

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 60180 / June 26, 2009

Admin. Proc. File No. 3-13096

In the Matter of the Application of

HUSKY TRADING LLC,
EUGENE O'BRIEN,
MICHAEL INEMER,
and
STEPHEN FLOIRENDO

c/o Paula D. Shaffner, Esq.
Stradley Ronon Stevens & Young, LLP
2600 One Commerce Square
Philadelphia, PA 19103

For Review of Disciplinary Action Taken by the
PHILADELPHIA STOCK EXCHANGE, INC.

OPINION OF THE COMMISSION

NATIONAL SECURITIES EXCHANGE – REVIEW OF DISCIPLINARY
PROCEEDING

Trading Through Quotations

Failure to Honor Priority

National securities exchange member organization and its president and two employees were charged with trading through the NBBO and the PBBO and with failing to allocate trades to parties with established price and/or time priority. *Held*, disciplinary action of the exchange *set aside*.

APPEARANCES:

Paula D. Shaffner, of Stradley Ronon Stevens & Young, LLP, for Husky Trading LLC, Eugene O'Brien, Michael Inemer, and Stephen Floirendo.

Mark Schepps and Eustace T. Francis, for NASDAQ OMX PHLX, Inc. (f/k/a Philadelphia Stock Exchange, Inc.).¹

Appeal filed: July 24, 2008

Last brief received: October 21, 2008

I.

Husky Trading LLC ("Husky"), a member organization of the Philadelphia Stock Exchange, Inc. (the "PHLX" or the "Exchange"); Eugene O'Brien, Husky's principal, president, and a floor broker; and Michael Inemer and Stephen Floirendo, floor brokers employed by Husky (collectively, "Applicants"), appeal from PHLX disciplinary action. The PHLX found that, on 172 occasions during the period from January 1, 2005 to November 20, 2006 (the "Relevant Period"), Husky violated Exchange Rules 1014, 1067, and 119 or 120, as applicable, which also constituted conduct inconsistent with just and equitable principles of trade, in violation of Exchange Rule 707.² Specifically, the PHLX found that, during the Relevant Period, O'Brien executed fifty-two option transactions, Inemer six option transactions, and Floirendo twenty-nine

¹ On July 24, 2008, the Philadelphia Stock Exchange, Inc. was acquired by the NASDAQ OMX Group, Inc. and renamed NASDAQ OMX PHLX, Inc. *See* Press Release, Philadelphia Stock Exchange, NASDAQ OMX Group to Complete Acquisition of The Philadelphia Stock Exchange (Jul. 24, 2008), *available at* <http://www.phlx.com/news/pr2008/08pr072408.asp>. Because the disciplinary action taken here was instituted before that date, we continue to use the designation PHLX. References to Exchange rules herein are to the applicable PHLX rules.

² Exchange Rule 1014 sets forth the obligations and restrictions applicable to specialists and registered options traders and addresses, among other things, how option contracts are to be allocated in the crowd among market participants who are on parity.

Exchange Rule 1067 provides that the "highest bid and lowest offer shall have precedence in all cases."

Exchange Rule 119 provides that the "highest bid shall have precedence in all cases" and sets forth rules for determining the priority and precedence of bids that have been made at the same price.

Exchange Rule 120 provides that the "lowest offer shall have precedence in all cases" and that, where offers are made at the same price, the priority and precedence are to be determined in the same manner as specified in the case of bids in Rule 119.

Exchange Rule 707 prohibits conduct inconsistent with just and equitable principles of trade.

option transactions in which the execution price traded through the Philadelphia Best Bid or Offer ("PBBO")³ and/or the National Best Bid or Offer ("NBBO").⁴ The PHLX also found that, during the Relevant Period, O'Brien executed twenty option orders, Inemer five option orders, and Floirendo six option orders that traded ahead of customer orders on the Limit Order Book (the "Book").⁵ The PHLX found further that, during the Relevant Period, O'Brien executed thirty-four option transactions, Inemer eleven option transactions, and Floirendo nine option transactions that traded ahead of Streaming Quote Traders ("SQT")⁶ and/or Remote Streaming Quote Traders ("RSQT")⁷ with established priority.⁸ The PHLX held that Husky, as a member organization, was liable for the violations of its employees, O'Brien, Inemer, and Floirendo.⁹ The PHLX found that O'Brien, as president and the principal of Husky, and as the supervisor of

