Spring 2008

Not Dead Yet: How New York's Finnerty Decision Salvaged the Stock Exchange Specialist

J. Scott Colesanti
Maurice A. Deane School of Law at Hofstra University

ARTICLES

NOT DEAD YET[1]: HOW NEW YORK'S *FINNERTY* DECISION SALVAGED THE STOCK EXCHANGE SPECIALIST

J. SCOTT COLESANTI[2]

INTRODUCTION/OVERTURE

For nearly 140 years, the Specialist system has primed the gears of the "open outcry" trading model of the nation's stock exchanges. For at least half as long, regulators and others have publicly questioned whether the liquidity and continuous trading afforded by the model outweigh its apparent informational asymmetries. In recent years, that criticism has crystallized into unprecedented criminal action against overly-opportunistic Specialists.

[1] In honor of the Specialist system's lengthy run near Broadway, the title and five subsections of this Article borrow from the song list of the hit musical *Spamalot*. ERIC IDLE ET AL., MONTY PYTHON'S SPAMALOT (Universal Classics Group 2005).

[2] The author is a Special Professor at the Hofstra University School of Law, teaching *Securities Regulation* and *Broker-Dealer Regulation*. All views expressed herein are purely personal.

While currently many factors are uniquely converging to raise questions about the Specialist system's continued vitality, perhaps none would more readily speed its demise than the criminalization of self-serving trading traditionally punished by reprimand and monetary fine. To wit, successful prosecution of individual Specialists engaging in profitable principal trading halts not only continuing practices on the Stock Exchange Floor but also brings ignominy to its overseers and subordinates as well.

In 2007, a federal judge granted a rare judgment notwithstanding a guilty verdict in a highly publicized criminal case charging a New York Stock Exchange (NYSE) Specialist with *interpositioning*, or taking profitable trades for his firm while counterparty customer orders were pending.[3] As shared brokerage house communications were condemned and other new applications of the securities fraud prohibition were subsequently attempted, the *Finnerty* decision grew in import as emblematic of the judicial brake on industry criminalization. Accordingly, this Article seeks to place the court decision in perspective by highlighting the history of the Specialist system (and criticism thereof), providing a detailed summary and analysis of the written opinion, and offering the most immediate regulatory ramifications for similar Specialist behavior in the future.

I. THE SPECIALIST SYSTEM: KNIGHTS OF THE BOUND TABLE

A. Legend and Lure

The NYSE Specialist system, which assigns an exchange member firm with the tasks of providing *agency* order execution, by matching buyers with sellers and filling *principal* trading execution to ensure liquidity,[4] is traced to the years 1871–1872.[5] One

[3] United States v. Finnerty, 474 F. Supp. 2d 530, 532 (S.D.N.Y. 2007) (holding that although the Government was able to illustrate that Finnerty engaged in interpositioning, the Government was unable to provide evidence to show that Finnerty's actions misled, defrauded or deceived his customers).

[4] *See* JOHN DOWNES & JORDAN ELLIOT GOODMAN, BARRON'S DICTIONARY OF FINANCE AND INVESTMENT TERMS 578 (5th ed. 1998). "A specialist or SPECIALIST UNIT performs two main functions: [E]xecuting LIMIT ORDERS on behalf of other exchange members for a portion of the FLOOR BROKER'S commission, and buying or selling—sometimes SELLING SHORT—for the specialist's own account to counteract temporary imbalances in supply and demand and thus prevent wide swings in stock prices."

story describes a broker whose broken leg limited him to one seat on the Exchange Floor, from where he handled all orders in Western Union stock.[6] The less ribald tale attributes the creation of the position to the desire to depart from the ancient system of stocks being auctioned off at "call times" throughout the day; to provide for continuous trading, brokers simply stationed themselves at one central location throughout the trading day.[7]

While authorities differ on the exact scope and nature of the Specialist's duties—and the distinct compensation therefor—the position is generally explained as entailing two separate trading functions: first, executing limit orders on behalf of other exchange members, and in turn sharing in the commission; and second, buying and selling in the Specialist's own accounts to offset order imbalances and adjust inventory[8] [hereinafter, the "Dual Roles"]. More colloquially, the Specialist is placed at the vortex of trading information in return for providing the capital necessary to keep listed stocks open for trading.

B. Front Row Seats

By the time of the New Deal,[9] and, more specifically, the Senate hearing that would result in the adoption of the first two federal securities laws,[10] it had become manifestly clear that the

[5] *See* George T. Simon & Kathryn M. Trkla, *The Regulation of Specialists and Implications for the Future*, 61 BUS. LAW 217, 357 (2005) (tracing the changing roles and functions of specialists and evaluating the efficacy of specialist regulation).

[6] *See* JOHN C. COFFEE, JR. & JOEL SELIGMAN, SECURITIES REGULATION: CASES AND MATERIALS 661 (Foundation Press 9th ed. 2006).

[7] *See* NYSE.com, Timeline, http://www.nyse.com/about/history/timeline_1860_1899_index.html (last visited Apr. 13, 2008) (stating the Exchange developed a new "system of continuous trading" to promote "more liquid markets" by stationing brokers who deal in a particular stock to a single location on the trading floor).

[8] *See* DOWNES & GOODMAN, *supra* note 4, at 578 (defining "Specialist").

[9] It was already generally accepted in 1934 that "'there [were] serious abuses in connection with the work of specialists. . . . [T]here are inherent difficulties in the situation where under normal circumstances the available orders are known to the specialist only.'" Nicholas Wolfson & Thomas A. Russo, *The Stock Exchange Specialist: An Economic and Legal Analysis*, 1970 DUKE L.J. 707, 717 (1970) (quoting H.R. REP. NO. 1383, 73d Cong., 2d Sess. 14–15 (1934)).

[10] *See* Elisabeth Keller & Gregory A. Gehlmann, *A Historical Introduction to the Securities Act of 1933 and the Securities Exchange Act of 1934*, 49 OHIO ST. L.J. 329, 338 (1998) (describing the significant role played by the Pecora hearings in the formulation of the Securities Acts).

Specialist enjoyed a uniquely profitable place in the market arena:

> The most damning practice uncovered was the activity of specialists (those who made markets on the floor of the exchanges). Because of their central location and function, specialists were able to control the flow of orders in a stock and manipulate its price. The hearings showed that some stocks on the exchanges had over a third of their volume traded by their specialists for their own accounts. Thus the specialists were in a privileged position to see prices before executing for the public and would often act for themselves before filling an order from the public being executed through a floor broker.[11]

The inevitable Congressional response to the Great Depression nonetheless avoided the drastic solution of splitting the Dual Roles[12] and opted instead for conflict of interest limitations/prohibitions aimed at the entire trading community (the SEC effectively echoed this sentiment in refusing to advocate for the bifurcation of the Specialist's principal and agency functions in both 1936 and 1963).[13]

Ultimately, the Securities Exchange Act of 1934[14] (the "Exchange Act") codified unrelated trading limitations, including a ceiling for the extension of margin and a ban on company officials selling their own shares "short."[15] The sanctity of the agency relationship between various Exchange Floor personnel and their customers was cemented by Section 11(a), which made it unlawful for any member of a national securities exchange "to effect any transaction on such exchange for its own account, the account of an associated person, or an account with respect to which it or an associated person thereof exercises investment

[11] CHARLES R. GEISST, WALL STREET: A HISTORY 213 (Oxford Univ. Press 2004) (1997).

