate trading programming. For example, a short sale must be identified as such. (Tr. June 6 at 136-39.) Thus, the new code was grafted onto 99% old code as the base. (Tr. June 6 at 152-54.)

The effort to obtain NASDAQ market data rebates was a team effort of Momentum; Amanat actively sought to involve Ignall, Ignatowitz, and others. (Tr. June 2 at 124, Tr. June 6 at 164-69; Resp. Ex. 15.) The goal was “to lower investor costs associated with listed securities.” (Resp. Ex. 17.) Amanat turned to Ignall, Connell, Ignatowitz, James Zogg (Zogg), Momentum’s risk manager, Lee, and other Momentum employees for advice. (Tr. June 6 at 141.) To create the new automated trading program (RLevi2 or rebate trading program), Amanat only had to modify 1% of his already existing arbitrage program. (Tr. June 6 at 153.) The RLevi2 program contained all the compliance rules that the traders had been using for years in the main system.

They had been “ironed out years ago.” Amanat did not think anything was missing. (Tr. June 6 at 142.) The MarketXT SORT system would be used to qualify. The spread would be a penny 90% of the time; a penny would be lost, but the market data rebate of \$1.75 per 100 shares would transform a loss of \$1 per 100 shares up front into a gain of \$0.75 per 100 after the rebate. (Tr. June 6 at 147-48.) Amanat thought the rebate program would yield \$50,000 in profit from NASDAQ. (Tr. June 6 at 172.)

Via e-mail, on March 15, 2002, Cummins observed that “there is no uptick requirement” for ETFs. (Tr. June 2 at 137-38; Resp. Ex. 11.) Ignatowitz knew that Amanat planned to short-sell ETFs with RLevi2 entering bids and offers. Ignatowitz also knew Cummins had referred to a computer link that explained that an SEC release allowed ETFs to be shorted. (Tr. June 2 at 141-42.) A memorandum to the traders at the firm was sent out to make sure that they also knew how easy it was to trade ETFs. (Tr. June 2 at 142.) On March 15, 2002, Ignatowitz also sent an e-mail to Amanat, Cummins, Ignall, Connell, and Lee clarifying the issue of ETF short selling. (Tr. June 2 at 143-44; Resp. Ex. 11.)

Bundy knew about the NASDAQ market data revenue rebate in March 2002, and that Amanat was working on a program to take advantage of the rebate incentive. (Tr. June 2 at 9, 35, 37-38.) He also knew that the program would be automated to trade in ETFs such as QQQs, Spiders, and Diamonds. (Tr. June 2 at 38-39.) The MarketXT system could execute 200 trades per second. (Tr. June 2 at 46.) In a series of e-mails in early March, Amanat and others sought to ascertain from Bundy how the trading program should function as they attempted to comply with securities trading rules. Issues discussed included: the life span of an order before canceling; regulations; internal matches; short sales; and trade throughs. (Tr. June 2 at 69-73; Resp. Ex. 10.)

ETFs are not thinly traded securities and were almost impossible to manipulate. For these reasons, Amanat chose ETFs for the new program. (Tr. June 6 at 180-82, 280-85; Resp. Ex. 16.) ETFs generally listed on AMEX Tape B had a higher market rebate per trade per print. QQQs comprise the entire NASDAQ 100. The DOW is the top thirty. S&P is the top 500. ETFs were also chosen for RLevi2 because:

ETFs also appear to attract investors as a low-cost and tax efficient investment vehicle. Like index-based mutual funds (index funds), index-based ETFs are passively managed to track an index and do not have significant turnover in portfolio securities. As a result, ETF expenses are typically lower than the expenses of actively managed mutual funds, which generally have higher management fees and brokerage expenses due to portfolio trading. In addition, ETF expenses are often lower than the expenses of index funds. Because most ETF shareholders purchase and sell ETF shares through secondary market transactions rather than through transactions with the ETF, ETFs do not have the same degree of shareholder recordkeeping and service expenses as index funds. However, investors who purchase and sell ETF shares in secondary market transactions pay brokerage commissions in connection with those transactions, which can represent an additional cost to investors that is not reflected in the expense ratio of an ETF. (Resp. Ex. 16 at 63) (citations omitted.)

...

The Exchange believes that both the size and breadth of the market QQQs dispels concerns regarding market manipulation and disruption. The average daily trading volume for the QQQs and QQQ options from January 1, 2001, to November 30, 2001, were 71.21 million shares and 148,181 contracts, respectively. The QQQ option is by far the most actively traded option product in the United States, and therefore, the most liquid. The underlying QQQ is the most actively traded equity security in the United States with greater trading volume than both Microsoft and Intel. Accordingly, the Exchange believes that the liquidity of the QQQ option and the underlying cash market for QQQs greatly reduces the potential for manipulations in both options and underlying cash market. To date, there has not been a single disciplinary action involving manipulation or potential manipulation in the QQQ or the QQQ option on the Exchange. (Resp. Ex. 16 at 82.)

In March 2002, Cummins was asked by Jim Lee to set up a proprietary account in Ignall's name through the clearing firm. (Tr. June 2 at 314-15; Div. Ex. 32.) She thought Ignall would trade in the account. (Tr. June 2 at 318.) At Momentum, a proprietary trading account had been set up, entitled SIGNR, for "Scott Ignall rebate." (Tr. June 2 at 109, 170.) Ignall, however, never traded in the SIGNR account, although he knew that Amanat would code the programs used in it. (Tr. June 2 at 172-73.) Before the SIGNR account was created, Ignall knew that Amanat would use a program to trade in the market as part of a "rebate trading model." (Tr. June 2 at 177.) Lee sent an e-mail to Brian Polazola, the chief financial officer at Momentum, to ensure that the new account would be segregated from others at the firm for settlement of future profit and loss at the end of the month. (Tr. June 2 at 149; Resp. Ex. 11.) Gains or losses in a proprietary account "go to the firm." (Tr. June 2 at 102.) Personnel from the clearing firm were also involved in e-mail exchanges that set up the new account. (Tr. June 2 at 152-53.)