³ The PBBO is the highest bid and lowest offer disseminated by the Exchange at any given time in a particular option class and constitutes the prevailing bid-offer spread for each security trading on the PHLX at a given time. *See* PHLX Rules 119-120, and 1067. *See generally* Securities Exchange Act Release No. 58,099 (July 3, 2008), 73 Fed. Reg. 39,769 (July 10, 2008) (notice of filing of File No. SR-PHLX-2008-5) ("July 2008 Notice").

⁴ The NBBO is the highest bid and lowest offer disseminated by all the options exchanges at any given time in a particular option class and constitutes the prevailing highest bid and lowest offer for each security across all exchanges at a given time. *See* PHLX Rule 1085; *see generally* July 2008 Notice, *supra* note 3, at 39,770.

⁵ The Book is the Exchange's automated limit order book. The Book automatically routes all unexecuted AUTOM (the Exchange's electronic order delivery, routing, execution, and reporting system) orders to the Book and displays orders real-time in order of price-time priority. *See* Exchange Act Release No. 50997 (Jan. 7, 2005), 70 Fed. Reg. 2444 (Jan. 13, 2005) (order approving File No. SR-PHLX 2003-40 at n.13). Orders not delivered through AUTOM also may be entered onto the Book. *Id.*

⁶ "Streaming" is the electronic delivery of bids and offers. An SQT is a Market Maker or Registered Options Trader who generates and delivers quotations electronically.

⁷ An RSQT is an SQT who is not located on the Exchange floor.

⁸ Husky and O'Brien were also charged with supervisory failure under Exchange Rule 748, but the Hearing Panel found that the Exchange failed to satisfy its burden of proof with respect to this charge.

⁹ As relevant here, Exchange Rule 960.1(b) permits a member organization to be charged with any violation within the Exchange's disciplinary jurisdiction committed by the member organization's officers, employees, or associated persons, "as though such violation were its own."

Inemer and Floirendo, was liable for the violations of Husky, Inemer, and Floirendo, respectively.¹⁰

The PHLX imposed fines of (a) \$106,000 on Husky and O'Brien, jointly and severally, based upon the 106 transactions charged to O'Brien; (b) \$22,000 on Inemer, Husky, and O'Brien, jointly and severally, based upon the twenty-two transactions charged to Inemer; and (c) \$44,000 on Floirendo, Husky, and O'Brien, jointly and severally, based upon the forty-four transactions charged to Floirendo.

The PHLX also suspended O'Brien for two months, Inemer for two weeks, and Floirendo for two weeks, with the suspensions to run consecutively, first Inemer, next Floirendo, and then O'Brien. The PHLX specified that O'Brien's suspension was to continue until the monetary penalties had been paid in full to the Exchange.¹¹

We base our findings on an independent review of the record. For the reasons set forth more fully below, we set aside PHLX's action.

II.

A. Background

O'Brien, who has worked in the securities industry for more than twenty-three years, started Husky. Husky's client base consists of large financial institutions and over-the-counter broker dealers. During the Relevant Period, Husky's trades averaged 1,000 options contracts per trade. Husky's trading volume at the Exchange was approximately 2.5 million options per month, or 100,000 - 150,000 options per day.

B. Delta Neutral Stock-Tied Option Transactions

Approximately ninety-five percent of Husky's business involved delta neutral stock-tied option transactions, which are the type of transaction at issue in this proceeding. A stock-tied option transaction is a type of contingent trade. A contingent trade is a "multi-component trade involving orders for a security and a related derivative . . . that are executed at or near the same

¹⁰ As relevant here, Exchange Rule 960.1(b) permits a person employed by or associated with a member organization to be charged with any violation within the Exchange's disciplinary jurisdiction committed by employees under his supervision or by the member organization with which he is associated, "as though such violations were his own."

