

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES ACT OF 1933
Rel. No.8334/November 7, 2003

SECURITIES EXCHANGE ACT OF 1934
Rel. No.48759/November 7, 2003

Admin. Proc. File No. 3-10140

In the Matter of :
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ROBERT J. SETTEDUCATI :
Brick, NJ 08723 :
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OPINION OF THE COMMISSION

BROKER-DEALER PROCEEDINGS
CEASE-AND-DESIST PROCEEDINGS

Ground for Remedial Action

Alleged Manipulation

Associated person of registered broker-dealer was alleged to have manipulated the price of securities sold to public investors. Held, allegation has not been established and, accordingly, proceeding is dismissed.

APPEARANCES:

John E. Birkenheier, Joy M. Boddie, Charles J. Kerstetter, and Sean E. Kreiger, for the Division of Enforcement.

Thomas M. Knepper, of Knepper & Gladney, for Robert J. Setteducati.

Appeal filed: August 30, 2002
Last brief filed: December 4, 2002
Oral argument: September 17, 2003

I.

The Division of Enforcement appeals from the decision of an administrative law judge dismissing proceedings against Robert J. Setteducati, formerly executive vice president of H.J. Meyers & Co., Inc. ("HJM" or the "Firm"), a former registered broker-dealer. 1/ The Division alleged that Setteducati was part of an effort by HJM to manipulate the price of the stock of Borealis Technology Corporation ("Borealis" or the "Company") during 1996. The Division alleged that Setteducati willfully violated Section 17(a) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934 and Exchange Act Rule 10b-5, 2/ and that he caused and willfully aided and abetted HJM's violations of Exchange Act Section 15(c)(1) and Exchange Act Rules 15c1-2 and 15c1-8. 3/

1/ HJM terminated operations in September 1998.

In addition to Setteducati, HJM, HJM's president, James Villa, HJM's sales manager, William Masucci, and HJM's head trader, Michael Vanechanos, were named as respondents in the Order Instituting Proceedings (the "OIP") in this matter. In addition to charges related to the manipulation at issue here, the OIP's allegations against HJM, Vanechanos, and Villa involved related claims of fraudulent markups by HJM in sales of securities to retail customers. These markup allegations were not made against Setteducati, who was charged only with manipulation. Each of the other respondents named in the OIP reached a settlement with the Commission. See H.J. Meyers & Co., Inc., Exchange Act Rel. No. 43579 (Nov. 17, 2000), 73 SEC Docket 2594; H.J. Meyers & Co., Inc., Exchange Act Rel. No. 43844 (Jan. 16, 2001), 74 SEC Docket 239; and H.J. Meyers & Co., Inc., Exchange Act Rel. Nos. 43945 and 43946 (Feb. 9, 2001), 74 SEC Docket 949 and 953.

2/ 15 U.S.C. § 77q(a), 15 U.S.C. § 78j(b), and 17 C.F.R. § 240.10b-5. These provisions prohibit fraud in connection with the purchase or sale of securities.

3/ 15 U.S.C. §§ 78o(c)(1) and 78o-4(c)(1); 17 C.F.R. § 240.15c1-2. Section 15(c)(1) and Rules 15c1-2 and 15c1-8 prohibit a broker-dealer in over-the-counter transactions from inducing the purchase or sale of securities by means of any manipulative, deceptive, or other fraudulent device or contrivance, including representations that a security is

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The law judge dismissed all of the allegations against Setteducati based on the law judge's conclusion that the market for Borealis had not been manipulated. The law judge further found that, even if the market for Borealis had been manipulated, Setteducati's role in the Borealis offering and the stock's aftermarket trading was insufficient to hold him liable for such misconduct. We base our findings on an independent review of the record, except with respect to those findings not challenged on appeal. 4/

II.

The Division alleged that Setteducati and other HJM officials participated in a scheme to inflate the price of Borealis stock during the first five days of aftermarket trading following the Company's initial public offering ("IPO") in late June 1996. HJM was the sole underwriter for the IPO. The Division further alleged that, through this manipulation, HJM and HJM officials (not including Setteducati) were able to charge the Firm's retail customers fraudulent mark-ups in sales of Borealis stock. 5/ As discussed below, we agree with the law judge that the record does not support the Division's allegations, and we therefore must dismiss the proceedings against Setteducati.

Background. Borealis was an "information technology" company based in Incline Village, Nevada. As of May 1996, Borealis had 31 full-time employees, including eight in research

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- 3/ (...continued)
being offered "'at the market' or at a price related to the market price," unless the broker-dealer has reasonable grounds to believe that a market for such security exists other than that "made, created or controlled by him"
- 4/ Rule of Practice 451(d), 17 C.F.R. § 201.451(d), permits a member of the Commission who was not present at oral argument to participate in the decision of the proceeding if that member has reviewed the oral argument transcript prior to such participation. Commissioner Atkins, who was not present at the oral argument, performed the requisite review.
- 5/ The Division stated, at the start of the hearing (after all the respondents but Setteducati and Masucci had settled), "[t]he excessive markup violations are no longer part of the case . . . what remains are the manipulation charges against the two respondents"

and development. According to its prospectus, in 1994 and 1995 Borealis had respective "net revenue" of \$1,011,060, and \$736,152 from the "licensing and sale of products . . . service and maintenance agreements and . . . consulting services." 6/ In 1996, Borealis "ceased sales and marketing of its entire product line and shifted its focus to the development of "Arsenal," which the Company described as "an advanced sales automation development tool which is designed to assist businesses in building and deploying customized mobile and client/server-based applications to enhance the productivity and effectiveness of their sales personnel." 7/ The prospectus stated that, "[a]lthough the Company has completed much of the development of Arsenal, significant additional development and testing will be required before commercial introduction, which introduction is not expected until the second half of 1996, at the earliest."