Ignatowitz worked with the employees who opened the proprietary trading account. (Tr. June 2 at 100.) On Friday, March 15, 2002, Amanat sent an e-mail to Ignatowitz, regarding what account number and trader identification number he would use for the rebate trading program. (Tr. June 2 at 133-34; Div. Ex. 32.) Ignatowitz interpreted Amanat's e-mail to mean that the automated system would use "a low risk strategy to trade the Spiders." (Tr. June 2 at 136.) Lee, via e-mail, asked for "a fuller term sheet describing how the automated trading system would work." (Tr. June 2 at 136-37; Resp. Ex. 11.) Amanat needed \$46,400 in buying power to begin trading with the system, which would trade in Spiders as well as QQQs. (Tr. June 2 at 103-04.) Lee made it clear in a related e-mail that Amanat would not be personally trading and that Ignall would be the registered representative on the account. (Tr. June 2 at 106.)

Ignall received a copy of the e-mail that listed him as the registered representative for the new automated trading account. He never objected to the decision or to the fact that Amanat would be using Ignall's registration number to run the RLevi2 program and participated in the plan. (Tr. June 2 at 131-32, 297-300; Div. Ex. 32.) Ignall and Amanat worked ten feet apart at the 57th Street office in New York City. (Tr. June 2 at 301-03.) Ignall was involved in the overall market data rebate program and in the ensuing ETF trading. (Tr. June 6 at 347-49.)

While the rebate trading program proprietary account was being set up, Ignatowitz and others were also generating a memorandum to pass on to traders to educate them about ETF trading. (Tr. June 2 at 153-54.) Ignatowitz never thought he was doing anything wrong. (Tr. June 2 at 158.) Nobody objected to the creation of the automated program or to the use of the proprietary account. (Tr. June 2 at 158-59.) Ignatowitz cannot read code and he did not know how Amanat's program worked. Although Ignatowitz drafted a memorandum to encourage the traders to consider ETFs, he knew that the traders did not have access to Amanat's program. (Tr. June 2 at 160-61.)

Ignatowitz and Amanat began tracking qualifying trades for the rebate once the SIGNR account was opened. (Tr. June 2 at 106.) On Wednesday, March 20, Amanat sent Ignatowitz an e-mail showing him how to determine how close MarketXT was to the breakpoint for the rebate. (Tr. June 2 at 108, Div. Ex. 32.) Ignatowitz told Amanat by e-mail that Zogg, Momentum's risk manager, was "setting up the Ignall account with \$60,000 in buying power." (Tr. June 2 at 110.) On March 22, Amanat told Ignatowitz that the break point was 30,000 trades for the quarter. (Tr. June 2 at 112; Div. Ex. 32.) On March 26, Amanat sent Ignatowitz an e-mail thanking him and Zogg for helping him "pull everything together." (Tr. June 2 at 114.)

In mid-March 2002, Buckenmaier told Bundy that the firm was below the number of trades for the quarter. On March 25, Ignall sent an e-mail to Amanat, Lee, Ignatowitz, and Cummins noting that there was no need to run RLevi2 because the firm would miss the qualifying threshold for quarterly revenue sharing. (Tr. June 2 at 170.)

Traders did not get rebates for transactions with QQQs because they traded on AMEX, not NASDAQ. (Tr. June 2 at 295-96; Resp. Ex. 12.) Island, using ISLD ECN programming, offered rebates to end users. To be competitive Tradescape companies offered rebates on its LSPD ECN programming to end users. (Tr. June 2 at 297; Resp. Ex. 12.)

The model was part of MarketXT's strategy to compete successfully with Island ECN, Inc.:

Last week, Island, New York, garnered a 28% market share in the Amex-listed issue that tracks performance of the NASDAQ 100 index, known by its ticker symbol, QQQ. That compares with a 24% market share for the Amex, a pioneer in the ETF business and historically the biggest market for the QQQ. Island provided the data, but the Amex doesn't dispute the results. While its stock business is seen as lackluster, Amex has benefited greatly from the popularity of ETFs. But rival markets, including not only Island but also the NYSE, are now eyeing the high volumes that some ETFs attract – investors of ten trade more QQQ shares than in any other stock – and are busy chasing the Amex's business. ETFs are securities that resemble mutual funds but trade like stocks. (Resp. Ex. 2.)

Thus, MarketXT employees were committed to doing "whatever it takes to get [it] competitive with Island" for prospective customers. (Resp. Ex. 12.) Amanat viewed the model

as likely to yield “short-term profits from the rebate, and long-term opportunities.” (Resp. Ex. 32.)

On March 14 and 15, Amanat first ran the rebate trading program, minus the automation, in his own Momentum account (IRFAN account). (Tr. June 6 at 195-96; Resp. Ex. 15.) Amanat soon ran out of buying power and needed a second account for additional trading. (Tr. June 6 at 197-200.) Amanat began trading in the SIGNR account before March 25. (Tr. June 6 at 207-09; Resp. Ex. 15.) For March 20, 21, and 22 trading, LSPD was sending “a new quote update on average of every eight to nine seconds during peak trading times” in QQQs and “every six to eight seconds” in DIA, “too fast for ARCA,” resulting in some canceled orders because LSPD “had moved their market prior to receiving the ARCA order.” Thus, the program early on manifested a glitch resulting from its great speed. (Resp. Ex. 15 at 11.) When an order entered the MarketXT system, RLevi2 was designed to check its internal network first for a match. The order would be routed by the program to the marketplace if it could not be filled in-house.

The Trades

March 25, 2002

On March 25, 2002, trading in DIAs, the rebate trading program was programmed to send market orders to buy 100 shares and to sell 100 shares at the bid. Amanat thought he would lose \$1 on each order and that the SORT algorithm would decide where to execute it. (Tr. June 6 at 228-29.) Amanat placed the buy and sell orders right behind each other in order to reduce his market risk as much as possible, with milliseconds difference in the order placements. (Tr. June 6 at 230-32).