¹¹ The Commission stayed Applicants' sanctions. *Husky Trading LLC*, Order Granting Stay, Admin. Proc. File No. 3-13096 (July 30, 2008).

time."¹² In a stock-tied option order, the ratio of option to stock depends on the number of shares necessary to offset the option position, and may vary. The economics of a contingent trade are based on the relationship between the prices of the underlying security and the related derivative.¹³ The sought-after spread or ratio between the relevant instruments is known and specified at the time of the order, and that ratio remains fixed regardless of the prevailing price of each instrument at the time of execution.¹⁴ Thus, the parties to a contingent trade will not execute one side of the trade without the other component or components being executed in full and at the specified spread or ratio.¹⁵ Husky executed delta neutral stock-tied option transactions at various ratios of option to stock.

During the Relevant Period, the PHLX, unlike other options exchanges, had no rules addressing the trading of delta neutral stock-tied option orders. Instead, PHLX's rules referred to "synthetic options," a type of stock-tied option order defined as an order to buy or sell options and the underlying stock or Exchange-Traded Fund Share ("ETF share") such that the stock or ETF shares would offset the option position on a one-to-one basis, *i.e.*, one option contract to 100 shares of the underlying stock or ETF.¹⁶ Less than one percent of Husky's business involved synthetic options, as defined by PHLX.

At the hearing, the parties stipulated to the manner in which each trade at issue was handled:

Husky floor broker enters the PHLX options trading crowd with an options order tied to stock. Husky communicates the terms of the order to trading crowd participants, which contain an options leg price ("OLP") tied to a stock leg price ("SLP"), the Delta, that results in a net debit or credit ratio. Members of the crowd who wish to participate in the options tied to stock trade reach agreement. Husky promptly submits the stock leg of the trade to a non-PHLX stock execution venue. The stock execution venue executes the

¹² See Exchange Act Rel. No. 54389 (Aug. 31, 2006), 71 Fed. Reg. 52,829 (Sept. 7, 2006) (order exempting qualified contingent trades from Exchange Act Rule 611(a)).

¹³ *Id.*

¹⁴ *Id.*

¹⁵ *Id.*

¹⁶ See former PHLX Rule 1066(g) (defining synthetic options); see also PHLX Rules 1066(g), 1033(e), and OFPA F-14 (rules applicable to synthetic options). In November 2007, the PHLX revised the definition of "Synthetic Option" in PHLX Rule 1066(g) to accommodate delta neutral stock-option orders. See Exchange Act Rel. No. 56,760 (Nov. 7, 2007), 72 Fed. Reg. 64,268 (Nov. 15, 2007) (order approving File No. SR-PHLX-2007-40) ("2007 Order").

stock portion of the trade and reports back the stock execution price to Husky. If the price differs from the SLP, an adjustment to the OLP is required. Husky reports the options leg price to the tape, and at the time of the tape report the options leg price was, on the occasions alleged by the Exchange, either: 1.) at a price that is at or outside the NBBO or PBBO of the options, or 2.) at a price that is at or below the price of a booked limit order to buy the options, or at or above the price of a booked limit order to sell the options, or 3.) at a price that is at or below the price of a remote streamer's bid price, or at or above a remote streamer's offer price, in the options.

O'Brien testified that he consulted with Floor Officials or Option Committee Members about how to conduct certain trades. He testified that, for the execution of stock-tied option transactions, a PHLX Head Floor Official "directed" him to PHLX Rule OFPA F-14 ("Rule F-14"), which provides in part:

In the case of a synthetic option order, the trade may be immediately executed at a single credit or debit which is superior to the aggregate price of the established market for the individual legs (on a buy-on-the-offer and sell-on-the-bid basis), provided that the option leg is executed at a price better than the established bid/offer for that option contract

[O]nce the credit or debit execution price to a hedge or synthetic option order is agreed upon, the stock portion of the order, if any, must be effected prior to the execution of the option portion and participants must promptly match the individual option legs for trade reporting.

O'Brien testified that Husky patterned the execution of its delta neutral stock-tied option transactions after Rule F-14. O'Brien analogized his reliance on Rule F-14 to a "sporting event . . . like the Phillies game, even though there is a red light, there is a cop outside waving you through, it is the same structure." O'Brien did not state when he sought the advice, did not identify the floor officials, did not explain what he told the floor officials about the transaction, and did not elaborate on the advice that he received.¹⁷ No floor official testified.