Testimony from various witnesses indicates that the Borealis IPO 8/ generated considerable enthusiasm among Firm salespersons. 9/ For example, David Steele, an HJM salesman in the Firm's San Francisco branch office, recommended the stock and purchased it for his personal account because he "was a big believer in sales force automation software," which Steele considered to be "a rapidly growing industry." 10/ Steele added

6/ Despite these revenues, the Company disclosed that it had "experienced significant operating losses in each of fiscal 1994 and 1995 and for the first three months ended March 31, 1996 and expect[ed] to incur significant losses for the foreseeable future." As a result of these recurring losses, Borealis' independent auditor, Ernst & Young LLP, expressed "substantial doubt about its ability to continue as a going concern."

7/ According to its prospectus, the Company's objective in developing Arsenal was "to become the leading supplier of sales automation development tools"

8/ The circumstances surrounding HJM's selection as underwriter for the Borealis IPO are not clear from the record.

9/ These witnesses, like all the witnesses discussed herein, were called by the Division. Setteducati, who gave direct testimony in defense, called no witnesses.

10/ Steele added that he believed Borealis' Arsenal product was "at least as good if not better than" the competition, and
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that he purchased the stock in the aftermarket for his retirement account. Steele also testified that his favorable view of Borealis was influenced by the fact that Pat Grady, an HJM investment banker based in the San Francisco office whom Steele respected, was favorably impressed with the Company. Steele testified that the Borealis offering was one of the most popular among brokers in HJM's San Francisco office because of the nature of the product, the proximity to San Francisco of Borealis' Nevada operations, and the enthusiasm of Grady and the branch's manager. Similarly, Chris Donofrio, a salesman in HJM's Chicago branch office, testified that the "brokers really liked the [Borealis] IPO. They were excited about it. That got me excited about it. They liked the management," who had traveled to Chicago to promote the offering.

Similarly, Mark Faith, the brother of Borealis's president and an HJM customer, testified that he invested close to \$20,000 in Borealis stock through the Firm based on his brother's recommendation. Faith described himself as "very familiar with the company, being close to my brother." Faith stated that his brother, whom he described as "an honest man," was very optimistic about the Company and "advised many people in the family to buy into it." Although Faith sought Borealis shares in the IPO, he was unsuccessful because it was oversubscribed. He therefore purchased 2,250 shares in the aftermarket, which he continued to hold at the time he testified at the administrative hearing. 11/

Borealis IPO and Aftermarket Trading. HJM sold 1,903,000 shares to its own retail and institutional customers in the Borealis IPO, which went effective on June 20, 1996. 12/ The offering price for the IPO was \$5 per share. An additional

10/ (...continued)
that the stock's "price was fair." According to Steele, Borealis was "competing with Siebel Systems sales force automation software and the market they were addressing was Fortune 500 companies that had a vast disparate sales force that did not as of yet have any form of automation to their sales force."

11/ Faith paid \$8.25 and \$8.75 per share for his Borealis stock, which he purchased in two blocks.

12/ The Company also issued, in May 1996, a warrant to purchase Borealis stock, exercisable for four years at \$5 per share, to its counsel, Wilson Sonsini Goodrich & Rosati.

418,000 shares were sold by twenty-one other firms that HJM had assembled as a selling group for the IPO. 13/ While most of the Borealis offering was sold to individual retail customers, at least 378,000 shares were sold to certain of HJM's institutional clients. 14/ Because the Borealis IPO was heavily oversubscribed, customers were unable to purchase all of the shares they had sought in the IPO.

Borealis, which was listed for trading on the Nasdaq SmallCap Market, began aftermarket trading on June 24, 1996. At some point between 10:16 a.m. and 10:20 a.m., 15/ HJM entered a bid quotation of \$7.25 and another market maker entered an ask quotation of \$8.25. 16/ HJM's quotation of \$7.25 remained the

13/ Although these firms were part of the selling group, they were not identified as underwriters of the offering in the prospectus. HJM's Underwriting and Syndicate Procedures required that it "allocate at least 20% of each offering to [a] selling group."

14/ Most of the institutional customers apparently took delivery of their Borealis stock through "agent banks," usually based overseas, which acted as nominees or custodians of the stock on the customers' behalf. As a result of this arrangement, HJM had no way of knowing the extent to which these institutional clients sold or retained their shares after the IPO.

15/ The exhibits conflict regarding when trading began. Division exhibits 38 and 50 indicate that HJM led or shared the inside bid beginning at 10:20 a.m., while Division exhibit 57 states that quotations were first entered at 10:16 a.m. when, the exhibit indicates, HJM entered a bid quotation of \$7.25. This conflict does not affect our analysis.

16/ The identities of other Borealis market makers are unclear from the record, as are other relevant market trading data. We also note that the Division did not call the Firm's trader or other senior Firm officials (except Setteducati, the Firm's sales manager Masucci, and Theodore Colby, who joined the Firm after the period at issue) as witnesses at the hearing.

As the law judge found, the "record shows nothing about the parties and counter parties to transactions during [the

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inside bid until 10:21:24 a.m. From 10:21:24 a.m. until 10:24:30 a.m., firms other than HJM raised the inside bid to \$8.50. According to the Division's brief, HJM "did not follow them." During the same time frame, a dealer other than HJM also raised the inside ask above \$9. The extent to which trades occurred based on these elevated quotations is unclear from the record. At 10:24:31 a.m., the inside bid fell to HJM's then bid of \$7.50, where it remained until the close of trading at 4:03:02 p.m. The inside ask also fell to \$8.125, where it remained for the rest of the day. HJM led or shared the inside bid for most of the next four trading days. 17/ The Firm rarely had the inside ask quotation during this period. 18/

The evidence establishes that HJM aggressively marketed Borealis to its customers. Encouraged by HJM's management and by the fact that they were paid extra "incentive" compensation to sell Borealis once aftermarket trading began, 19/ the Firm's salespersons strongly recommended the stock to their customers. The Firm's efforts were highly successful as evidenced by the facts that the IPO was oversubscribed and that there was heavy demand for the stock in the aftermarket. The following table summarizes trading in Borealis for the first five days of the aftermarket.