Before he left on March 25, Nigito told Bundy about trades he thought were “wrong.” (Tr. June 2 at 12.) Bundy saw unusual trading in the ETFs Diamonds, Spiders, and QQQs as he reviewed trading on a quoting application, either “real tick or trade desk.” (Tr. June 2 at 14-15.) He showed Bill Lauderback (Lauderback), the Houston office manager, the screens; Lauderback in turn contacted Cummins. (Tr. June 2 at 15-18.) The office of Cummins was “three or four doors down the hall” from Bundy, but he had not gone to her after Nigito called him. (Tr. June 2 at 47-48.)

Because the computer was conducting the trading, Amanat did not monitor the tape. If he had stopped the rebate trading program to monitor it, the computer would have been slowed down and a trade would have been missed. For this reason, nobody puts quotes up while the computer is trading. (Tr. June 6 at 237-38.) On March 25, 2005, Amanat got a complaint from Zogg that ARCA or AMEX could not handle the orders. Amanat then slowed the system down to build in more delay between the market buy and the market sell. He also increased share size to 500. There were 150,000 trades on March 25 from Momentum. (Tr. June 6 at 232-33.)

On March 25, 2002, every six seconds, “there was an execution on MarketXT from two simultaneous buy and sell orders.” (Tr. June 1 at 269; Div. Exs. 15, 16.) From the total of 1,700 MarketXT trades that day, over 99% were trades between MarketXT and the Momentum IRFAN trading account. (Tr. June 1 at 269; Div. Ex. 15.) Those trades consisted of “near simultaneous

buy and short orders, approximately every six seconds. They were executed immediately or within a second.” (Tr. June 1 at 274.) For the 1,696 DIA trades, the IRFAN account first bought DIA at the exact same market prices at which the IRFAN account then immediately sold short the same number of DIA. (Div. Ex. 34.)

By the end of the day on March 25, 2002, Amanat stopped limit orders, which had been placed unintentionally by a “rounding problem” in the trading program. He thought that the problems in the trading program that had been called to his attention were caused by limit orders. When he learned from the Commission, long after 2002, that the trading data showed matching problems resulting from market orders he was “stunned.” (Tr. June 6 at 329.) A market order is executed immediately at the prevailing market price. A limit order sets a price for the execution, and no sale occurs “until the market gets to that price.” (Tr. June 1 at 266-67.)

March 26, 2002

On March 26, 2002, after speaking with Buckenmaier, Amanat reduced the share orders to 100; he had been assured that the share size did not matter. Amanat knew, however, that the smaller share size would generate more tape rebate revenue for MarketXT. (Tr. June 6 at 244-45.) By the end of the trading day on March 26, the IRFAN account and the SIGNR account had both engaged in the same trading pattern for, first SPY, and then for DIA ETFs. The IRFAN account first bought the ETFs at the exact same market price at which the IRFAN account then immediately sold short the same number of ETFs. The SIGNR account did the same. The total SPY trades with this pattern were 1,516. The total DIA trades were 49. Thus, for March 26, the total trades at issue were 1,565. (Div. Exs. 18, 25, 34.) The market buy and market short orders had been sent about every two to three seconds. (Div. Exs. 18, 25, 34.) Limit orders, QQQ orders, and orders filled after they were routed out of MarketXT are not included in the number above, although they also qualified for market data rebates. (Tr. June 2 at 251.)

March 27, 2002

On March 27, 2002, NASDAQ called to ask MarketXT whether there was a “system problem” in reference to the MarketXT 100-share trade volume it was monitoring. A MarketXT employee responded that there was no problem. (Div. Ex. 43.) The trading program had operated from 9:42 a.m. to 1:00 p.m. During that time, MarketXT traded in SPY ETFs using essentially the same pattern established on the two preceding trading days. The IRFAN or SIGNR accounts appeared on both sides of the trades in SPYs for 11,405 trades. (Tr. June 1 at 332-35; Div. Exs. 24, 26, 27, 34.) Amanat had reduced the time between orders on March 27 by 50% to 700 milliseconds. (Tr. June 6 at 247-48.) He told Zogg he was leaving the office for a couple of hours, but during this time anyone at Momentum could have shut down the rebate trading program remotely. (Tr. June 6 at 248.) Zogg sent Cummins an Excel spreadsheet showing the SPY trades. (Tr. June 2 at 322-23; Div. Ex. 35.)

Pursuant to a call from Chris Rogers at MarketXT on March 27, Bundy noticed the same trading pattern, and he contacted Lauderback and together they called Cummins. (Tr. June 2 at 18-20, 48-50, 55-57.) Cummins told him that the trading had been approved by Lee, the president of Momentum. (Tr. June 2 at 57-58.) However, seconds after she actually looked at the

trading, she stated that it had to stop and the trading did stop shortly thereafter. (Tr. June 2 at 59-60; Div. Ex. 35.) Cummins notified the trading desk to remove the trading privileges from the account by zeroing it out. (Tr. June 2 at 22-23, 319-21.) Bundy did not contact Amanat on March 25 or 27 because he was not comfortable about confronting someone about what he thought they had “done wrong.” (Tr. June 2 at 46-47, 74-75.)

Connell asked that the rebate trading program be stopped. (Tr. June 2 at 258; Div. Ex. 33.) Ignall located a program running on Amanat’s machine and stopped it. (Tr. June 2 at 258-60; Div. Exs. 33, 34.) When Amanat returned to the office, the program was not running. Amanat started the program up again without reading any e-mails or talking to anyone. He received an e-mail from Connell telling him to shut down the rebate trading program, the phones started to ring, and “all hell broke loose.” (Tr. June 6 at 249.) Amanat shut down the rebate trading program permanently.