C. The Options Floor Brokerage Management System

In 2000, the Commission ordered the options exchanges, including the PHLX, to design and implement an accurate, time-sequenced, consolidated audit trail system to enable the Exchange to reconstruct markets promptly, effectively monitor them, and enforce order handling,

¹⁷ O'Brien's testimony suggests that some of these conversations may have occurred after PHLX Market Surveillance challenged Husky transactions.

firm quote, trade reporting, and other rules.¹⁸ In response, the PHLX created the Options Floor Broker Management System ("FBMS").¹⁹ FBMS is designed to enable floor brokers and/or their employees to enter, route, and report transactions stemming from option orders received on the Exchange.²⁰ Upon the execution of an order, the floor broker is required to enter the time of execution of the trade into the FBMS.²¹ The resulting trading records comprise the electronic order audit trail. Applicants stipulated to the accuracy of the FBMS data.

D. Proceedings Below

On December 12, 2006, the PHLX issued a statement of charges against Husky only, charging a single count of failure to honor order priority. On March 19, 2007, the PHLX amended its statement of charges to include O'Brien, Inemer, and Floirendo as individual applicants. This new statement charged Applicants with trading through the NBBO and/or the PBBO and with failure to honor order priority, and also charged Husky and O'Brien with supervisory failures.²²

The Hearing Panel's decision was based largely on FBMS trading records documenting the trades at issue in the proceeding. The Hearing Panel found that, based on the execution times provided to FBMS by Applicants, Applicants executed eighty-seven transactions that traded through the PBBO and/or the NBBO and that seventy-six of those trade-through violations were based on execution times provided by Applicants. The Hearing Panel concluded that, because Exchange rules require floor brokers or their employees to enter the time of execution of the trade promptly into the FBMS, it was "reasonable to conclude that the execution time entered into the FBMS was at or about the time of actual execution of the trade." The Hearing Panel

¹⁸ See Order Instituting Public Administrative Proceedings Pursuant to Section 19(h)(1) of the Securities Exchange Act of 1934, Exchange Act Rel. No. 43268 (Sept. 11, 2000), 73 SEC Docket 697, 709.

¹⁹ FBMS is a component of AUTOM. AUTOM provides for the automatic entry and routing of equity option and index option orders to the Exchange trading floor. See Order Relating to the Options Floor Broker Management System, 84 SEC Docket 2473, 2474 n.10. Equity option and index option specialists are required by the Exchange to participate in AUTOM. *Id.*

²⁰ See *id.* at 2474. The PHLX issues to floor brokers "Handhelds," portable electronic devices that function as FBMS terminals, on which they are required to enter such option order information as the order type, the option symbol, and the nature of the transaction – buy, sell, cross, or cancel.

²¹ *Id.*

²² See *supra*, note 8.

noted further that, because Applicants chose not to provide the execution times in the FBMS for four of the remaining eleven trade through violations, the Exchange was forced to rely on the tape report time to establish the time of trade execution. In addition, the Hearing Panel observed that, for the remaining seven of those eleven trade-through violations, the market for the options at issue never traded at any time during the life of the order at the price at which the option was executed and reported to the tape.

The Hearing Panel found that on thirty-one occasions Applicants traded ahead of customer orders on the Book. The Hearing Panel noted that, in 2006, Husky settled allegations that Husky had traded ahead of a customer order on the Book in violation of Exchange rules during the period of January 13, 2004 through June 30, 2005.²³ The Hearing Panel concluded that this settlement put Applicants on notice of the Exchange's position that floor brokers have an independent obligation to not execute transactions that trade ahead of booked customer orders.