[12] *See* GEISST, *supra* note 11, at 254 ("The danger was that the new law would be too radical, severely restraining the ability of the stock exchanges to function."). *See* GEISST, *supra* note 11, at 234.

[13] *See* ROBERTA S. KARMEL, REGULATION BY PROSECUTION: THE SECURITIES AND EXCHANGE COMMISSION VS. CORPORATE AMERICA 117 (Simon and Schuster 1982) (noting concern that bifurcation would "radically change the composition of the securities industry.").

[14] Securities Exchange Act of 1934, 15 U.S.C.S. §§ 78a–78nn (2008).

[15] A "short" sale is a strategy involving the sale of a security not owned in expectation of a price decline. *See* DOWNES & GOODMAN, *supra* note 4, at 556.

discretion."[16] The effectuating SEC Rule 11a-1 ("Regulation of Floor Trading") clarified as follows:

> No member of a national securities exchange, while on the floor of such exchange, shall initiate, directly or indirectly, any transaction in any security admitted to trading on such exchange, for any account in which such member has an interest, or for any such account with respect to which such member has discretion as to the time of execution, the choice of security to be bought or sold, the total amount of any security to be bought or sold, or whether any such transaction shall be one of purchase or sale.[17]

Specialists were expressly exempted from Rule 11a-1's prohibition by 11a-1(b).[18]

C. The Slowly Thickening Plot

In 1963, the Securities and Exchanges Commission ("SEC") released a special study of the markets, which concluded in relevant part that many Specialists traded excessively in their own accounts;[19] the study prompted SEC Rule 11b-1, which called upon the stock exchanges to adopt rules delineating the Specialists' roles.[20] In response thereto, the NYSE adopted Rule 104,

[16] 15 U.S.C.S. § 78k (2008).

[17] 17 C.F.R. § 240.11a-1 (2008).

[18] The prohibition in Rule 11a-1 does not apply to "[a]ny transaction by a registered specialist in a security in which he is so registered on such exchange." *Id.*

[19] *See* COFFEE & SELIGMAN, *supra* note 6, at 662 (noting specialists trading for their own accounts exceeded 29% of overall market trading).

[20] Rule 11b-1 reads in relevant part as follows: § 240.11b-1 Regulation of specialists. (a)(1) The rules of a national securities exchange may permit a member of such exchange to register as a specialist and to act as a dealer. (2) The rules of a national securities exchange permitting a member of such exchange to register as a specialist and to act as a dealer shall include: (i) Adequate minimum capital requirements in view of the markets for securities on such exchange; (ii) Requirements, as a condition of a specialist's registration, that a specialist engage in a course of dealings for his own account to assist in the maintenance, so far as practicable, of a fair and orderly market, and that a finding by the exchange of any substantial or continued failure by a specialist to engage in such a course of dealings will result in the suspension or cancellation of such specialist's registration in one or more of the securities in which such specialist is registered; (iii) Provisions restricting his dealings so far as practicable to those reasonably necessary to permit him to maintain a fair and orderly market or necessary to permit him to act as an odd-lot dealer; (iv) Provisions stating the responsibilities of a specialist acting as a broker in securities in which he is registered; and (v) Procedures to provide for the effective and systematic surveillance of the activities of specialists. 17 C.F.R §240.11b-1 (2006).

which indirectly addresses, among other things, *interpositioning* (described later herein) where it states the following:

> **Rule 104. Dealings by Specialists**
>
> **(a)** No specialist shall effect on the Exchange purchases or sales of any security in which such specialist is registered, for any account in which he, his member organization or any other member, allied member, or approved person . . . in such organization or officer or employee thereof is directly or indirectly interested, unless such dealings are reasonably necessary to permit such specialist to maintain a fair and orderly market, or to act as an odd-lot dealer in such security.[21]

The Rule codified the SEC's long-held belief of the Specialist's coexistent "affirmative obligation" (*i.e.*, his duty to trade as principal to keep the markets continuous and stable) and "negative obligation" (the duty to not trade excessively for his own accounts while maintaining the markets). The NYSE subsequently adopted Rule 92, which limits trading by Specialists and other NYSE members when in possession of "knowledge of any particular unexecuted customer's order to buy (sell) such security which could be executed at the same price."[22]

Despite the vaguely defined Dual Roles, occasional invective, and competing obligations, the lure of profits apparently outpaced the risks, as data consistently showed Specialists earning significant returns on equity when trading both blue chips and low-priced stocks.[23]

D. Success, Dominance, and Blame

From the late 1960s forward, a sole Specialist was assigned to each stock listed on the NYSE.[24] Concurrently, it was known that

[21] NYSE Rule 104 (2003).

[22] NYSE Rule 92 (2003).

[23] *See* COFFEE & SELIGMAN, *supra* note 6, at 661-62 (stating NYSE Specialists earned an average of a 30% return on equity in 1999); *see also* Jay F. Coughenour & Lawrence E. Harris, *Specialist Profits and the Minimum Price Increment* (2003), *available at* http://www.usc.edu/schools/business/FBE/seminars/papers/F_1-9-04_HARRIS_coughenour.pdf (finding "high frequency trading profits" for NYSE Specialists handling low-priced stocks and stocks that regularly traded outside of their quote).

[24] *See* JOEL SELIGMAN, THE TRANSFORMATION OF WALL STREET: A HISTORY OF THE SECURITIES AND EXCHANGE COMMISSION AND MODERN CORPORATE FINANCE 337–38

Specialists trading for their own account enjoyed consistent profits.[25] Add to this menu the finite number of NYSE member firms and the existence of NYSE Rule 390 (which, until its repeal in 2000, prohibited trading in NYSE issues by NYSE members in the OTC market),[26] and it was readily apparent that the Floor Crowd (and the customers they represented) were for decades literally bound to the Specialist table serving a particular stock.

Not surprisingly, the Specialist often found himself singularly blamed for unpredictable or complex exchange failures. On the day of the Kennedy assassination, for example, Specialists were cited for a 3% market loss prior to the Exchange's early close.[27]

E. Countdown to Intermission

Historically, the SEC had developed a "hands off" approach to regulating the Specialists. The 1950s saw that détente demise upon the SEC preparation of the American Stock Exchange Report, which publicized the "dominant role of the specialist."[28] Later in 1972, an internal SEC study of three months of trading days in 1970 concluded that Specialists were buying as the market rose and selling as it dropped.[29]

In 1975, Congress convened to contemplate sweeping revisions to the Securities Laws.[30] That effort ultimately yielded piecemeal and/or exhortatory measures aimed most directly at the SEC's authority to compel market structure. This led one former SEC Commissioner to conclude (in hindsight) that the Commission's

(Northeastern Univ. Press, rev. ed. 1995) (contrasting this with the role of Specialists in 1933 when stocks were usually handled by multiple Specialists).

[25] *See* LOUIS LOSS & JOEL SELIGMAN, SECURITIES REGULATIONS § 7-A-2 (Aspen Publishers 3d ed.) (2006) (setting forth 1966 study estimating Specialists dealing for their own accounts were profitable over 80% of the time).

[26] *See* Order Approving Proposed Rule Change to Rescind Exchange Rule 390, Exchange Act Release No. 42758, 2000 SEC LEXIS 1015, at *4 (May 5, 2000).