A close examination of the March 27 SPY trades at issue reveals that the trade execution price moves. For example, the execution price varies from \$113.85 at 9:41:49, to \$114.80 at 12:41:25, to \$114.89 at 12:58:01, to \$114.82 at 15:33:17 in a series of buys and shorts by TSCP accounts. (Div. Ex. 25 at 1, 467, 516, 519.) Thus, although the price remained identical as between the buy and sell in the same Momentum account, the market caused the price to move in between the pairs.

The problem with the rebate trading program was that Amanat thought that the orders would go out a few milliseconds apart to other computers to get filled for the SPYs. (Tr. June 3 at 150.) This was the first time Amanat had sent large, varied orders through the SORT system, which had been built in Java and tweaked so that programming became multi-threaded. When orders got sent, they most likely arrived literally simultaneously and thus filled each other by mistake. The mistake most likely occurred because Amanat had an “old school mentality” that did not foresee multi-threading by the computer. (Tr. June 3 at 155.) The problem occurred because Amanat had not been maintaining the close relationships with the programmers that he had in the past. It was “transition time” for the firm, and he had been unaware of the newest improvements in the SORT programming. (Tr. June 3 at 160-61.)

Volume and decimalization are also factors in the trades at issue:

With the expansion in trading volume in recent years, the amount of information handled by the Plan processors has expanded dramatically. For example, in 1994, SIAC processed 73 million transaction reports and 115 million quotations for Network A and Network B. In 2000, these figures increased to 312 million transaction reports and 691 million quotations, for an increase, respectively, of 327% and 500%. The increase in peak messages per second also reflects the recent growth in trading volume. For example, the highest peak messages per second for quotations processed by NASDAQ in 1995 and 2000 were 37 and 569, respectively.

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The implementation of decimal pricing in 2001, and the current move to a minimum tick of one penny in the equity markets, was another factor that caused the SEC to reassess current market data systems. By increasing the potential number of quote increments by more than six-fold, decimalization was widely expected to lead to less depth being available at each price point. . . . In addition, there was concern that decimalization might lead to a surge in quote traffic and a corresponding drain on systems capacity, since the larger number of price increments could cause market participants to update their quotes more frequently. (Resp. Ex. 7 at 29, 37) (footnotes omitted.)

As a result of the trades at issue and thousands of other trades executed through its system, MarketXT averaged over 500 trades per day for the first quarter of 2002, and “they were entitled to their pro rata share of the 40% that NASD made available.” (Tr. June 1 at 335.) They received a market data rebate for nearly \$50,000 later in 2002. (Jt. Ex. 1 at 3.) The phenomenon of trading for tape revenue was generally criticized in 2002. (Resp. Exs. 8, 9; Div. Exs. 6, 7, 8.)

NASDAQ monitored the MarketXT trades at issue here on a daily basis from March 22. (Tr. June 6 at 187-90; Resp. Ex. 15.) On January 27, 2005, the CTA Tape B Administrator was given a check for \$31,001 for reimbursement to the CTA. NASDAQ had “been informed by the SEC staff that they believe that transactions in the three-exchange traded funds reported by MarketXT on March 25 through 27 were improper.” (Div. Ex. 5.) A methodology for distribution of the proceeds to the other Plan participants in the next revenue distribution has been proposed. (Div. Ex. 5.)

A February 9, 2005, SEC Release, a Report of Investigation, addressed problems posed by the March 2002 MarketXT trading activity for the sole purpose of obtaining rebates. (Resp. Ex. 5.) It criticized NASDAQ officials and enumerated several “remedial steps” that NASDAQ undertook in response to the investigation. Among them was a change in rebate processing. “NASDAQ members receiving rebates are now paid in the form of a reduction of outstanding liabilities, rather than by wire transfer.” (Resp. Ex. 5.)

Michael Goldstein

Michael Goldstein (Goldstein) has a Ph.D. from the Wharton School of Business of the University of Pennsylvania, and is a professor of finance at Babson College. (Tr. June 3 at 178-79.) He has published papers on liquidity and equity in the securities marketplace. (Tr. June 3 at 185.) He was able to read the computer code at issue in the instant case. (Tr. June 3 at 185.) I adopt his opinion as an expert in the area of securities markets and trading. The MarketXT trades in the IRFAN and SIGNR accounts in SPYs on March 26 “paired off against each other.” (Tr. June 3 at 197.) Traders “inadvertently or sometimes intentionally pair off their buys and their sells as a regular aspect of the marketplace. Riskless principal trades are functionally pairing off your buy and your sell.” (Tr. June 3 at 197.) Furthermore, “two to three seconds on MarketXT would not constitute simultaneous.” (Tr. June 3 at 198.)

For the March 27 SPY trades, the same is true, because “every one to three seconds is not sufficiently simultaneous in MarketXT to constitute a wash sale.” (Tr. June 3 at 199.) Thirty

percent of the time on March 27, the SPY trades were executed against another investor, so the trading was not riskless. (Tr. June 3 at 199-200.) The mere fact that “a trade occurred is not necessarily an intent to deceive.” (Tr. June 3 at 201.)

The fact that the March 26 and 27 trades at issue were market orders makes it impossible for the trader to set a price. The market order trades, thus, “hit a price somebody else set.” (Tr. June 3 at 202.) For two simultaneous limit orders, the “risk is much lower of somebody else executing with you.” (Tr. June 3 at 202-203.) Submission of market orders “reduces the possibility that you will pair off.” (Tr. June 3 at 203.) For March 25, the matching orders were filled in the same second. (Tr. June 3 at 204.) This phenomenon occurred because Amanat “thinks like a programmer, not a market trader.” (Tr. June 3 at 204.)