The Hearing Panel also concluded that on fifty-four occasions, Applicants traded ahead of SQT and/or RSQT orders. In thirty-seven of those instances, SQTs or RSQTs had already posted their quotes and therefore established priority before Applicants had received the applicable orders from their clients. The Hearing Panel observed that, for ten of the remaining transactions, the streamers posted their quotes after Applicants' receipt of orders but before Applicants reported the transactions to the tape. The Hearing Panel noted that in each of those ten instances, Applicants had failed to record the actual execution time. The Hearing Panel concluded that, as a result, the tape report time of those ten trades constituted the best available evidence of the time of execution for purposes of evaluating priority. In addition, the Hearing Panel noted that, for the remaining seven transactions, some streamers posted their quotes before, and some after, Husky received the orders for representation. For the sum of these violations, the Hearing Panel imposed the monetary sanctions described above and suspensions of six months on O'Brien, three weeks on Inemer, and six weeks on Floirendo.

On appeal, the Board affirmed the Hearing Panel's findings of fact and conclusions of law and the monetary sanctions it had imposed, but reduced the length of the suspensions to two months on O'Brien, two weeks on Inemer, and two weeks on Floirendo. The Board's Advisory Committee, which had heard oral argument, had noted that the Hearing Panel decision did not explain how the suspensions would protect the trading public from harm, and the Board accordingly found that the suspensions were "not supported by substantial evidence and are arbitrary, capricious, or an abuse of discretion on the part of the [Hearing] Panel." However, the Board also did not explain the basis for the length of the suspensions it imposed.

²³ *In the Matter of Husky Trading LLC*, Enf. No. 2006-02 (June 22, 2006). The trading ahead charge at issue in this settled proceeding also involved a delta neutral stock-tied transaction.

III.

A. Regulatory Framework

In general, PHLX rules require that all trades at the Exchange be executed at a price that is at or better than the highest bid or lowest offer.²⁴ Execution of a trade at a price that is inferior to the highest available bid or the lowest available offer is called a "trade through." Exchange Rule 1085 generally prohibits trade throughs of the NBBO "[a]bsent reasonable justification" and during normal market conditions, although it sets forth ten exceptions to the prohibition against trading through the NBBO.²⁵ There are no exceptions under PHLX rules that permit trading through the PBBO.

Pursuant to Exchange Rules 119 and 120, bids (or offers), including SQT and RSQT quotations, that are made at the same price generally are prioritized according to the time they are made, with the earliest-entered bids (or offers) taking precedence. Trades that disregard these priority and precedence restrictions are said to "trade ahead" of those orders with established priority. Exchange Rule 1014(g)(i)(A) further prohibits broker-dealer orders from trading ahead of customer orders.

Applicants do not dispute that, at the time the execution of the option leg of each delta neutral stock-tied option transaction was reported to the tape, the trades at issue entered by Applicants traded through and/or traded ahead. Applicants, however, argue that their trades should nonetheless not be deemed violative of PHLX rules. We address their arguments in turn.

B. Trading Through

1. Applicants argue that their delta neutral stock-tied options were a kind of synthetic option. They contend that the trading of synthetic options is covered by Rule F-14, and thus their trades were permitted. However, as discussed earlier, during the Relevant Period, former Exchange Rule 1066(g) limited the term "synthetic option" to stock-tied options with option-to-stock ratios of one-to-one. Since the delta neutral stock-tied option transactions at issue were not synthetic options as defined by former Rule 1066(g), Rule F-14 did not apply to Applicants' trades during the Relevant Period.

Applicants assert in their brief that, if Husky's delta neutral stock-tied options are not deemed synthetic options, "Husky's millions of delta neutral stock-tied options trades – ninety-five percent of Husky's business – are entirely beyond the scope of the business permitted by the PHLX. This is not, and cannot be, correct." However, the exclusion of delta neutral stock-tied

²⁴ See PHLX Rules 119-120, and 1067.

²⁵ See PHLX Rule 1085(b). Applicants do not argue that any of these exceptions are applicable to their transactions.

option orders from the definition of "synthetic option" did not place delta neutral orders "entirely beyond the scope of business permitted by the PHLX." It merely excluded them from PHLX rules applicable to synthetic options, including Rule F-14.²⁶

2. In the alternative, Applicants assert that Husky "reasonably relied on the guidance of PHLX floor officials to apply Rule F-14" for the execution of Husky's delta neutral trades. As noted, O'Brien testified that he sought advice from unidentified Exchange floor officials during the Relevant Period regarding how to effect Husky's stock-tied option transactions, and that the floor officials "waved them through," directing Applicants to follow Rule F-14.