16/ (...continued)
early minutes of the aftermarket], the volume of shares changing hands . . . and whether retail customers, institutional customers, or interdealer trades were involved." In light of the lack of trading data, the law judge concluded that it would require a "leap of faith to conclude that any overpricing between 10:20 a.m. and 10:28 a.m. was the result of scienter-based fraud, rather than honest misjudgements in the price discovery process."

17/ The Firm led or shared the inside bid except for roughly 10 minutes on June 26, 29 minutes on June 27, and 1 hour 16 minutes on June 28.

18/ According to the Division's expert witness, HJM led or shared the inside ask between June 24 and June 28 "only 2% of the time."

19/ Salespersons were paid a portion of the spread between the bid and ask quotes.

Borealis Trading Summary
June 24-June 28, 1996

<u>Date</u>	<u>Shares sold</u>	<u>Bid (open)</u>	<u>Ask (open)</u>	<u>Closing Price</u>
6/24	759,258	\$7.25	\$8.25	\$8.125
6/25	167,190	7.5	8.125	8.125
6/26	63,810	7.5	8.125	7.375
6/27	92,305	7	7.375	7.125
6/28	37,636	6.75	7.125	6.75

While most of the retail demand for Borealis came from HJM's own customers, there also was considerable customer interest at other firms in the stock. On June 24, HJM's customers purchased 718,764 Borealis shares, while customers of other firms bought an additional 40,494 shares. On June 25, HJM's customers purchased 121,595, while customers of other firms purchased an additional 45,595 shares, more than one-third the total sold that day by HJM. 20/ In addition, while most of the aftermarket sales were to individual retail accounts, at least 395,000 shares were sold to institutional customers.

During the remainder of 1996, Borealis' stock price fluctuated in a downward trend, with prices ranging between \$3 and \$6 per share. The following table provides a sampling of the stock's trading history through 1996.

20/ Despite this customer interest away from HJM, other firms appear to have been net sellers, i.e., they sold more Borealis stock than they purchased during the early aftermarket.

Sampling of Borealis Trading History
July-December 1996

<u>Date</u>	<u>Volume</u>	<u>High</u>	<u>Low</u>	<u>Closing Price</u>
7/1/96	59,800	\$7.125	\$6.75	\$6.75
7/23	35,300	6.50	5.625	5.625
7/24	61,800	5.50	4.625	4.875
7/25	31,700	5.25	4.625	4.625
8/7	4,200	5.125	4.75	5.125
8/8	21,400	5.125	4.75	4.875
8/20	14,500	5.219	4.625	5.219
9/5	60,100	5	4	4.625
9/10	39,000	5	4.5	5
9/19	50,100	5.25	4.531	4.968
10/8	30,300	4.625	3.625	3.75
10/29	55,700	4.25	3.50	4.125
11/8	55,400	4.25	3.75	4.125
11/26	86,300	4.375	3.75	4.25
12/2	102,400	5.343	4.125	4.687
12/30	44,100	4.625	4	4.375
12/31	7,600	4.50	4.375	4.375

The record contains limited data regarding the stock's subsequent trading history but indicates that Borealis traded at \$5.50 a share on January 31, 1997, \$6.125 on April 25, 1997, and \$5.63 on August 29, 1997. 21/

III.

Manipulation Analysis. The Division alleges that Setteducati violated antifraud provisions through his and HJM's manipulation of the price of Borealis between June 24 and June 28, 1996. A manipulation has been defined as "intentional or willful conduct designed to deceive or defraud investors by controlling or artificially affecting the price of securities." 22/ As we have held,

21/ The record contains little information about Setteducati's role in the Borealis IPO, other than that he was involved in determining the allocation of stock to the Firm's branch offices and that, generally speaking, he played a role in motivating the Firm's salespersons to market offerings underwritten by the Firm to their customers. We discuss these matters further below.

22/ Ernst & Ernst v. Hochfelder, 425 U.S. 185, 199 (1976).

When individuals occupying a dominant market position engage in a scheme to distort the price of a security for their own benefit, they violate the securities laws by perpetuating a fraud on all public investors. In addition, their failure to disclose that market prices are being manipulated not only constitutes an element of a scheme to defraud, but is also a material omission of fact in the offer and sale of securities. 23/

In determining whether a manipulation has occurred, we generally look to see whether the trading and surrounding circumstances suggest an effort to "interfere[] with the free forces of supply and demand." 24/ We also have noted that "[p]roof of a manipulation almost always depends on inferences drawn from a mass of factual detail [including] patterns of behavior . . . apparent irregularities, and . . . trading data." 25/

Among the "earmarks" we have identified as supporting a finding of manipulation are: "a rapid price surge dictated by the firm that controlled the security's market, little investor interest, an abundant supply, and the absence of any known prospects for the issuer or favorable developments affecting it." 26/ We observe in this connection, however, that a "finding of manipulation does not hinge on the presence or absence of any

23/ Pagel, Inc., 48 S.E.C. 223, 228 (1985), aff'd, 803 F.2d 942 (8th Cir. 1986).

24/ Pagel, Inc., 48 S.E.C. at 226. We note in this connection that, "[w]hile profit is the normal goal of manipulators, their actions are not rendered innocent simply because they fail to achieve the desired result." Michael J. Markowski, Exchange Act Rel. No. 43259 (Sept. 7, 2000), 73 SEC Docket 625, 630, aff'd, 274 F.3d 525 (D.C. Cir. 2001), cert. denied, 537 U.S. 819 (2002).

25/ Pagel, 48 S.E.C. at 226.