[27] *See* GEISST, *supra* note 11, at 282 (leading to criticism of specialist system as outdated and unable to withstand crisis).

[28] SELIGMAN, *supra* note 24, at 336 (stating that statutes, common law, and custom placed tremendous trust in the hands of Specialists).

[29] *See id.* at 343 (referencing Senate staff summary conducted from March 1 to June 30, 1970 which indicated that specialists were "net buyers" when market rose and "net sellers" when it declined).

[30] *See* Eric J. Pan, *A European Solution to the Regulation of Cross-Border Markets*, 2 BROOK. J. CORP. FIN. & COM. L. 133, 151 (2007) (attributing the 1975 amendments to the increase in SEC control over exchanges and placement of "new obligations on exchanges to regulate broker-dealers and market makers.").

focus on "consumer protection," although designed to eliminate "the monopoly profits of the stock exchange specialist," ultimately led to the SEC's failure to meet its obligations.[31]

Still, as late as 1981, some scholars continued defending the Specialist, noting that his role involved risk to capital and, was more often than not, passive in nature.[32] NYSE disciplinary actions against Specialist firms failing to honor their affirmative obligations were somewhat rare, but always noteworthy. One such decision from 1989 imposed a censure, a fine of $210,000, and the reallocation of a stock from a member Specialist firm based upon its failure to maintain an orderly market in violation of NYSE Rule 104.[33] On appeal, an NYSE Board committee reduced the fine.[34]

A report authored by the SEC's Division of Market Regulation after the October 1987 Crash faulted the Specialists (whose ranks dropped precipitously from over three dozen during the downturn) for unpredictable actions in maintaining order flow in dropping markets:

> While specialists, in the aggregate, performed satisfactorily, there was a wide variation in individual specialist performance. In particular, a disturbing number of NYSE specialists on October 19 either were net sellers or did not take substantial positions. This inconsistent specialist performance deteriorated further during the afternoon of October 19 and throughout October 20 . . .
>
> In light of our findings, the Division believes that the [American Stock Exchange] and the NYSE should examine carefully individual specialist performance dur-

[31] *See* KARMEL, *supra* note 13, at 102–03 (stating Securities Acts Amendments of 1975 gave SEC extensive regulatory authority, irrespective of its purported purpose to protect consumers).

[32] *See* Norman S. Poser, *Restructuring the Stock Market: A Critical Look at the SEC's National Market System*, 56 N.Y.U. L. REV. 884, 890 (1981) (suggesting that specialists offset any imbalances in market by buying and offering to resell stock).

[33] *See* NYSE, Inc., Exchange Hearing Panel Decision 89-61, 1989 NYSE Disc. Action LEXIS 58, at *1, 11 (July 13, 1989) (reviewing the penalty consented to by the member firm).

[34] *See* NYSE, Inc., Appeal from Exchange Hearing Panel Decision 89-61 (Oct. 5, 1989), *available at* http:/www.nyse.com/regulation/1020656068674.html (modifying prior decision by providing censure, reduced fine, and reallocation of stock from member specialist firm Morelli, Nick & Co.).

> ing the market break. In this connection, the Division believes the [American Stock Exchange] and NYSE must use their powers to reallocate stock pursuant to their rules where they identify specialists that exhibited a substantial or continued failure to maintain fair and orderly markets.[35]

The 1987 Report also concluded that about one-in-four Specialist firms followed its affirmative duty until its pockets were empty on October 19th.[36]

The Specialist system got a boost, at least indirectly, from the SEC's scathing 1996 report on the competing NASDAQ market maker model, in which numerous unnamed NASDAQ market makers were cited for volumes of trading violations and the NASD[37] itself was cited for failing "over a period of time to conduct an appropriate inquiry" into anticompetitive arrangements between the same.[38] Concomitantly, some noted that the privileged position of Specialist was regrettable, but happily limited in number.[39]

Overall, the consistent criticism from decade to decade seemed to sound the same refrain: Specialists may trade too much for their own accounts, but they remain the best means of operating a continuous Floor-based market.

F. Changing the Guard?

For competitive and other reasons, noteworthy markets have moved away from the open outcry market in the past thirty

[35] DIV. OF MKT. REGULATION, U.S. SEC. & EXCH. COMM'N, THE OCTOBER 1987 MARKET BREAK xvii (Feb. 1988).

[36] *See id.* at 4–49, 4–58 (stating that of the fifty-five specialists in the NYSE, by the end of trading on October 19, 1987, thirteen specialists were left with "no buying power" on account of their taking increased positions at least twice the normal size).

[37] *See* Report Pursuant to Section 21(a) of the Securities Exchange Act of 1934 Regarding the NASD and the NASDAQ Market, Exchange Act Release No. 34-37542, 52 S.E.C. 882, 906 (Aug. 8, 1996) ("The [Commission] investigation revealed numerous [trading] violations . . . by Nasdaq market makers.").

[38] Report Pursuant to Section 21(a) of the Securities Exchange Act of 1934 Regarding the NASD and the NASDAQ Market, Exchange Act Release No. 34-37542, 52 S.E.C. 882, 883 (Aug. 8, 1996) ("These practices by market makers directly harmed the Nasdaq market, other market participants, and large and small investors;" at n. 6).

[39] *See* DOUG HENWOOD, WALL STREET: HOW IT WORKS AND FOR WHOM 165 (Verso 1997) ("Even if they do have access to privileged information on which they can profitably trade, specialists and corporate insiders are nonetheless a small class of investors.").

years. In 1978, the Cincinnati Stock Exchange went electronic.[40] In 1986, in a series of moves termed "Big Bang," the centuries-old London Stock Exchange abolished face-to-face trading in favor of transaction execution via computer and telephone. In 2006, the Chicago Stock Exchange abandoned the Specialist system in favor of a "participant" model that now allows electronic trading by approximately sixty "Institutional Broker Representatives" or "Money Market Traders." In 2006, the NYSE—the Specialist system's progenitor—both restructured as a for-profit corporation and converted to a trading system that combines Floor transactions, with electronic entry/execution of large orders (the "Hybrid Market").[41]

The question thus arises, in a decade largely characterized by a Bull Market, what precipitated this aversion to the model? Two instances of SEC intervention on the NYSE Floor in the past decade perhaps most readily explain the current intense scrutiny of the Specialist system.

II. THE PRESSURES OF RECENT YEARS: TWICE IN EVERY SHOW

The warning shot for government maintenance of trading Floor integrity might possibly have been an SEC release of June 1999, which censured the NYSE for inadequate supervision of the activities of a group of independent "$2 brokers."[42] Eight of these Floor players had been indicted for Section 11 violations premised upon their sharing in customer accounts. Noting that the NYSE had failed to detect the wrongdoing, the SEC bluntly stated the following:

> The NYSE failed to dedicate sufficient resources to allow the regulatory staff responsible for Routine Independent Member Surveillance to perform both random and for-cause reviews simultaneously . . . . Although random selection was not designed to detect or iden-

[40] *See* Corinne Bronfman, Kenneth Lehn & Robert A. Schwartz, *The SEC's Market 2000 Report*, 19 J. CORP. L. 523, 523 n.2, 524 (1994) (noting several factors affecting "the change in industry structure, including the increased importance of institutional investors, the development of new trading strategies, and technological innovations in the trading of financial assets.").