The record includes no evidence of who O'Brien may have spoken with when the conversations occurred, or what O'Brien told them about the structure of the trades for which he sought guidance. Beyond stating that he was "directed" to Rule F-14, O'Brien did not describe what the floor officials said to him. Nor did Applicants call floor officials to testify on this point. Thus, for example, if O'Brien asserted to floor officials then, as Applicants insist now, that the trades were synthetic options, then directing Applicants to Rule F-14 would have been an appropriate response, albeit not the correct one for the delta neutral transactions at issue.²⁷ The record is insufficient to permit a conclusion as to the reasonableness of any reliance Applicants may have placed on any advice of floor officials. In any event, O'Brien did not suggest that he had been told that he could trade through the established PBBO.

Moreover, even if Rule F-14 applied to these transactions, Applicants did not comply with the rule's requirements. Rule F-14(d) provides a three-step process: first, there is agreement in the crowd as to the terms of the tied transaction, *i.e.*, the price of both the stock and the options legs, which determines the net debit or credit of the tied trade; second, the stock trade is

²⁶ Applicants also suggest that the PHLX disciplinary action against them is tantamount to a denial of access to the Exchange's services, citing *William J. Higgins*, 48 S.E.C. 713 (1987) (setting aside Exchange's denial of request to install telephones to enable communications with non-members away from the trading floor). Of the nearly 76,000 trades involving over 57 million options contracts conducted by Husky during the Relevant Period, the PHLX charged and found that only 172 trades were in violation of PHLX rules. The PHLX has not denied Applicants access to PHLX services for any delta neutral trade; it has sanctioned Applicants because a small minority of their trades did not comply with PHLX's rules.

²⁷ The Exchange's witnesses both testified that floor officials do not have the authority to make prospective rulings on the applicability of Exchange rules to transactions on the floor. We previously have held that erroneous advice from self-regulatory organization ("SRO") officials does not relieve regulated persons of their duty to comply with SRO rules. *B.R. Stickle & Co.*, 51 S.E.C. 1022, 1025 (1994). We have also stated that members and their associated persons cannot shift their compliance obligations to SRO officials. *See Schon-Ex, LLC*, Exchange Act Rel. No. 57857 (May 23, 2008), 93 SEC Docket 6195, 6204 n.21 and authorities cited therein.

executed; and third, the option leg is executed. As Applicants note, between the time crowd agreement is reached and the time the option leg is executed, the market may have moved. If this happens, and the stock leg has been executed, the only way to preserve the agreed-upon net debit or credit would be to adjust the price of the option. However, Rule F-14 states that the option leg of a synthetic option order must be "executed at a price better than the established bid/offer for that option contract." Accordingly, Rule F-14, by its terms, does not authorize any adjustment to the option price if such an adjustment would result either in a trade through of the PBBO at the time the options order is executed or in trading ahead of an order with priority.

3. Applicants argue that:

Husky could not refuse to execute half of a tied trade and ignore the option piece of the trade if the stock price had changed. The PHLX had no cancellation rule that would have permitted cancellation of the entire trade after market movement in the stock price Without a cancellation rule, the operation of Rule F-14 made adjusting the option the only reasonable alternative.

Assuming that Applicants are correct that they could not cancel the option leg of the transaction in the absence of a PHLX rule permitting a cancellation, that absence does not justify non-compliance with existing applicable PHLX rules. Applicants could have structured the stock leg as a contingent trade or asked the contra-party to cancel voluntarily. If those remedies were not adequate, Applicants should have sought to change the PHLX's rules, not to violate them.

4. Rule 1085(a) prohibits trading through the NBBO unless there is "reasonable justification." Applicants contend that the "reasonable justification" language provides an additional exception to the ten exceptions enumerated in Rule 1085(b) because, in their view, the term "reasonable justification" otherwise would be rendered meaningless.