The code for all three days of trading was written “to buy orders and sell orders with no other condition.” Thus, the mere execution of trades was accomplished by the code. The “design of the code is not consistent to be conditional on anything . . . no other conditions beyond what the last trade was.” (Tr. June 3 at 209.) Thus, the code is written to facilitate “trading for trading’s sake.” In this context, it is definitely consistent with reasonable behavior in the securities industry to get actually paid to trade in the form of tape rebate. The marketplace is not affected by these kinds of trades, which “do not involve information.” (Tr. June 3 at 210.) The rebate trading program’s behavior of sending market orders separated in time “and executing against each other at whatever the prevailing market price is, is consistent with trading for trading’s sake and getting market data rebates.” It is not consistent with a pattern of trying to manipulate or move or adjust or deceive prices for the effect of “causing other traders in the marketplace to change their actions.” (Tr. June 3 at 210-11.) Even for the 1,696 DIA trades on March 25 there was “an element of risk” albeit “close to de minimus.” (Tr. June 3 at 218.) The trading had no effect on the market. (Tr. June 3 at 218.) The price for each trade was random, because it was set, even with a one-second timeframe, “somewhere else.” (Tr. June 3 at 219.)

The prices for trades in the ETFs at issue here were similar to the prices and the price changes that emerged from Goldstein’s study of ETF prices before and after the dates of the trades at issue in the instant case. (Tr. June 3 at 221-22.) The mere buying and selling of ETFs, “especially if it is against yourself” would make it very difficult to move ETF prices “artificially” because ETF underlying value is transparent, “known by almost everybody.” (Tr. June 3 at 223-24.) Goldstein’s study revealed that seven days in March 2002 showed “higher volatility of price or midpoint movement” in SPYs than the dates at issue here. (Tr. June 3 at 227-28.)

The matching 1,696 SPY orders generated by the IRFAN account on March 25, 2002, constituted less than .006% of AMEX trades for the annual period used for tape rebate allocation in the instant case. (Tr. June 3 at 249-50.) The trades and quote database maintained by NASDAQ does not display for its customers a record of orders, but rather prints post-1997. The incentive of market data rebates for prints post-1997 makes it difficult for students of the market to ascertain who is “behind the trading” because 100-share orders may now be likely to be placed by institutional instead of retail traders. (Tr. June 3 at 251-52.) Pursuant to a new regulation, Reg. NMS, the type of trades at issue here would have resulted in no tape revenue to NASDAQ and, thus, would not have qualified for any tape rebate. (Tr. June 3 at 257-59.) Amanat’s trading

activity did not deviate from the industry standards in 2002 because it was common for “a lot of activity” to take place simply “to generate tape revenue for NASDAQ and tape revenue rebates.” (Tr. June 3 at 259.)

The programming in which the instant case appears to be written is “very similar” to the coding that Goldstein is familiar with. (Tr. June 3 at 261-62.) There is a flaw in the coding that Goldstein pointed out to Amanat that might have caused the buy order to cross with the sell order at the same share price. Amanat had created and run the program as an “experiment . . . to attempt to increase the number of executions that were routed out to other market centers” to be “executed on the other market centers.” This type of automated experimentation is still “common.” (Tr. June 3 at 281.) One final error in the code consisted of buys as starting the program. The CTA plan gives credit for sells, however, not buys. Thus, MarketXT might never have gotten credit for any of the trades. On the other hand, if the program had started out with a sell instead, MarketXT would have been “guaranteed the value of the print.” If the buy order had been executed in Boston, Massachusetts, NASDAQ would not have gotten credit because the tape credit is determined by “only the location of sale.” (Tr. June 3 at 281-82.) Some of the best firms test code on a live system in a proprietary account and, thus, occasionally “lose gobbles of money.” Citibank lost \$7 million in seven seconds on a trading glitch in QQQs. (Tr. June 3 at 282.) On the other hand, when companies match internally by taking the opposite side of a customer buy and customer sell and bring the price to the marketplace, this type of intentional riskless sell, or internalization has been a source of “complaints” but it is “very common” in the pursuit of tape revenue. (Tr. June 3 at 289-90.) For this behavior, NYSE specialists historically “get in trouble,” but NASDAQ market makers do not. (Tr. June 3 at 291.)

CONCLUSIONS OF LAW

The OIP alleges that Amanat willfully violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. Amanat is alleged to have engaged in manipulative trading of securities through the execution of thousands of wash trades and matched orders. Amanat is alleged to have known, or recklessly disregarded, that the wash sales and matched orders had a deceptive impact on the marketplace, and/or deceptively qualified MarketXT for tape revenue rebates that actually belonged to other exchanges. Additionally, Amanat is alleged to have engaged in a scheme to obtain tape revenue fraudulently. Each wash trade and matched order that Amanat executed in ETFs was in furtherance of the scheme for MarketXT to obtain tape revenue from the CTA (through NASDAQ), thereby defrauding other exchanges of their fair share of the available pool of revenues. (OIP at 9.)

Further, the OIP alleges that Amanat willfully aided and abetted and caused MarketXT’s violations of Section 15(c)(1)(A) of the Exchange Act. For example, Amanat and MarketXT engaged in manipulative trading of securities through the execution of thousands of wash trades and matched orders. Additionally, Amanat and MarketXT engaged in a scheme to obtain tape revenue fraudulently. Each wash trade and matched order that Amanat executed in ETFs was in furtherance of the scheme for MarketXT to obtain tape revenue from the CTA (through NASDAQ), thereby defrauding other exchanges of their fair share of the available pool of revenues. (OIP at 9-10.)

Section 10(b) and Rule 10b-5

Exchange Act Section 10(b) and Rule 10b-5 make it unlawful “in connection with the purchase or sale of any security,” by jurisdictional means, to:

- (1) employ any device, scheme, or artifice to defraud;
- (2) make any untrue statement of a material fact or omit to state a material fact necessary to make the statements made not misleading; or
- (3) engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon any person.