26/ Patten Securities Corp., 51 S.E.C. 568, 573 (1993) (citations omitted). See also Jay Michael Fertman, 51 S.E.C. 943, 948 (1994) ("classic factors" of a manipulation include "a rapid surge in a security's price that is driven by control of the security's supply and that occurs despite scant investor interest in the security and in the absence of any known prospects for or favorable developments affecting the issuer") (citations omitted).

particular device usually associated with a manipulative scheme." 27/ Based on our review, we conclude that the evidence in this record is insufficient to support a finding of manipulation.

While Borealis's price rose significantly in the first minutes of the aftermarket, the evidence does not establish that the rise was caused by HJM. Although the record contains limited evidence regarding other market makers in Borealis, there is sufficient evidence to show that HJM was not alone in entering quotations in the stock that were substantially above the IPO price. Moreover, the record shows that, during the critical first minutes of aftermarket trading, when Borealis' price peaked well above the bid level set by HJM at the start of trading, it was not HJM, but other unidentified firms that were responsible for causing the price rise. There is no evidence of collusion between HJM and other dealers in Borealis to inflate the stock's price.

The evidence also fails to establish that HJM's bid quotations were not reflective of market forces. After purchasing well over 2 million shares in the IPO, customers bought more than 900,000 additional shares on the first two days of aftermarket trading. This investor interest, while strongest among HJM's customers, was shared to a not insubstantial degree by customers of other firms who purchased roughly 90,000 Borealis shares during the first two days of trading.

Nor does the evidence establish that this investor interest was disproportionate to Borealis' apparent prospects. Although it had suffered losses prior to the IPO, Borealis was an active business, with a promising product in a potentially lucrative business software sector. The evidence indicates that customer interest in the stock was due in significant part to the sales efforts of HJM personnel, who were highly enthusiastic about the Company.

The evidence further indicates that customer interest was not limited to retail investors, but also extended to institutional customers who purchased a total of more than

27/ Swartwood, Hesse, Inc., 50 S.E.C. 1301, 1307 (1992). See also Herpich v. Wallace, 430 F.2d 792, 802 (5th Cir. 1970) (antifraud provisions designed to "encompass the infinite variety of devices that are alien to the 'climate of fair dealing' . . . that Congress sought to create and maintain") (citations omitted).

750,000 Borealis shares in the IPO and aftermarket. Such large sales to institutional customers are evidence that Borealis appealed to investors who were presumably more sophisticated than the typical retail investor and that the Firm was willing to place large amounts of Borealis stock with customers whose accounts they could neither track nor control. 28/

Based on these various factors, we can readily distinguish this matter from the situation presented in Castle Secs. Corp., 29/ where we found a manipulation based on the fact that the stock of a newly-formed "blind pool" company with "no operating history, inexperienced management . . . no business plan other than the proposed acquisition of an unspecified business," and no "favorable developments affecting it," rose in an "ever increasing, arbitrary manner" despite little investor interest. 30/

An additional factor we consider is Borealis' trading history following the alleged manipulative period. Typically -- although not invariably -- the manipulation of a stock's price is followed by a "price collapse." 31/ The evidence does not establish that such a collapse occurred here. On June 28, the fifth day of aftermarket trading and the final day of the "manipulative period" identified by the Division in the Order Instituting Proceedings, Borealis' closing price was \$6.75. Although the stock's price fell below the initial offering price of \$5 within the next month, it did so gradually. Borealis subsequently traded at prices of \$5 and above periodically

28/ See n.14, supra. Professor Jay Ritter, testifying as an expert on behalf of the Division, conceded that selling to institutional customers who held their shares in overseas accounts (as was the case for most of the institutional investors here) could make it more difficult for HJM to control trading unless the Firm were "in cahoots" with the customers. The record does not establish the existence of any such improper relationship between HJM and its institutional customers.

29/ 53 S.E.C. 406 (1998).

30/ Castle Secs. Corp., 53 S.E.C. at 410.

31/ See SEC v. Resch-Cassin & Co., Inc., 362 F.Supp. 964, 976 (S.D.N.Y. 1973) (identifying "the collapse of the market for the security when the manipulator ceases his activity" as indicative of a manipulation).

throughout the remainder of 1996 and into 1997. The stock also traded in considerable volume during this period. Such continued investor interest further supports the conclusion that the initial price rise following the IPO was not the product of manipulation.

IV.

The Division asserts that the law judge erred in basing his dismissal on the Division's failure "to prove all common indicia of a manipulative scheme." To the contrary, the law judge expressly noted that, as we have held, 32/ a finding of manipulation does not depend on the presence or absence of any particular device usually associated with a manipulative scheme. The law judge held, however, that, while "one or two" of the classic factors have been "proven in part," the weight of the evidence, based on the record as a whole, does not support the Division's allegations. We agree that the record as a whole does not establish a basis for a finding of manipulation.

The Division asserts that the law judge found that HJM dominated and controlled the market for Borealis stock during "virtually the entire five-day manipulative period." The law judge found that certain of the factors associated with domination and control were present during a portion of the first five days of the aftermarket, including that HJM had sold the majority of the Borealis IPO to its own customers and was responsible for a significant amount of the total aftermarket trading volume in the stock. The law judge also found that HJM controlled "a good bit of the floating supply [of the stock] and was attempting to control more of it." 33/ However, the law judge expressly declined to find that the Firm controlled the Borealis market during what he considered to be the crucial initial minutes of the aftermarket, when the stock's price rose above \$9, because, among other reasons, the Firm did not have the inside bid quote during that time. Moreover, we have held that the fact that a dealer dominated and controlled a market does not necessarily mean that the dealer manipulated that market. 34/

32/ See n.27, supra.

33/ See Barrett & Co., 9 S.E.C. 319, 327 n.8 (1941) ("The 'floating supply' of a stock is that part of the issue which is outstanding and which is held by dealers and the public with a view to resale for a trading profit, as distinguished from that part of the stock held for investment.").