[41] Exchange Act Release No. 34-52954 (Dec. 14, 2005), *available at* www.sec.gov/rules/sro/nyse/34-52954.pdf.

[42] *See, e.g.*, Levine v. SEC, 407 F.3d 178, 180 (3d Cir. 2005) (noting that independent floor brokers are commonly referred to as a "two-dollar brokers").

> tify profit-sharing arrangements, had the Exchange deployed additional resources to maintain random surveillance while also conducting for-cause reviews, it would have created an additional deterrent effect by heightening the presence of NYSE officials in policing floor activities . . . which might have led to the discovery of illegal trading schemes.[43]

Meanwhile, industry criticism grew in intensity. By 2002, former SEC Chairman Arthur Levitt bluntly summarized the Specialist's role in his short treatise on investor protection:

> Specialists are in business for themselves, and they often buy and sell shares for their own accounts. Unlike other types of auctioneers, the specialist is allowed to bid for shares while conducting the auction. If you think a specialist's ability to see incoming orders gives him a built-in advantage when trading for himself, you're right. It's like being in a card game in which only one of the players gets to see everyone else's hand. exploit that advantage, too: in late 2001, they were accounting for about 32 percent of all the shares traded.[44]

To be sure, the import of this pejorative description cannot be overstated: here was the Chair with the longest tenure in the history of the Commission (and a former stock exchange chairman himself) advising the public that the knights who have long kept the game going have an insurmountable lead in the tilt.

A. The Damaging Reviews

That insurmountable lead may or may not have galvanized the public, but it certainly did not avoid SEC scrutiny. In October 2003, *The Wall Street Journal* loosed shock waves by reporting that the SEC had forwarded to the NYSE a confidential report decrying Specialist practices. The report was said to have detailed trading tactics coined "trading ahead" and interpositioning, leading to profits to the top five Specialist firms of over $155

[43] *In re* New York Stock Exchange, Exchange Act Release No. 41574, 70 SEC Docket 106 (June 29, 1999) (emphasis added).

[44] ARTHUR LEVITT & PAULA DWYER, TAKE ON THE STREET: WHAT WALL STREET AND CORPORATE AMERICA DON'T WANT YOU TO KNOW 179 (Pantheon Books 2002).

million between 2000 and 2002.[45] While such critical oversight might have escaped the journalistic eye in quieter times, following a period during which the NYSE Chairman resigned and former NYSE Board member Martha Stewart was indicted, the scrutiny of Exchange Floor trading practices resounded in the press.[46] Within months, NYSE investigators and their SEC counterparts effected unprecedented discipline against all NYSE Specialist firms.

As an example, in March 2004, the SEC entered into a cease-and-desist order with Fleet Specialist, Inc. ("FSI"), the registered Specialist for approximately 430 NYSE issues and one of seven such NYSE Floor firms at the time.[47] FSI consented to violations of SEC Rules 11b-1 and 10b-5 between 1999 and 2003 through "unlawful proprietary trading."[48] The trading practices in issue were described as "interpositioning" (*e. g.,* filling a customer sell order with a trade with the firm account, and in turn filling a separate customer buy order from the same account) and "trading ahead" (*e.g.,* purchasing/selling stock for a proprietary account before a customer can grab the same opportunity). The wrongful interpositioning was said to have caused a customer disadvantage of over $38 million, while the trading ahead was described as resulting in a customer disadvantage of over $26 million.[49]

The 2004 settlement explained the Dual Roles, listed specific stocks, detailed certain improper transactions and divided wronged customers into two camps: electronically entered "DOT" ["Designated Order Turnaround"] orders, and "Crowd" orders. In concluding that FSI had violated "its basic obligation to serve

[45] *See* Greg Farrell, *NYSE Feels SEC's Sting*, USA TODAY, Nov. 4, 2003, at 3B (describing trading ahead as "buying or selling stock on [the firm's] own account at an attractive price before a customer moves on the same opportunity" and interpositioning as buying stock at a price that is slightly higher than the current bidder's and selling to the first available bidder instead of letting buyer and seller come together).

[46] See *id.* ("The cracks in the walls of the New York Stock Exchange keep getting bigger."); *see also* Gary Weiss, *This Watchdog Is On The Way Out*, BUS. WK., Dec. 1, 2003, at 106 ("Under [NYSE Executive Edward] Kwalwasser, securities lawyers and institutional investors have complained, the exchange's enforcement division had a relaxed culture and tended to focus on minor infractions while overlooking systemic violations on the trading floor.").

[47] *See In re* Fleet Specialist, Inc., Exchange Act Release No. 49499, 2004 SEC LEXIS 744, at *3 (Mar. 30, 2004).

[48] *See id.* at *3–7.

[49] *See id.* at *8-12.

public customer orders over its own proprietary interests," the SEC was blunt and concise:

> As a specialist firm on the NYSE, FSI had a general duty to match executable public customer or "agency" buy and sell orders and not to fill customer orders through trades from the firm's own account when those customer orders could be matched with other customer orders.
>
> By effecting proprietary transactions that were not part of a course of dealings reasonably necessary to maintain a fair and orderly market, FSI violated Section 11(b) of the Exchange Act and Rule 11b-1 thereunder. In addition, with certain transactions in six particular stocks, certain specialists at FSI engaged in unlawful proprietary trades with **scienter**, violating their implied representations to public customers that they were limiting dealer transactions to those reasonably necessary to maintain a fair and orderly market. In those instances, individual specialists at FSI violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.[50]

The SEC thus concluded that a "fair market" is, by definition, free of such self-dealing as interpositioning, which was indirectly termed a "manipulative and deceptive practice."[51] In turn, an "orderly market" is "characterized by regular, reliable operation, with price continuity and depth, in which price movements are accompanied by appropriate volume, and unreasonable price variations between sales are avoided" and, most importantly, achieved through only *necessary* transactions.[52]

Apart from citing the presence of the pleading element of *scienter*, the SEC settlement addressed the Rule 10b-5 violations only by generically linking them to the famed prohibition's three disjunctive provisions: artifice to defraud, misleading statements, and course of business fraud.[53] Strikingly (at least in hindsight),

[50] *Id.* at *3–4 (emphasis added).

[51] *Id.* at *4, 10 ("A 'fair' market is free from manipulative and deceptive practices, and affords no undue advantage to any participant . . . . Interpositioning disadvantages a market buy order (i.e., a purchaser) and/or a market sell order (i.e., a seller)").

[52] *Id.* at *4–5.

[53] *Id.* at *23.

the SEC concluded that the Specialist *always* makes representations to the public, albeit of an implied nature.[54]

FSI was also found to have violated §15 of the Exchange Act (through its failure to supervise), as well as other NYSE rules addressing supervision, good business practices, and/or Specialist duties. The Specialist firm consented to a censure, a report by an outside consultant, and related undertakings. The total disgorgement charged to FSI was set at over $38 million and the corresponding civil penalty pegged in excess of $21 million; both payments by FSI were made in satisfaction of payments ordered by a contemporaneous NYSE proceeding.[55]

By late July 2004, all seven NYSE Specialist firms had been subject to joint NYSE–SEC actions premised upon violations of SEC Rules 11b-1 and 10b-5. Pursuant to those administrative settlements, over $247 million in disgorgement and civil penalties was recovered by the Commission.[56] The two separate SEC press releases describing the settlements, while highlighting the lack of "reasonable systems or procedures to monitor, detect, or prevent those violations," each also pointed out that the wrongful

[54] Likewise, the "public misrepresentation" theory has been strengthened by developments in class action litigation involving Specialists. Specifically, in September 2007, an appellate court, in upholding a portion of a lawsuit against the NYSE for its alleged failure to police its Specialists during the years discussed herein, held that precedent did not preclude allegations of misrepresentations by a non-issuer. *See In Re* NYSE Specialists Securities Litigation, 503 F.3d 89, 102 (2d Cir. 2007).