To establish violations of these provisions the Division must show: (1) misrepresentations or omissions of material facts or other fraudulent devices; (2) made in connection with the purchase or sale of securities; and (3) that the respondent acted with scienter. See Basic Inc. v. Levinson, 485 U.S. 224, 240 (1988); Aaron v. SEC, 446 U.S. 680, 701-02 (1980); Ernst & Ernst v. Hochfelder, 425 U.S. 185, 195-97 (1976). Scienter is defined as “a mental state embracing intent to deceive, manipulate or defraud.” Hochfelder, 425 U.S. at 193 n.12. It is established by a showing that the respondent acted intentionally or with severe recklessness, defined as highly unreasonable conduct involving not merely simple or inexcusable negligence, but “an extreme departure from the standards of ordinary care.” Meyer Blinder, 50 S.E.C. 1215, 1229-30 (1992) (quoting Sundstrand Corp. v. Sun Chem. Corp., 553 F.2d 1033, 1045 (7th Cir. 1977)); see also Hollinger v. Titan Capital Corp., 914 F.2d 1564, 1568-69 (9th Cir. 1990); SEC v. Carriba Air, Inc., 681 F.2d 1318, 1324 (11th Cir. 1982).

Section 10(b) of the Exchange Act prohibits “manipulative or deceptive device[s] or contrivance[s] in contravention of” the Commission’s rules, including Rule 10b-5. Rule 10b-5 prohibits the use of fraudulent devices in securities transactions. Matched orders and wash sales may constitute violations under Section 10(b) and Rule 10b-5 of the Exchange Act. A matched order is a securities transaction entered with the knowledge that a transaction of substantially the same amount would be entered at substantially the same time for substantially the same price on the opposite side of the market. See Rockies Fund, Inc. v. SEC, No. 4-1255, 2005 U.S. App. LEXIS 24521, at *10 (D.C. Cir. Nov. 15, 2005) (citations omitted). Wash sales are transactions involving no change in beneficial ownership. Id. Neither of these devices alone constitutes a securities violation, as both Section 10(b) and Rule 10b-5 require a showing of intent and materiality. Id. at *11.

In Rockies Fund, the parties disagreed on what standard of intent applies under Rule 10b-5 where there is an allegation of wash sales or match orders. The petitioners argued for specific intent, while the SEC argued for a recklessness standard. Id. at *11. The petitioners argued that a lower standard under Rule 10b-5 would undermine Section 9(a)(1) of the Exchange Act, which expressly prohibits wash sales or matched orders “for the purpose of creating a false or misleading appearance of active trading” of a registered security on a national exchange. Id. at *12. Thus, Section 9(a)(1) requires a showing of specific intent, which is a stronger showing than the extreme recklessness standard of Rule 10b-5. Id. The court commented that “the

difference between the standards could potentially have significant effects on the interplay between Section 10(b) and Section 9(a)(1) and SEC actions under each provision.” Id. In making its ruling, the court found that the SEC had not met its burden under either standard; thus, it did not reach the question of what standard of intent should be applied to wash sales and matched orders under Section 10(b) and Rule 10b-5. Id. at *12-13.

I conclude that the specific intent standard should be applied to the alleged wash sales and matched orders in the instant case. To conclude otherwise would be to set Exchange Act Section 9(a)(1) in conflict with Rule 10b-5. More importantly, it could result in prosecution and sanctions for legitimate conduct that results from mere inadvertence or of the “trading for trading’s sake” that might lead to the next technological breakthrough in electronic trading.

The Division argues that through his automated trading program Amanat knowingly or recklessly engaged in a deceptive scheme to gain Tape B market data rebates for MarketXT. According to the Division, he knowingly or recklessly generated thousands of fictitious trades (identified by the Division as either wash trades or market orders) that MarketXT reported to the NASDAQ in the first quarter of 2002. Amanat, thereby, misrepresented the number of legitimate trades executed on MarketXT for that quarter. The misrepresentation was material in that it wrongfully caused NASDAQ to conclude that MarketXT had reached the required trading threshold needed to earn valuable market data rebates. The misrepresentation triggered the payment of revenue rebates for all of MarketXT’s Tape B reported trades – both legitimate and illegitimate, and resulted in a payment to MarketXT of rebates it would only have earned if all the trades that it reported were legitimate. In doing so, Amanat defrauded CTA member exchanges of their rightful shares of market data revenue. (Div. Post-Hearing Br. at 15.)

Wash trades and matched orders have been found to violate Section 10(b) and Rule 10b-5 of the Exchange Act. See generally Edward J. Mawod & Co. v. SEC, 591 F.2d 588, 595 (10th Cir. 1979) (using the appearance of volume trading to raise the price of the security). Specifically, wash trades and matched orders that affect the price of a security or induce others to trade in a security have consistently been found to have violated Section 10(b) and Rule 10b-5 of the Exchange Act. See e.g. Sharon M. Graham, 53 S.E.C. 1072 (1988), aff’d on other grounds, 222 F.3d 994 (D.C. Cir. 2000) (finding a violation of Section 10(b) and Rule 10b-5, for aiding and abetting purposes, when a customer engaged in hundreds of wash trades in one stock); Thornton v. SEC, 28 S.E.C. 208 (1948), aff’d, 171 F.2d 702 (2d Cir. 1948) (engaging in wash sales and matched sales to raise the price of stock). However, the question remains as to whether a wash sale or matched order needs to affect the marketplace directly, i.e. the price of the stock, to be considered a deceptive device under the antifraud provisions.

The cases cited by the Division, while involving wash trades or matched orders either involve intent to manipulate the market for a security or, specifically, the price of a stock. See e.g. Edward Mawod & Co. v. SEC, 591 F.2d 588, 595 (10th Cir. 1979) (stating that the purpose was to manipulate the price of stock); Thornton & Co., 28 S.E.C. 208, 220 (1948) (stating that the purpose was to manipulate the market); Sharon M. Graham, 53 S.E.C. at 1081 (stating that creation of deceptive market activity was manipulative because the trades were a substantial proportion of the daily volume). In the instant case there is no evidence that Amanat’s rebate trading program was set up with the intent to depress or inflate the price of any of the ETFs. It

did not manipulate the marketplace in general and it was not a substantial proportion of the daily trading volume of any ETF. Accordingly, I conclude that the cases relied on by the Division are easily distinguished.