34/ See Pagel, Inc., 48 S.E.C. 223, 226 (1985) (because "an underwriter is in a position to dominate and control the trading market does not necessarily produce a manipulation"), affd, 803 F.2d 942 (8th Cir. 1986).

As we have held, a firm that controls the supply of a stock by, for example, selling a high percentage of the offering to its own customers can be liable for manipulation if it "abuses" its dominant position by "set[ting] prices arbitrarily." 35/ Although HJM sold a significant percentage of the Borealis offering to its own customers and purchased on behalf of those customers a large number of additional shares of Borealis stock in the aftermarket, most of the institutional customers, who purchased a substantial percentage of the stock sold by HJM, held it away from the Firm, in non-HJM accounts. These sales to institutional customers, on their face, reduced the Firm's control over a significant portion of the Borealis float. In any event, whether HJM dominated and controlled the market for Borealis, the evidence does not establish that the Firm used its market position to set prices arbitrarily.

Most of the Division's arguments relate to its claim that the Firm engaged in abusive sales practices which were intended to further the manipulation by ensuring HJM's control of the Borealis market. According to the Division, HJM marketed the stock, at the direction of Setteducati and others, in a way that created high customer demand and discouraged customer resales into the aftermarket. The Division argues that the Firm's marketing efforts had three main features: an allocation of the IPO to Firm personnel who had demonstrated an ability to market new offerings and discourage resales during the early aftermarket; the pressuring by HJM management, including Setteducati, of Firm personnel to sell Borealis stock and to discourage resales; and the use of so-called "penalty bids" to further discourage resales of Borealis stock during the early aftermarket. We discuss each in turn.

According to the Division, Borealis was allocated in early June 1996, prior to the receipt by the Firm of indications of interest from its customers. This allocation, which Setteducati approved, was structured so that a substantial portion of Borealis shares could be sold by the Firm's San Francisco, Chicago, and Atlanta branch offices. 36/ The San Francisco and

35/ Pagel, 48 S.E.C. at 226.

36/ The Division asserts that Setteducati did not "wait[] to see how, and whether, customer demand developed," but instead allocated "set numbers of shares to various offices and then demanded that those offices sell the shares they had been allocated." The Division further asserts that these

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Chicago offices were, in terms of revenue, the Firm's top two offices, and were responsible for generating over one quarter of the Firm's total revenues. 37/ Allocating the stock in this way furthered the manipulation, according to the Division, because the San Francisco and Chicago offices "were known for discouraging aftermarket sales by customers and for encouraging aftermarket purchases by customers." HJM's Atlanta office was where the Firm's institutional sales force was based and, the Division asserts, "the institutional customers of the Atlanta office had proven essential to the success of HJM in the aftermarket trading of any IPO."

The Division conceded before the law judge that, as "a general matter, there is no requirement that [an allocation] be fair or in strict conformance with" indications of interest by customers. The Chicago and San Francisco branch offices, which received allocations of 800,000 and 175,000 shares, respectively, were known within the Firm as being effective at supporting the market for new issues. The salespersons in these two offices were highly enthusiastic about the Borealis offering and likely to be effective at marketing it. The Chicago and San Francisco offices together eventually sold a total of 1,436,104 shares in the IPO and aftermarket. Based on the evidence, we cannot find that the allocations to these offices served anything other than legitimate sales marketing objectives.

36/ (...continued)

allocations violated the Firm's Underwriting Procedures because they were made prior to the receipt of indications of interest from the Firm's customers. The cited portion of those procedures, however, states merely that the "final allocation of an offering will not be confirmed until on or after the effective date" of the offering. The evidence indicates that the June 6 allocation was a preliminary rather than the final allocation, although the two were not significantly different in terms of the number of shares distributed to the Firm's branch offices.

37/ HJM had sixteen branch offices.

The San Francisco office, which received 33.9% of the Borealis allocation, generated 15.9% of total Firm revenues between January and June 1996. The Chicago office, which received 7.41% of the allocation, generated 11.11% of total Firm revenues during that period.

Similarly, the Division has not demonstrated that there was anything improper about the large allocation to HJM's Atlanta office. That office, which was allocated 437,000 shares, ultimately sold a total of 872,450 Borealis shares in the IPO and aftermarket, mostly to institutional customers. 38/ There is nothing in the record to indicate that the Atlanta allocation was not responsive to legitimate marketing considerations.

The Division asserts that Setteducati used "abuse and intimidation" to pressure the Firm's branch managers and salespersons to sell the Company's stock and to discourage customers who had bought the Company's stock from reselling it in the aftermarket. According to the Division, Setteducati's "pressure led the sales force to create the artificial, pent-up demand necessary for the manipulation to succeed." The Division's evidence included testimony from nine customers regarding what they had been told by their HJM salespersons in connection with their purchases of Borealis stock. 39/

Some of the testifying customers asserted that their salespersons recommended the stock without disclosing the associated risks and claimed that the stock was going to be a "home run." One customer testified that his salesman called him repeatedly urging him to buy Borealis and told the customer to disregard concerns the customer had expressed after reviewing the prospectus.

Certain of the customers also stated that the Firm's salespersons and, in some cases, branch managers, actively discouraged them from immediately reselling, or "flipping," their Borealis shares. One customer, who had purchased Borealis stock in the IPO, testified that he told his salesman that he wanted to sell the stock if its price rose 30%, but the salesperson failed

38/ As noted earlier, see n.14, supra, the evidence indicates that HJM did not control the stock held by most of its institutional customers, and thus a large allocation to such customers would seem to be inconsistent with the alleged manipulation.