[55] *Id.* at 32–33.

[56] *See* Press Release, SEC, Settlement Reached with Five Specialist Firms for Violating Federal Securities Laws and NYSE Regulations (Mar. 30, 2004), http://www.sec.gov/news/press/2004-42.htm; Press Release, SEC, Settlement Reached with Two Specialist Firms for Violating Federal Securities Laws and NYSE Regulations (July 26, 2004), http://www.sec.gov/news/press/2004-99.htm; *see also* NYSE LLC, Hearing Board Decision 07-055 (Apr. 25, 2007), *available at* http://www.nyse.com/pdfs/07-055.pdf (explaining indicted Specialist's violations of SEC Rule 10b-5 and NYSE Rules 104 and others, imposing a censure and a permanent bar from the securities industry); *see generally In re* American Stock Exchange LLC, Securities Exchange Act of 1934 Release No. 55507, 2007 SEC LEXIS 535, at *15–16 (Mar. 22, 2007) ("In several instances, the Amex excused what appear to be clear violations, such as when a specialist traded for his or her account at a better price than the specialist's account received."); Press Release, SEC, SEC Charges American Stock Exchange & Former Chairman & CEO Salvatore Sodano with Failing to Exercise Regulatory Oversight Responsibilities (Mar. 22, 2007), http://sec.gov/news/press/2007/2007-51.htm (revealing in an unprecedented move, the SEC brought charges against the former Amex CEO, alleging his failure "to enforce compliance with federal securities laws and exchange rules by Amex members").

interpositioning activities "were heavily concentrated in a few stocks overseen by a small number of specialists at each firm."[57]

On a related note, in April 2005, the SEC censured and disciplined the NYSE for "failing to police Specialists" between 1999 and 2003, noting that the failure followed "on the heels of a regulatory failure by the NYSE in the late 1990s involving independent floor brokers."[58] The consensual settlement provided for the Exchange's retention of a regulatory auditor to conduct audits of its regulatory program through 2011 as well as the implementation of an eighteen-month pilot audio and video surveillance system to surveil Specialists.[59]

To be sure, the second federal government discipline of members of the NYSE Floor community in five years shone the spotlight on the nation's oldest exchange. Moreover, the need for the federal government to twice intervene no doubt prompted the unprecedented fines. But conclusions of violations of technical trading limitations by faceless entities—albeit accompanied by eye-catching fines—do not alter or foretell the end of a suspect trading model. In order to either effect widespread change in the Specialist system or permanently alter it altogether, some of its players would have to be identified and prosecuted. And such successful prosecution often sounds the death knell for financial institutions.

III. THE FINNERTY CASE: YOU WON'T SUCCEED ON BROADWAY

The "small number of specialists" cited in the SEC settlement turned out to be fifteen, all of whom were indicted in April 2005.[60] By the time of the *Finnerty* trial eighteen months later,

[57] Press Release, SEC, Settlement Reached with Five Specialist Firms for Violating Federal Securities Laws and NYSE Regulations (Mar. 30, 2004), http://www.sec.gov/news/press/2004-42.htm; Press Release, SEC, Settlement Reached with Two Specialist Firms for Violating Federal Securities Laws and NYSE Regulations (July 26, 2004), http://www.sec.gov/news/press/2004-99.htm.

[58] *See* Press Release, SEC, SEC Charges the New York Stock Exchange with Failing to Police Specialists (Apr. 12, 2005), http://www.sec.gov/news/press/2005-53.htm ("This failure by the NYSE to police trading ahead and interpositioning by specialists follows on the heels of a regulatory failure by the NYSE in the late 1990s involving independent floor brokers, which was addressed by the Commission in an order against the NYSE in June 1999.").

[59] *Id.*

[60] *See* Jenny Anderson, *Fifteen Specialists From Big Board Are Indicted*, N.Y. TIMES, Apr. 13, 2005, at C1. The fifteen specialists indicted were members of the NYSE's five

the government's record in interpositioning cases had been less than stellar. The scorecard included two plea deals, two jury convictions, two acquittals, and seven cases in which charges were dropped.[61] By far the most noteworthy case to date—and perhaps most illustrative—involves David Finnerty, whose case yielded in turn, a jury finding of guilt, some hesitant closing remarks by the trial judge, and an ultimate (and rare) JNOV.[62]

A. Libretto

Finnerty had been indicted on three counts of securities fraud, citing interpositioning and trading ahead in violation of Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder.[63] After a loss in a separate criminal case against a Specialist from another firm,[64] the U.S. Attorneys amended their Finnerty indictment on August 22, 2006 to eliminate the "trading ahead" charge. That left interpositioning as the sole predicate for the Finnerty's Rule 10b-5 violation. Upon subsequent consideration of pre-trial motions, Judge Chin limited the government's claims to sections (a) and (c) under Rule 10b-5 (*i.e.*, allowing assertions of employing "any device, scheme or artifice to defraud," as well as assertions that the defendant "engaged in any act, practice, or course of business which operates or would operate as a fraud or deceit," but not allegations of misrepresentation).[65]

major specialist firms and were alleged to have reaped $13.4 million in illegal profits as a result of interpositioning. *Id.*

[61] *See* Paul Davies, *Specialists Mark Rare Setback for U.S. Attorney—Decision to Drop Remaining Cases Against Elite NYSE Floor Traders Follows Series of Miscalculations*, WALL ST. J., Nov. 24, 2006, at C1. The dismissal of these criminal cases does not directly impact related SEC or NYSE cases against Specialists or their firms. *Id.*

[62] *See* Dick Thornburgh, *Corporate, Criminality: Legal, Ethical, and Managerial Implication: The Dangers of Over-Criminalization and the Need for Real Reform: The Dilemma of Artificial Entities and Artificial Crimes*, 44 AM. CRIM. L. REV. 1279, 1284 (2007) ("[Judge Chin] took the rare step of overriding a jury's guilty verdict and granting a motion for judgment of acquittal . . . because the government failed to prove fraudulent or deceptive conduct").

[63] *See Finnerty*, 474 F. Supp. 2d at 536.

[64] *See* Chad Bray, *Ex-Van der Moolen Specialist Acquitted*, BOSTON GLOBE, Sept. 18, 2006, *available at* http://www.boston.com/business/healthcare/articles/2006/09/18/ex_van_der_moolen_specialist_acquitted (announcing acquittal of former specialist for making improper trades on firm's account).