In Orlando Joseph Jett, 82 SEC Docket 1211 (Mar. 5, 2004), a case relied upon heavily by the Division, the Commission found that a government bond trader and registered representative who recorded illusory profits through an anomaly in a broker-dealer's trading and accounting systems violated Section 10(b) and Rule 10b-5 of the Exchange Act, even though no trades actually occurred. In Jett, the respondent deceived his firm into believing that a pyramid like scheme was actually a legitimate trading strategy through which he greatly inflated his trading profits, which were used to determine his salary, bonuses, and standing in the firm. Id. at 1253-54. Essentially, the respondent deceived only his firm about the profitability of his securities trading and his "trading program" had no direct consequences on the marketplace. Id. at 1253. The Division states that Jett's strategy of deceiving his firm is analogous to Amanat's automated program in that it deceived NASDAQ and diverted revenues from other CTA members. (Div. Post-Hear. Br. at 19-21.) However, in Jett, the respondent did not rely on wash trades, matched orders, ETFs, or electronic trading for his scheme. Jett relied on forged trading records. The trades in the instant case were real and generated a profit.

The Division has failed to prove a violation because it has misinterpreted the context of the automated trading program at issue. It has failed to appreciate how the trades were executed; and it ignores the reality confronted by Amanat during the three business days at issue. The context of the automated trading program is NASDAQ. Amanat created and ran a program that was intimately integrated with the NASDAQ interface. The Division makes much of the RLevi2 program. (Div. Br. at 5-9.) However, the system that MarketXT was required to put into place as an ECN and a Super SOES entity dwarfed and incorporated the code tweaks that Amanat used for placing orders. The Division could not have understood this because Alex Sadowski (Sadowski), its expert, could not read computer code. (Tr. June 2 at 218.) Sadowski did not compute the thousands of trades that were excluded from the Division's exhibits, and he did not know how many trades during the three-day period fell outside his parameters for wash sales. Although he knew that the MarketXT program could execute trades in milliseconds, Sadowski never took that into account and the data he used for his computations were displayed in seconds. (Tr. June 2 at 218-22.) Most importantly, Sadowski mistakenly applied the same trade standard for wash sales to the MarketXT data that he would use in analyzing the conduct of an individual who traded on the NYSE. (Tr. June 2 at 222-23.)

For MarketXT, the tape rebate program always meant more than a few thousand dollars in the bank. It meant market share. If MarketXT could keep trading costs down, they could pass those savings on to customers and, thus, lure them away from Island, their competitor. NASDAQ worked closely with Amanat because its executives knew that the exchange would benefit from increased market share by attracting new investors who could not afford the fees that institutional investors historically paid. Amanat and his peers had been experimenting with the automated trading coding for weeks before the three days at issue, in an effort to eliminate the wasted time and errors introduced by human intervention in trading and execution.

The second area of confusion demonstrated by the Division's position is in the manner of execution of the trades. When the NASDAQ SelectNet system received the market order, it searched a huge universe. No price was set by the trade or by the account holder for the buy. The system swept the entire market to arrive at a market price. That market price fluctuated between MarketXT trades. Thus, as soon as Amanat's buy order at market price hit the SORT system, risk attached to the executed trade. Risk attached because there was no way the programmer/trader could predict what the market price might be during a given period. The risk remained until the security was sold successfully, that is until the trade settled.

The Super SOES system took the buy at market and searched MarketXT in-house for a seller. The trade rebate program presented Super SOES with a short seller at market price. For some of the trades, Super SOES located a buyer other than the IRFAN or SIGNR account and then maybe a seller that was not an IRFAN or SIGNR account. The Division ignores the fact that ETFs were chosen so that the market would not be affected by MarketXT trading volume. Amanat could have lost a great deal of money via the trading program. That he made a profit on the trades instead, demonstrates the risk involved in the trade rebate program from its inception on March 25. The trades occurred in real accounts. During the time that the books and markets were swept for market price the account holders were at market risk. The matches and washes were a result of settlements by the entire NASDAQ Super SOES system, not just the program launched by Amanat on March 25.

Finally, the Division misinterprets the reality faced by Amanat during the three days of running the program. At least six highly paid employees of the Related Entities were part of the launching of the rebate trading program. E-mails, telephone calls, and advice from NASDAQ demonstrate that the new venture was indeed a team effort. The result would be a milestone for NASDAQ as well as for MarketXT. Any one of several people could have switched off the rebate trading program. Nobody switched it off until March 27 because the program did what it was designed to do – settle thousands of trades as rapidly as possible. Problems with the new program code were identified by several entities in a few hours of running time, stretched over three days. NASDAQ, MarketXT compliance, and programmer peers who monitored the trading all played a part in shutting the system down.

They were not all accurate in identifying what the exact problem might be, however. Amanat was "stunned" to learn that the system was so fast that it settled trades in an instant with consecutive short-sell market orders from the same account. Initially, he thought the glitch came from limit orders. When Amanat looked at his screen, he did not see the data admitted into evidence at the hearing in this form. The data streaming down his screen was broken into milliseconds and consisted of many thousands of trades. Thus, it would have been impossible for him to accurately identify a problem.

The Division makes much of the fact that Amanat continued to pursue and obtain the market data rebate even after the automated trading had been stopped by executives at MarketXT. It ignores the fact that NASDAQ found nothing improper in the trades and that Amanat had not found the pattern of matching market orders that the SEC investigation unearthed. The NASD itself has never characterized the trading here as improper. The funds sent to the Tape B Administrator were sent as a result of "SEC staff" assessments.