39/ The Division claims that its evidence regarding HJM's high pressure sales tactics "explains why only customers of H.J. Meyers were interested in buying Borealis." However, as noted above, the Division's own exhibits show that interest in Borealis was not limited to HJM's retail customers, but also extended to institutional customers and customers of other firms.

to do so or contact the customer when the stock reached that target price. Another customer testified that he tried to sell Borealis stock when the price started to fall but was told by his salesman that the stock could not be traded for an unspecified "holding period" following the IPO. 40/

This evidence of aggressive sales practices is troubling. Such practices can constitute violations of the antifraud provisions of the securities laws and justify the imposition of severe sanctions. However, taken as a whole, the evidence that the Firm's salespersons engaged in such sales practice abuses in this case was unpersuasive. For example, despite some efforts of Firm personnel to discourage flipping, many of HJM's customers, including certain of the testifying customers, encountered no resistance when they sought to sell stock early in the aftermarket. One customer testified that his salesperson contacted him one week after the IPO and suggested that the customer sell his shares.

Even if we were to assume that HJM personnel engaged in abusive sales practices in connection with the Firm's trading in Borealis, there is little evidence linking those practices to Setteducati. 41/ None of the testifying customers had any

40/ Another customer testified that when she tried to sell she was told that it "would be a really bad mistake [because HJM was] trying to support the stock. It was a company that was going to have a big future, and that if [she] ultimately did attempt to sell the stock, that she would get a lousy execution on the sale." The law judge, however, found this witness to be "unreliable," and we have found no basis for rejecting that determination. See, e.g., Anthony Tricarico, 51 S.E.C. 457, 460 (1993) ("credibility determinations of an initial fact finder are entitled to considerable weight because they are based on hearing the witnesses' testimony and observing their demeanor").

41/ The Division cites Setteducati's disciplinary history to support its allegations, including that he acted with scienter in pressuring HJM personnel to sell Borealis in the IPO and aftermarket. For example, the Division referred at oral argument to a proceeding brought against Setteducati and others at the Firm by the Florida Department of Banking and Finance in 1990 on the "basis of very similar conduct" to that alleged here. Setteducati settled the Florida proceeding, however, and no final findings of violation were
(continued...)

contact with Setteducati and none of their salespersons, who may have had such contact, testified. Instead, the Division presented the testimony of a small number of HJM employees regarding general Firm practices and Setteducati's role within the Firm. These Firm employees offered little if any relevant evidence regarding Setteducati's actions in connection with the Borealis offering. In addition, the law judge found the testimony of these employees to be, for the most part, not credible.

One employee, Timothy Bartelt, who had met Setteducati once or twice during his two years with the Firm, testified that Setteducati told him that, at HJM, "We do deals. If you don't want to support our deals, don't work for us." 42/ Bartelt further claimed that his branch manager told him that the Firm's "upper management" was insisting that their branch get its customers to buy a specified number of Borealis shares. 43/ Bartelt added that, in the event customers wanted to sell their shares, salespersons "were encouraged to keep them in it." 44/

While Bartelt claimed that Setteducati and other Firm officials pressured him to participate in the Firm's IPOs, he

41/ (...continued)
made. See Thomas James Associates, Inc., Admin. No. 1223-S-2/90 (Apr. 19, 1991), 1991 Fla. Sec. LEXIS 82. Under the circumstances, we agree with the law judge that the Florida proceeding and the other disciplinary matters raised by the Division are not probative regarding the allegations in this case.

42/ Bartelt further testified that his reaction to Setteducati's statement was that he "[k]ind of laughed at it at the time" because he did not take Setteducati's warning seriously.

43/ When the Division asked Bartelt whether his branch manager told Bartelt what he meant by "upper management," Bartelt answered: "no."

44/ The law judge found that Bartelt was "not a very believable witness" and credited his testimony only to the extent that it was corroborated by others or by documentary evidence. Much of Bartelt's testimony was not corroborated. Nor would we attach much significance to Bartelt's testimony if it had been fully credited because it failed to support the Division's claim of manipulation or to link Setteducati to that alleged manipulation.

admitted during cross-examination that he declined to do so 10 to 20% of the time, when he considered the offerings unsuitable for his clients or was otherwise uninterested in the issuer. 45/ Bartelt further testified that one-third of salespersons in his branch generally did not participate in the Firm's IPOs. 46/

We do not consider it significant that the Firm's salespersons were encouraged to "support the deal." As the Division's expert witness, University of Florida Professor Jay Ritter, conceded in response to questions from the law judge, underwriters are expected to support the stock price of an issue that they have underwritten. Ritter also acknowledged that an underwriter should not let a stock's price quickly fall below the initial offering price without "putting up a fight," and added that, during a period comparable to the period at issue in this case, "if it was a less hot offering, both individuals and institutions would normally be discouraged from flipping." 47/

Another Firm employee, James Battaglia, testified that he committed to the Firm's management (including Setteducati) to sell shares in Firm underwritings because "[p]eriodically, the conference calls [where the offering would be discussed] would turn abusive, vulgar and belligerent." 48/ On occasion, Setteducati would "yell" at branch managers who he believed were not selling enough shares in an offering or in the aftermarket

45/ It does not appear that Bartelt was penalized because of his decisions not to participate.

46/ Another HJM salesman, from a different branch, who declined to participate in the Borealis offering without apparent penalty, also testified that Setteducati stated during Firm conference calls that salespersons could sell whatever securities they wanted to sell, including mutual funds and bonds. According to this salesperson, Setteducati expected only that a salesperson work hard and generate revenue for the Firm.

47/ Additionally, Ritter acknowledged that underwriters whose offerings "routinely tank after the opening" are not likely to win future offerings.

48/ Battaglia admittedly had little recollection of circumstances surrounding the Borealis offering, and testified about the Firm's and Setteducati's general practices.

and single out for praise branch managers who were "meeting or beating whatever the expectation or commitment was."

Setteducati did not challenge Battaglia's description of him as highly demanding and, at times, belligerent in his dealings with HJM personnel. Rather, Setteducati asserted that such behavior simply reflected his strong ambition to build up the Firm. Setteducati testified that, "because I'm passionate about what I was doing, I held people accountable, and most times human nature is people don't like to be held accountable. But I didn't high-pressure anybody."