[65] *See* United States v. Finnerty, 2006 U.S. Dist. LEXIS 72119, at *8–10 (S.D.N.Y. Oct. 2, 2006); *see also In re* NYSE Specialists Sec. Litig., 405 F. Supp. 2d 281, 317, 319 (S.D.N.Y. 2005). Interestingly, in the related class action civil litigation, Judge Robert Sweet allowed the misrepresentation allegation as a means of satisfying Rule 10b-5. *Id.*

At trial in October 2006, the government presented evidence speaking to motive, means, and profit. Prosecutors adduced three FSI clerks who testified to Finnerty's practices of trading for the FSI account when pending customer orders could have been matched. The government also presented the testimony of the FSI's "primary financial officer," who testified to Finnerty's compensation of salary plus an annual bonus based in part upon the profitability of FSI's principal account.[66]

The government also introduced NYSE computer exception reports identifying all of the allegedly interpositioned trades in stocks assigned to Finnerty. These reports showed over 26,000 such trades between November 1999 and April 2003, resulting in profits approximately 95% of the time and a total benefit to FSI's principal account of $4.5 million.[67] Additionally, the reports evidenced Finnerty's halting his practices on the day that FSI announced both internal and NYSE investigations into order "arbitrage."[68] Finally, the prosecutors offered Finnerty's NYSE investigative testimony, in which he acknowledged a duty to obtain a price for the customer matching or exceeding the price obtained by the Specialist, awareness of his "negative obligation," and knowledge that interpositioning violated NYSE rules and FSI policy.[69]

In his defense, Finnerty offered one witness, an expert, who testified that the number of instances of interpositioning offered by the government represented "less than 1%" of the total number of trades executed by Finnerty as a Specialist during the relevant time period.[70]

On October 26, 2006, after a two-week trial, Finnerty was convicted by the jury on all three counts.[71] The press later noted Judge Chin's displeasure with the verdict, quoting him as acknowledging that there had been "some fuzziness in the law" advanced by the prosecutors[72] and that he believed the govern-

[66] *See Finnerty*, 474 F. Supp. 2d at 533–35.
[67] *Id.* at 534.
[68] *See id.*
[69] *See id.* at 534–35.
[70] *Id.* at 535–36.
[71] *Id.* at 532.
[72] Paul Davies & Aaron Lucchetti, *Moving the Market: Ex-Trader Found Guilty, but Judge Questions Case*, WALL ST. J., Oct. 27, 2006, at C3 (stating that while Judge Chin did not seek to reverse the verdict, his comments would likely strengthen any appeal or reduce sentences).

ment's numbers concerning interpositioned trades to be "clearly" inflated.[73] Four months after the trial concluded, Judge Chin apparently followed his instincts and reversed the verdict.[74]

B. The Curtain Call of February 2007

Judge Chin's written opinion neither excused nor whitewashed Finnerty's behavior. In sum, while acknowledging that the defendant profited on many occasions from self-dealing, the jurist did not find the regulation defining securities fraud to be quite elastic enough. In explaining his dismissal, the Judge divided his ruling into four parts.

First, Judge Chin highlighted the rare occurrence of a reversal of a jury verdict. Noting the "heavy burden" weighing on the defendant seeking dismissal of a conviction by the trial judge, Judge Chin nonetheless educated that the government "must do more than introduce evidence at least as consistent with innocence as with guilt."[75]

Second, the Judge provided a terse background on Rule 10b-5 and the requisite elements of a Rule 10b-5 violation. Citing to two famed insider-trading precedents,[76] Judge Chin emphasized the prohibition's focus on customer protection, concluding:

> Thus, the very core of the federal securities laws in question is the premise that there must be some form of deception. If consumers are getting 'exactly what they expect,' then the conduct is neither deceptive nor fraudulent—and therefore not within the ambit of 10(b) and Rule 10b-5 . . . To convict under Rule 10b-

[73] *See* Anna Driver, *Ex-NYSE specialist found guilty of fraud*, INS. NEWSCAST, Oct. 26, 2006, http://www.insurancebroadcasting.com/103106.htm (highlighting that Judge Chin thought the government's allegation that Finnerty engaged in 26,000 illegal trades was exaggerated).

[74] *See New York Judge Reverses Verdict Convicting Former Trading Specialist of Securities Fraud*, 5-9 MEALEY'S EMERGING SEC. LITIG. 24 (2007) [hereinafter *New York Judge Reverses Verdict*].

[75] *Finnerty*, 474 F. Supp. 2d at 537 (quoting United States v. Mulheren, 938 F.2d 364, 372 (2d Cir. 1991)).

[76] *See id.* at 537 (citing to Chiarella v. United States, 445 U.S. 222, 234–35 (1980) (declaring 10(b) a catchall fraud provision) and United States v. O'Hagan, 521 U.S. 642, 658 (1997) (highlighting honest markets and investor confidence as the purposes behind the Exchange Act).

> 5(a) and (c) then, the Government must prove that a defendant committed a deceptive act.[77]

Third, Judge Chin focused on the defendant's petition for reversal (*i.e.*, that interpositioning is not "deceptive"). Here, in the heart of the Decision, Judge Chin engaged in a two-part analysis: first, determining whether proof of customer expectations was required for an interpositioning violation; and second, determining whether such proof had been presented by the government.[78]

As to the first question, Judge Chin pointed out that it was the government who had asserted in its opening statement that public customers placing orders on stock exchanges expect the Specialist to try to "get them the best possible fair price" under the circumstances, a point reiterated during summations. Accordingly, the government itself had repeatedly recognized that "proof of customer expectations was required to prove deception."[79]

Judge Chin clarified that the defendant was not arguing that evidence of customer expectations "is an element of the crime that the Government must establish for a conviction under Rule 10b-5," but rather, given the present facts, proof of interpositioning was not possible "without showing what the investing public expected."[80] The jurist lightened this load by adding that the expectation need not be proven by the actual testimony of customers; nonetheless, he stated, "[w]ithout evidence of what the customers expected, no rational juror could conclude that the interpositioning trades had a tendency to deceive or the power to mislead."[81]

Having reasoned that proof of customer expectations was required for a conviction, the Judge next demonstrated that such proof was lacking in the present case. He opined that Finnerty's NYSE testimony did not rise to the level of establishing proof of customer notice.[82] Next, he provided precedent for the conclusion that an NYSE violation by itself does not equate with evidence of

[77] *Id.* at 537–38 (quoting Chem. Bank v. Arthur Anderson Co., 726 F.2d 930, 943 (2d Cir. 1984)).

[78] *See id.* at 538–42.

[79] *Id.* at 538.

[80] *Id.* at 539.

[81] *Finnerty*, 474 F. Supp. 2d at 540. "To be clear, the Government is not required to call public customers as witnesses to prove their actual expectations." *Id.*

[82] *See id.* at 540–41.

fraud.[83] Finally, he posed a series of practical questions (*e.g.*, "what did customers 'trust' the specialists to do?;" "or did customers know that the specialist was trading for his own account and making a profit?") that had not been answered by the government's case.[84] "Some of the answers to these questions may be obvious to those with knowledge of the industry, but none of these questions were answered by the evidence presented at trial," the Judge added.[85]

C. Rejected Scripts

Lastly, Judge Chin weighed the government's arguments for upholding the convictions on alternate theories. A theory premised upon *manipulation* would fail for, again, the same lack of proof of customer deception; moreover, the case for interpositioning as a violation akin to a broker charging an excessive commission was noted as having been precluded by his ruling on the pretrial motion to dismiss.[86]

Likewise, a case predicated upon findings of *theft* would constitute securities fraud "only when it is accompanied by a violation of a fiduciary duty."[87] On this point, the Judge carefully canvassed judicial viewpoints on the existence of a Specialist's fiduciary duty and ultimately denied its existence, most clearly in a later section of the opinion decrying the government's analogy to a real estate broker.[88] Here Judge Chin came closest to equivocating, initially proclaiming that "the only case to have squarely addressed the issue" had concluded that Specialists do not owe a fiduciary duty to their public customers,[89] and then countering that, regardless, the issue had not been briefed nor submitted to the jury.[90] In perhaps the most damning yet supportive comment

[83] *Id.* at 541 (citing Shemtob v. Shearson, Hammill & Co., 448 F.2d 442 (2d Cir. 1971)).