They claim their trading through was reasonably justified because it: was a virtually inevitable result of executing a large delta neutral trade with multiple components on different exchanges [I]n a delta neutral trade the net debit or credit ratio must be maintained. Husky reasonably believed that Rule F-14 . . . applied. Husky reasonably believed . . . that the stock component was executed first. The PHLX had no cancellation rule applicable to these trades. Consequently . . . if the option leg "traded through" when posted to the tape, there was reasonable justification.

However, as noted above, the absence of a cancellation rule does not justify their conduct. Further, on the record before us, Applicants have failed to demonstrate that their reliance on Rule F-14(d) was reasonable. In any event, Rule 1085 does not permit trading through the PBBO.

Applicants note that current Rule 1083 now defines "complex trades" to include delta neutral transactions such as theirs.²⁸ Applicants assert that, accordingly, the enumerated exception for "complex trades" in Rule 1085(b) is now applicable to delta neutral transactions. However, the enumerated exceptions in Rule 1085(b) are only for trading through the NBBO. The proscription against trading through the PBBO is sacrosanct, and no exemption is provided anywhere in the PHLX rules. Of the eighty-seven trading-through transactions at issue, seventy would still have traded through the PBBO and only seventeen would have been exempted from trading through the NBBO pursuant to the amended rules.

Applicants also argue that PHLX justified this amendment of its rules to the Commission as "modernizing" the rule to "reflect actual practice."²⁹ They claim this language shows that the PHLX has recognized that Applicants' trades were occurring on the PHLX and were reasonable. In approving the amendment, however, we noted that the new definition of "Complex Trade" was "consistent with the definition of Complex Trade adopted by other Linkage Plan Participants" and could "increas[e] the number of markets in which customers may execute such orders,"³⁰ suggesting that the actual practice to which the PHLX intended to conform its rules was that of other Linkage Plan Participants.

C. Trading Ahead

1. Applicants assert that PHLX's decision that they traded ahead of SQTs and RSQTs is unsupported by evidence because its electronic audit trail does not show whether the SQT or RSQT "stepped aside" or yielded priority to Applicants. The audit trail evidence indicates that SQT and RSQT orders had priority over theirs for the trades alleged, establishing a *prima facie* case that they violated Rules 119 and 120.

²⁸ The PHLX amended Rule 1083 in November 2007 to include within the definition of Complex Trade "the execution of a stock option order ('synthetic option order') to buy or sell a stated number of units of an underlying stock . . . coupled with the purchase or sale of option contract(s) on the other side of the market representing," among other things, "the number of units of the underlying stock . . . necessary to create a delta neutral position . . ." See 2007 Order, *supra* note 16.

²⁹ *Id.*

³⁰ Exchange Act Rel. No. 56760 (Nov. 7, 2007), 91 SEC Docket 3101, 3101. See, e.g., Chicago Board Options Exchange Rule 6.80 (including delta neutral transactions in definition of "Complex Trade"). The Linkage Plan is a national market system plan for the operation of the Intermarket Option Linkage.

Applicants had the burden going forward to establish any affirmative defense.³¹ O'Brien testified at the hearing that Husky had "gone out of [its] way in numerous situations to find[] streamers, to find the representation of the Market Maker who's streaming, and asking him if he wants to do the trade." O'Brien stated that he was not aware that any SQT or RSQT had complained either that its priority had not been honored or that O'Brien traded ahead of its orders without an agreement to do so. However, O'Brien conceded that he did not document what occurred with SQTs or RSQTs with respect to any of the transactions at issue. Although witnesses testified that the audit trail would reflect step asides, there is no other evidence in the record that SQTs or RSQTs yielded priority to Husky. We find that PHLX's findings are supported by a preponderance of the evidence.

2. Applicants do not dispute PHLX's findings that they traded ahead of public customer orders as alleged. Rather, they attempt to avoid liability by shifting blame to the specialist. O'Brien testified that he did not see whether there were customer orders on the Book and that he "would have to think that the specialist would have a responsibility, since he is charging the order on the [B]ook, to tell us whether it is a bid or offer by a customer," and that the specialist "has a fiduciary responsibility to honor that best bid and that best offer for that customer if it is on the [B]ook."