Theodore Colby, who joined the Firm as a compliance principal in the trading department in August 1996, shortly after the Borealis IPO, presented a largely favorable picture of Setteducati. For example, Colby characterized Setteducati as "cooperative" and "support[ive]" of Colby's compliance efforts. While Setteducati sometimes questioned Colby's determinations that the Firm was dominating and controlling trading in a particular stock (a determination that affected the Firm's pricing of retail securities), Colby testified that Setteducati was "cordial and . . . upon occasions might have been right" (and Colby wrong) about HJM's relationship to the market. 49/

The Division further supports its claim of manipulation by pointing to HJM's use of so-called penalty bids to discourage flipping. According to a former HJM official who testified generally regarding penalty bids:

It's standard practice in the industry. With [HJM], all of our offerings had penalty bids which meant if the customer were to sell within the first thirty days of trading, the broker would lose the commission [from the customer's purchase in the IPO] . . . and the customer would be charged the full commission on the way out. 50/

49/ When Setteducati persuaded Colby that his analysis was wrong, Colby would generally agree to "watch" trading in the stock a bit longer before making a determination of whether HJM dominated and controlled the market. Colby added that, "in most cases Bob went along with [his] decision" regarding domination and control.

50/ The testifying official was not associated with the Firm during the Borealis offering. We note that his testimony indicates that penalty bids were enforced at HJM generally following IPOs.

The Firm's Underwriting and Syndicate Procedures stated that penalty bids were intended to:

reward those brokers who allocate stock to bona fide accounts with long term perspectives and penalize the fast money, flipper type accounts. Although the penalty bid does not preclude the owner from selling, it does result in a commission reversal for the broker who initially sold the stock to the account.

The Division concedes that penalty bids are not inherently manipulative and can be a legitimate device to discourage flipping. ^{51/} Division expert Ritter also acknowledged that he "had no reason to think that [HJM's] motivation for [enforcing penalty bids] was different than the normal motivation" which was to depress potential resales of stock purchased in a new offering. The Division argues, however, that the Firm's selective enforcement of penalty bids -- i.e., customers of certain favored employees including Setteducati and of firms within the selling group were permitted to flip their Borealis stock without the employee or firm losing the commission or selling concession generated through the sale of that stock in the IPO -- indicates that penalty bids were used in this case for

^{51/} The Division stated at the hearing that it was "not alleging anything is wrong with the penalty bid, but rather that it was used here for manipulative purposes."

In a 1996 release declining to regulate penalty bids and similar aftermarket practices, the Commission recognized that "[o]ne of the primary objectives of a penalty bid is to encourage syndicate participants to sell the securities to those persons who intend to hold them rather than to engage in short term profit-taking, i.e., to combat flipping." Trading Practice Rules Concerning Securities Offerings, Securities Act Rel. No, 7282 (April 18, 1996), 61 SEC Docket 2021, 2037-38. The Commission added that such "aftermarket activities . . . are not uncommon and may act to support the price of the offered security in the aftermarket." Id. at 2038. See generally Friedman v. Saloman/Smith Barney, Inc., 2000 WL 1804719 at * 9 (S.D.N.Y.) (discussing regulation of penalty bids and other market stabilizing practices), aff'd, Friedman v. Saloman/Smith Barney, Inc., 313 F.3d 796 (2d Cir. 2002).

manipulative purposes. 52/ We are unpersuaded by the Division's argument. Because penalty bids are intended to discourage sales and support a stock's price, any failure to enforce them would seem likely to have a downward effect on prices and therefore work against the alleged manipulation. 53/

The Division also supports its allegation that Borealis' stock price was manipulated by claiming that there was no valid basis for investor interest in the stock and that its price rise, therefore, had to be the result of a manipulation. As support, the Division presented the testimony of Professor Ritter. Using what he termed an "objective valuation of the company," Ritter asserted that Borealis' price rise was "difficult to explain," in light of Borealis' lack of an immediate saleable product or current revenue. 54/ Ritter also noted that there appeared to be little or no "venture capital" interest in Borealis and that, in Ritter's view, such lack of interest was a sign of the Company's "dim" prospects.

We give little weight to Ritter's "objective valuation" of Borealis. While Ritter claimed Borealis' prospects were dubious, he conceded that a stock's price may "not accurately reflect" the objective valuation of an issuer. Moreover, while Ritter identified the apparent lack of venture capital financing as reflecting an absence of interest by sophisticated market participants, and thereby confirmed his low opinion of the Company's prospects, he admittedly was "completely perplexed" by the significant interest in the stock shown by institutional customers. 55/ Such institutional interest suggests that,

52/ Twenty-one of Setteducati's customers flipped Borealis stock they received in the IPO, generating total profits to those customers of \$65,875 and total commissions to Setteducati of \$15,325.

53/ While the selective use of penalty bids could be a means whereby a dealer distributes trading profits (generated by a manipulation or otherwise) to certain of its employees, there is no explanation as to why HJM would employ such a means here rather than some other means that would not have tended to act against the alleged manipulation.

54/ As discussed, Borealis's Arsenal product was still in development at the time of the IPO.

55/ Ritter conducted no investigation into the reasons for this institutional interest, or the identities of the

(continued...)

notwithstanding the apparent lack of involvement by venture capital investors, at least some more sophisticated market participants had decided to invest in the Company.