[84] *Id.*

[85] *Finnerty*, 474 F. Supp. 2d at 542. Judge Chin found that the customers were not deceived because they were not aware of Finnerty's obligations, and because precedent provides that a NYSE violation, without more, does not constitute fraud. *Id.* at 540–42.

[86] *See id.* at 542–43.

[87] *Id.* at 543.

[88] *See id.* at 547 ("The real estate broker has a fiduciary duty to the party he is representing, while the specialist does not.").

[89] *Id.* at 543–44 (citing United States v. Hunt, 2006 U.S. Dist. LEXIS 64887, at *6 (S.D.N.Y. Sept. 6, 2006)).

[90] *See id.* at 543–44 (explaining that the issue was never submitted to the jury and therefore not an issue at all).

on Finnerty's behavior, Judge Chin concluded, "[b]ecause the Government never demonstrated that defendant owed a fiduciary duty to the public customers, the mere demonstration of theft is insufficient to uphold the securities fraud conviction."[91]

The opinion also made clear that profits, while speaking to motive, will not singularly establish a Rule 10b-5 violation. Specifically, Judge Chin reminded that "historically specialists have made a profit in the overwhelming majority of their proprietary trades" and concluded with the admonition that showing that the defendant "was good at what he did and was well compensated for his efforts was hardly compelling evidence that he engaged in securities fraud."[92]

Finally, the decision reiterated its unequivocal two-part holding. Finnerty's conviction was overturned through judgment notwithstanding the verdict. Moreover, Judge Chin held that if the judgment of acquittal were later vacated or reversed, because of the persistence of questions on common Specialist practices, a new trial would be granted.[93]

D. Analysis/Audience View

In sum, the *Finnerty* decision at once eschewed criminal regulation of an Exchange Trading Floor while affirming the existence of advantageous (if not carnivorous) trading behavior thereon. While the prosecutors and judge seemingly were in accord on that behavior telling a tale of theft, the two ultimately appeared at odds over some key lines in the script. For when the government showed scienter, the Judge cited a lack of investor harm.[94] When the prosecutors displayed defendant's knowledge of a duty, Judge Chin pointed to the investor's unawareness thereof.[95] And when the government highlighted profits, the jurist discounted their import and questioned their breadth.[96] On one point the experienced judge saw no room for debate: Rule 10b-5 was not the answer.[97]

[91] *Id.* at 543.

[92] *Finnerty*, 474 F. Supp. 2d. at 544.

[93] *See* notes 79–80 and accompanying text (noting ambiguity concerning common practices on the Stock Exchange Floor).

[94] *Finnerty*, 474 F. Supp. 2d at 544.

[95] *Id.* at 541 n.9.

[96] *Id.* at 544.

[97] *See New York Judge Reverses Verdict*, *supra* note 74.

As decisive as the tone of the opinion was, the likelihood that questions would abound:

- Is the Specialist the agent of the buyer or seller? And who exactly *is* the customer—the institution that entered the order, or its retail client? The *Finnerty* decision—like the SEC settlement three years prior—generically divided the category of "customers" into those individuals who entered DOT orders and those institutions that utilized Floor brokers without concomitantly clarifying whether different standards of care attend dealings with each.[98] It would seem rational that a Floor trader customer has differing (and more informed) expectations of Specialist practices than does the retail customer sitting in his broker's office.

- What will constitute adequate proof of *deception*? This is a particularly vexing query given that Finnerty's own acknowledgement that "no order should be disadvantaged in price" did not suffice.[99]

- Generally speaking, at what point, if any, do Specialist profits overcome the vagaries of generic regulatory limitations, such as Rule 10b-5, or even more specific prohibitions, like NYSE Rule 92? While profits make for a strong prima facie case of insider trading,[100] their presence in interpositioning charges (which more often than not are accompanied by the related "trading ahead" violation[101]), had been discounted.

Such considerations for the practitioner aside, the case revealed equally daunting legal enigmas.

[98] *See Finnerty*, 474 F. Supp. 2d at 532–33.

[99] *See id.* at 545. In parallel class action litigation, plaintiffs alleged that the Specialists made statements to customers about first being responsible to the market, and second to their own portfolio. *Id.* at 540 n.7.

[100] *See, e.g.*, SEC v. Ginsburg, 362 F.3d 1292, 1299 (S.D. Fl. 2002) ("The larger and more profitable the trades, and the closer in time the trader's exposure to the insider, the stronger the inference that the trader was acting on the basis of inside information.").

[101] *See* Press Release, SEC, SEC Charges 14 in Wall Street Insider Trading Ring, (Mar. 1, 2007), http://www.sec.gov/news/press/2007/2007-28.htm (describing "trading ahead" as a specialized form of insider trading committed by market professionals).

E. Legal Plot Points

The *Finnerty* decision, which cited to cases both civil and criminal, largely concurred with jurists recently confronting similar legal issues for Specialists. For example, like another Southern District of New York ruling in related criminal litigation, Judge Chin dismissed the possibility of Rule 10b-5 misstatement claim.[102] Moreover, like the holding in a separate but related criminal case, [103] Judge Chin failed to find that Specialists owe a fiduciary duty to their public customers.[104] Yet Judge Chin alone found the regulation to be an insurmountable obstacle to a jury verdict, and his resulting stamp on the Rule 10b-5 landscape remains his emphasis on the requirement of customer deception for purposes of finding securities fraud on an Exchange Trading Floor.

That emphasis on Rule 10b-5's deception requirement is ripe for debate. Judge Chin cited a string of cases standing for its absolute need[105] when he could have readily cited at least a few cases to the contrary.[106] It is axiomatic that such a pleading re-

[102] *See* United States v. Bongiorno, 2006 U.S. Dist. LEXIS 24830 at * 22–23 (S.D.N.Y. May 1, 2006). The court dismissed Rule 10b-5 misstatement charges against seven NYSE Specialists because the government's indictment had failed to allege material misstatements or omissions. *Id. But see In re* NYSE Specialists Sec. Litig., 405 F. Supp. 2d at 319 (S.D.N.Y. 2005). The court found fraud on the market theory applicable in civil class actions, holding that "[p]laintiffs may be presumed to have relied upon information indicating that securities would be matched by specialists, as opposed to bought and sold at artificially high and low prices" in upholding misstatements claims. *Id.*

[103] *See* United States v. Hunt, 2006 U.S. Dist. LEXIS 64887 at *18 (holding specialists do not owe a fiduciary duty to the public).

[104] *See Finnerty*, 474 F. Supp. 2d. at 543 ("[T]heft constitutes securities fraud only when it is accompanied by a violation of a fiduciary duty.").