Rule 1014(g)(i)(A) states that accounts under common control with a broker-dealer "are required to yield priority to customer orders when competing at the same price." The rule thus places an onus on the broker-dealer to yield priority to a public customer. Moreover, we agree with PHLX that the 2005 settlement of disciplinary charges involving findings that Husky traded ahead of customer orders on the Book put Applicants on notice of this obligation.

D. Notice of Applicability of Rules to the Transactions at Issue

Applicants argue that there was "rampant confusion about when the trade was actually 'executed,'" *i.e.*, whether the trade was executed (for purposes of determining trade through and trading ahead issues) at the time of crowd agreement, or at the time of the execution of the option leg of the transaction. Applicants note that, during the hearing, there was disagreement among the witnesses on this point. Moreover, while the Hearing Panel majority concluded that the relevant time was the execution of the option leg, one member dissented and expressed the view that the time of crowd agreement controlled, although the basis of his dissent is not clear from the Hearing Panel decision.

³¹ See *SEC v. Ralston Purina Co.*, 346 U.S. 119, 126 (1953) (stating that "imposition of the burden of proof" on a party "who would plead the exemption seems for us fair and reasonable" (internal citations omitted)); *Donald T. Sheldon*, 51 S.E.C. 59, 77 n.70 (1992), *aff'd*, 45 F. 3d 1515 (11th Cir. 1995).

As an initial matter, we note that the PHLX Board affirmed the Hearing Panel majority. Thus, that majority view was the final decision of the PHLX. We review the final decision.³² We agree with PHLX that it was appropriate to separate the elements of Husky's delta neutral transactions and deem execution to occur upon entry of the option leg on AUTOM. The view rejected by PHLX that the time of crowd agreement should control may have been useful historically, when trading on exchanges occurred solely in open outcry auctions, and exchanges may have recognized the existence of binding oral contracts formed when the crowd reached agreement but before the agreement was reported or recorded. However, with the implementation of automated trading systems such as AUTOM, and the need to integrate an exchange's open outcry market with such systems, the rules governing the use of trading using these systems have evolved. We believe PHLX reasonably construed its rules as requiring the execution time of the options leg of the delta neutral transactions to be the basis for determining trade through and trading ahead liability.

We are concerned, however, that the disagreement among the witnesses testifying at the hearing, and among the Hearing Panel members, indicates that some level of uncertainty may have existed during the Relevant Period concerning the correct interpretation of PHLX's rules. These circumstances raise a question whether, during the Relevant Period, Applicants were properly on notice that their conduct was violative. While the proper application of PHLX rules is now clarified with the issuance of this opinion, under the circumstances of this case we believe that it is appropriate to set aside the PHLX's action.

An appropriate order will issue.³³

By the Commission (Chairman SCHAPIRO and Commissioners WALTER, AGUILAR, and PAREDES); Commissioner CASEY not participating.

Elizabeth M. Murphy
Secretary

³² See, e.g., *Schon Ex*, 93 SEC Docket at 6206 n.25 (noting the Exchange board had affirmed sanctions choice of the majority of hearing panel, and that Commission reviewed that final decision).

³³ We have considered all of the parties' contentions. We have rejected or sustained them to the extent that they are inconsistent or in accord with the views expressed in this opinion.

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 60180 / June 26, 2009

Admin. Proc. File No. 3-13096

In the Matter of the Application of

HUSKY TRADING LLC,
EUGENE O'BRIEN,
MICHAEL INEMER,
and
STEPHEN FLOIRENDO

c/o Paula D. Shaffner, Esq.
Stradley Ronon Stevens & Young, LLP
2600 One Commerce Square
Philadelphia, PA 19103

For Review of Disciplinary Action Taken by the
PHILADELPHIA STOCK EXCHANGE, INC.

ORDER SETTING ASIDE DISCIPLINARY ACTION TAKEN BY REGISTERED
SECURITIES EXCHANGE

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

ORDERED that the disciplinary action of the Philadelphia Stock Exchange, Inc. against Husky Trading LLC, Eugene O'Brien, Michael Inemer, and Stephen Floirendo be, and it hereby is, set aside.

By the Commission.

Elizabeth M. Murphy
Secretary