Ritter also identified what he considered to be certain unusual features of the Borealis market, which he asserted supported his conclusion that it had been manipulated. For example, he characterized the spread between Borealis's bid and ask quotations as wide considering the stock's "high turnover," and also considered it suspicious that the spread remained unchanged throughout most of the first day of aftermarket trading, June 24. We, too, are perplexed by the fact that, despite heavy demand, there was such little movement in quotations for Borealis during much of the trading period at issue. Nevertheless, we are uncomfortable on the basis of this record, with the various evidentiary gaps identified earlier, 56/ concluding that a manipulation occurred based on the static nature of the spread. 57/

Additionally, in our view, Ritter's opinion was undercut by his admission that an "important factor" influencing his conclusion that a manipulation had occurred was his opinion that HJM was not a "reputable" securities firm. Ritter stated that, in performing his analysis of Borealis trading, he sought to compare it with trading in other contemporaneous IPOs that, in

55/ (...continued)
institutions involved.

56/ See n.16, supra. Among other gaps, it is not clear that Professor Ritter's analysis fully reflected all quotations for Borealis stock during the period at issue.

57/ Although HJM controlled the bid side of the market, the inside ask generally was set by firms other than HJM, and there is no evidence that HJM was responsible for the quotations of those other dealers. We note, however, that, because a manipulating firm seeks to drive the price upward, such a firm typically will not enter the inside, i.e., lowest, ask quotation, unless, for example, it does so by default when it dominates the market to such an extent that other firms are unwilling to make a market in the security. HJM did not dominate the Borealis market to this extent. Where, however, the bid side of the market has been artificially inflated, dealers may compete to sell stock at the inflated price by entering competitively attractive ask quotations, and thereby narrow the spread. Such narrowing, apparently, did not happen here.

his view, "were not likely to be manipulated." His methodology for selecting such IPOs, however, was based on his opinion of the reputation of the firm underwriting the IPO. He identified members of the selling syndicate for a 1999 IPO by Goldman, Sachs & Co. as having a "high" reputation. Conversely, he considered firms that did not participate in the Goldman IPO as having a "low" reputation. Although Ritter claimed that his methodology was not "subjective," he justified his selection of the Goldman, Sachs IPO selling group on his opinion that "[a]ll of the large, reputable brokers were in the syndicate." We do not believe that Ritter's standard for judging firms was objective or reliable. 58/ In any event, we do not consider a firm's reputation to establish evidence of its misconduct or that of those associated with it. 59/

The Division also places emphasis on the testimony of former HJM official Colby, who reviewed certain of HJM's trading records after joining the Firm in mid-August. Colby testified that he "could not understand why" the Firm paid its salespersons incentive compensation to sell Borealis stock when the stock was, as he understood, a "hot issue," i.e., in high demand. Colby also stated that he could not explain why there was so much interest in the stock at HJM when other dealers were "predominantly sellers" of the stock during the early aftermarket, i.e., that there were "opposite points of view on the stock" between HJM and other firms.

The features of the Borealis aftermarket identified by Colby, while possibly unusual, do not establish the existence of a manipulation. In this connection we note that the record provides little information regarding the Firm's compensation arrangements with its salespersons. It is unclear, for example, whether HJM routinely provided incentives to its employees to support new offerings it underwrote, or whether its decision to do so here constituted a deviation from its regular practice or

58/ Among other things, Ritter failed to provide a proper foundation for his conclusions.

59/ We recognize that "reputation," as that term is used by economists, is a valid and frequently employed means of grouping securities firms based on certain objective criteria. See, e.g., Laurie Krigman, Why Do Firms Switch Underwriters?, 60 Journal of Financial Economics 245 (2001). We simply do not consider Professor Ritter's conclusions, based only on his perceptions concerning HJM's and other firms' reputation, to be persuasive evidence regarding the legal issues in this case.

with industry practices generally. By itself, the Firm's compensation arrangements merely support the conclusion, suggested by other evidence in the record, that the Firm provided very strong marketing support to its IPOs.

Nor are we prepared to draw any adverse conclusion from the fact that the customers of some firms were far more inclined to sell, at a significant profit, their Borealis holdings than were HJM's customers. Although the evidence indicates that HJM's salespersons were highly enthusiastic about the Company, there is no evidence in the record about the attitudes of the sales personnel at other firms. We also note that, notwithstanding these apparent differences in attitude that developed after the start of aftermarket trading, interest in Borealis was by no means limited to HJM.

* * * * *

In short, the record does not establish that the Firm's efforts in connection with the Borealis offering crossed the line into the kind of manipulative activity prohibited by the antifraud provisions of the securities laws. 60/ We therefore have determined that the proceedings against Setteducati should be dismissed.

An appropriate order will issue. 61/

60/ Among other things, we are perplexed by the Division's failure to provide more detailed evidence regarding trading during the initial aftermarket. Although the rapid rise in Borealis' stock price raises questions, there was insufficient evidence to establish that that rise was unrelated to prevailing market dynamics. Another gap in the case, in our view, concerns the role of the institutional customers. Without evidence that they were involved in some way with the manipulation, the magnitude of their holdings away from HJM's control seems inconsistent with a manipulation. In addition, the record contains very little information about the actions of Setteducati, or other senior HJM officials, in connection with the Borealis offering. As a result, we, like the law judge, would have had difficulty holding Setteducati liable in the event the evidence supported a finding of manipulation.

61/ We have considered all of the arguments advanced by the parties. We reject or sustain them to the extent that they are inconsistent or in accord with the views expressed in
(continued...)

By the Commission (Chairman DONALDSON and Commissioners GLASSMAN, ATKINS and CAMPOS); Commissioner GOLDSCHMID not participating.

Jonathan G. Katz
Secretary

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Rel. No.8334/November 7, 2003

SECURITIES EXCHANGE ACT OF 1934
Rel. No.48759/November 7, 2003

Admin. Proc. File No. 3-10140

In the Matter of :
:
ROBERT J. SETTEDUCATI :
Brick, NJ 08723 :
:
:
:

ORDER DISMISSING PROCEEDINGS

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

ORDERED that proceedings instituted February 7, 2000 against
Robert J. Setteducati be, and they hereby are, dismissed.

By the Commission.

Jonathan G. Katz
Secretary