The Division contends that the instant trades are wash sales or matched orders. I disagree, and conclude that they have not proved that the trades fit the definition in Rockies Fund. Wash sales are transaction involving no change in beneficial ownership. The instant case involves pairings, not wash sales. The first transaction is a buy at market price. The second transaction is a short sell at market price of the same amount of the same liquid security, a minute or more apart, by a computer system that can settle a trade in milliseconds. For the span of time between these particular buys and sells, the security changed beneficial ownership because Super SOES swept the entire market twice, once for the buy and once for the sell, to obtain the market price. Once it obtained the market price, it swept the house books to settle the trade, however. Thus, the few pairings among the thousands of trades were inadvertent. They were not matched orders because the orders were consecutive and because the trades were all settled at market price, without further intervention by the broker-dealer or the account owners.

Even if I am mistaken and the Division has successfully proved that the trades were wash trades or matched orders they have not proved that Amanat acted intentionally to defraud the Tape B Administrator, NASDAQ, or the investing public. In this regard, I adopt the expert opinion of Goldstein. Amanat's trading is inconsistent with a pattern of trying to manipulate or move or adjust or deceive prices for the effect of causing other traders in the marketplace to change their actions as the rebate trading program was trading for trading's sake and obtaining market data rebates.

Even if the standard of proof is not specific intent the Division has not proved its case against Amanat, as Amanat did not act recklessly. See Rockies Fund, Inc. v. SEC, 2005 U.S. App. LEXIS 24521, at *10. Amanat sent e-mails to and worked closely with NASDAQ officials and several employees of the Related Entities in establishing RLevi2. Not one person who was aware of the rebate trading program disapproved of it. Amanat solicited advice on how it should function so that it would be in compliance with SEC and NASDAQ rules. He sought advice on ETFs and ended up choosing them for his program because they were highly liquid and would be extremely difficult to manipulate. Additionally, Amanat based 99% of the RLevi2 program on preexisting software that had already been in use. This software incorporated all compliance rules and many "glitches" had already been ironed out. Finally, he tested the RLevi2 program weeks before March 25. These actions fall far short of recklessness.

In reality a small percentage of market orders in ETFs, highly liquid and highly traded, placed by the RLevi2 program, which were intended to execute with third parties, paired with each other. This unintended, inadvertent, and unforeseeable result was due to a perfect storm wherein the speed of a technological innovation and its effect on the marketplace went beyond what any of the participants intended. I find that Amanat did not violate Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

Aiding and Abetting and Causing

For aiding and abetting liability under the federal securities laws, three elements must be established: (1) a primary or independent securities law violation committed by another party; (2) awareness or knowledge by the aider and abettor that his or her role was part of an overall

activity that was improper; also conceptualized as scienter in aiding and abetting antifraud violations; and (3) that the aider and abettor knowingly and substantially assisted the conduct that constitutes that violation. See Graham v. SEC, 222 F.3d 994, 1000 (D.C. Cir. 2000); Investors Research Corp. v. SEC, 628 F.2d 168, 178 (D.C. Cir. 1980); SEC v. Coffey, 493 F.2d 1304, 1316-17 (6th Cir. 1974); Russo Sec. Inc., 65 SEC Docket 1990, 1998 & n.16 (Oct. 1, 1997); Donald T. Sheldon, 47 S.E.C. 471, 502-03 (1981), aff'd, 45 F.3d 1515 (11th Cir. 1995); William R. Carter, 47 S.E.C. 471, 502-03 (1981). A person cannot escape aiding and abetting liability by claiming ignorance of the securities laws. Sharon M. Graham, 53 S.E.C. 1072, 1084 n.33 (1998), aff'd, 222 F.3d 994 (D.C. Cir. 2000). The Division has failed to meet its burden in establishing an aiding and abetting or causing charge.

The Division failed to prove a primary violation by MarketXT. Section 15(c)(1)(A) of the Exchange Act prohibits a broker or dealer from “effect[ing] any transaction in . . . any security . . . otherwise than on a national securities exchange of which it is a member . . . by means of manipulative, deceptive, or other fraudulent device or contrivance.” The violation on which the Division bases its claim is grounded in the same conduct upon which Amanat’s Section 10(b) and Rule 10b-5 charges are based; that the alleged wash trades and matched orders had a deceptive impact on the marketplace, and/or deceptively qualified MarketXT for tape revenue that actually belonged to other exchanges. For the same reasons that I found that Amanat did not violate Section 10(b) and Rule 10b-5, I find that MarketXT did not violate 15(c)(1)(A) of the Exchange Act. Specifically, the rebate trading program was not a manipulative device and was not set up to, and did not, have a deceptive impact on the marketplace and did not deceptively qualify MarketXT for the tape revenue rebate.

Even if MarketXT was found to have violated Section 15(c)(1)(A) of the Exchange Act, the Division failed to establish the second element for an aiding and abetting or causing charge. For the same reasons that Amanat was not found to have the requisite scienter to violate Section 10(b) of the Exchange Act and Rule 10b-5, I conclude that his conduct does not exhibit scienter as an aider and abettor. At the time Amanat formulated the rebate trading program, and at all times during the trades in question, he lacked specific intent to engage in illegal conduct and his actions fall below the threshold of recklessness or negligence.

CONCLUSION

I conclude that the Division has failed to prove by a preponderance of the evidence that Amanat violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. I further conclude that the Division has failed to carry the necessary burden to prove that, Amanat aided and abetted or caused MarketXT to violate 15(c)(1)(A) of the Exchange Act. This matter must be dismissed.

CERTIFICATION OF 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 August 31, 2005, as revised by an order from the undersigned on September 15, 2005.

ORDER

Based on the findings and conclusions set forth above:

IT IS ORDERED THAT the proceeding brought against Respondent Irfan Mohammed Amanat be, and it hereby is, DISMISSED.

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 to correct a manifest error of fact. 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 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.

Lillian A. McEwen
Administrative Law Judge