[105] *See generally* Dura Pharm., Inc. v. Broudo, 544 U.S. 336, 338 (2005) (discussing untimely management disclosure of material facts in class action); SEC v. Zandford, 535 U.S. 813, 815 (2002) (illustrating a stock broker accused of theft from a client's account); *Chiarella*, 445 U.S. 222, 224 (1980) (describing a financial printer accused of insider trading); United States v. Russo, 74 F.3d 1383, 1385 (2d Cir. 1996) (examining alleged market manipulation); Chem. Bank v. Arthur Andersen & Co., 726 F.2d 930, 933 (2d Cir. 1984) (studying an accounting firm alleged to have prepared false and misleading financial statements).

[106] *See, e.g.*, *In re* Burlington Coat Factory Sec. Litig., 114 F.3d 1410, 1433 (3d Cir. 1997) (holding voluntary and ultimately inaccurate disclosures by corporations do not trigger Rule 10b-5 liability); Zlotnick v. Tie Communications, 836 F.2d 818, 823 (3d Cir. 1988) (noting that aggrieved market short sellers have been relying on the market price to not indicate its true value); *see also*, Blackie v. Barrack, 524 F.2d 891, 904 (9th Cir. 1975) (declaring that Specialists trading in violation of exchange rules commit fraud on the market).

quirement has emerged as an afterthought to the Rule.[107] That afterthought has been attenuated (if not altogether eradicated) in cases alleging Internet manipulation,[108] insider trading,[109] and corporate misstatements and mismanagement.[110] However, a recent Southern District of New York case reinforced Judge Chin's disdain for the singular premise of theft by dismissing an SEC case against a foreign national who had allegedly obtained inside information through his "hacking" into a firm's computer network.[111]

To the same indeterminate end is the focus on the related question of proof of customer expectations as a co-requisite to theft for a finding of securities fraud. This question is intrinsically tied to the query of whether or not the Specialist is a *fiduciary*. The cited and contemporary United States v. Hunt actually considered the question of fiduciary duty in the context of supporting a Rule 10b-5(b) charge (*i.e.*, failure to disclose/misrepresentations).[112] Judge Batts concluded in *Hunt* that the defendant, also an FSI Specialist accused of interpositioning,[113] could not be found guilty under Rule 10b-5 on the allegation of "failure to disclose" that his trading was violative of NYSE rules.[114] Additionally, Judge Batts both distinguished a "position

[107] *See* JAMES D. COX, ROBERT W. HILLMAN & DONALD C. LANGEVOORT, SECURITIES REGULATION: CASES AND MATERIALS 654 (Aspen Publishers 5th ed. 2006) ("From this perspective, contrary to the Supreme Court's teachings, neither a strict deception nor a scienter requirement is implicit in the statute.").

[108] *See* SEC v. Mandaci, 2004 U.S. Dist. LEXIS 19143, at *25 (S.D.N.Y. Sept. 27, 2004) (granting summary judgment in favor of the Commission since proof of manipulation was absent).

[109] *See O'Hagan*, 521 U.S. at 643 (finding fraud in defendant's "feigning fidelity" to his employer law firm through silence).

[110] *See* Basic Inc. v. Levinson, 485 U.S. 224, 247 (1988) ("Indeed, nearly every court that has considered the proposition has concluded that where materially misleading statements have been disseminated into an impersonal, well-developed market for securities, the reliance of individual plaintiffs on the integrity of the market price may be presumed."); *see also* Goldberg v. Meridor, 567 F.2d 209, 217–18 (2d Cir. 1977) (finding Rule 10b-5 fraud present under "controlling influence" doctrine where defendant parent corporation convinced its subsidiary to issue stock and deceived plaintiff shareholders into relinquishing available New York State court relief).

[111] SEC v. Dorozhko, SDNY Dkt. No. 07 Civ. 9606 (NRB) (Jan. 8, 2008).

[112] 2006 U.S. Dist. LEXIS 64887 at *16 (S.D.N.Y. Sept. 6, 2006) ("While specialists may have an obligation to maintain the market economy, they do not owe the public a fiduciary duty, and therefore an alleged breach of fiduciary duty cannot serve as a basis for security fraud.").

[113] *Id.* at 2, 6.

[114] *Id.* at 12.

of public trust" from a fiduciary duty and likened the Specialist to a stockbroker not possessing discretion over a customer's account;[115] such considerations were not emphasized by Judge Chin's ruling.

More importantly, Judge Chin's reference to the stockbroker analogy in *Hunt* is problematic. Specifically, *Hunt*'s reliance upon discretionary trading authority (or the lack thereof) as an index of the broker's fiduciary duty to customers (and, in turn, the duty to speak truthfully thereto) tells but part of the larger debate. While it is relatively undisputed that a broker possessing discretionary trading authority serves as fiduciary to his customer, there are other ways for the broker-customer relationship to reach that level of care. Indeed, a more traditional fiduciary analysis might have focused on whether the trades were executed by the Specialists as *principal* rather than as *agent*. As the leading treatise on securities regulation continues to remind, the SEC (in part addressing the Dual Roles) professed a higher duty of principals long ago:

> If employed to sell securities a broker may not, without complete disclosure to his customer, purchase such securities for his own account; and if authorized to purchase securities, he may not supply them from his own account without such disclosure . . . . Where he discloses to his customer that he is acting as dealer and obtains the customer's consent, a broker may take or supply for his own account securities named in a brokerage order.[116]

Under this form of analysis, since Judge Chin had accepted the prosecutor's assertion that all Specialists profits result from interpositioned trades executed on a principal basis,[117] the Specialist, as principal, is obliged to disclose to his public customers that he benefited from the interpositioned trade. In the *Finnerty* case, such a burden would make conviction not only sustainable but also likely. The trial burden would shift from the prosecutor (to

[115] *See id.* at 14–15, 17.

[116] LOUIS LOSS & JOEL SELIGMAN, SECURITIES REGULATION §8-A-3 n.39 (3d ed. 2006) (quoting SECURITIES AND EXCHANGE COMMISSION, REPORT ON THE FEASIBILITY AND ADVISABILITY OF THE COMPLETE SEGREGATION OF THE FUNCTIONS OF DEALER AND BROKER (1936)).

[117] *See Finnerty*, 474 F. Supp. 2d at 544 (stating Government's assertion that only purpose of interpositioning is to make money for specialist firm).

prove a duty to speak) to the defense (to prove that adequate and truthful disclosures were made). In such a scenario, evidence of customer expectations becomes irrelevant, and dollars to the Specialist's principal account serve not as evidence of scienter but rather a measure of the harm.

Alternatively, under a more modern view, the Specialist as *agent* broker would still arguably owe a fiduciary duty to the public customer.[118] Of course, on the specific question of interpositioning, the SEC has made clear in recent years that it holds the Specialist to a fiduciary duty when acting as either principal or agent;[119] further, the NYSE, in enforcing its own Rules 104 and 92, has paraphrased but nonetheless echoed the call.[120]

Finally, pursuant to industry rules, a Specialist, when interpositioning, would fail mightily as a stockbroker, the NASD rules for which require best pricing for the retail customer at all times. Significantly, NASD Rule 2320 states as follows:

> **Best Execution and Interpositioning**
>
> (a) In any transaction for or with a customer . . . a member and persons associated with a member shall use reasonable diligence to ascertain the best market for the subject security and buy or sell in such market so that the resultant price to the customer is as favorable as possible under prevailing market conditions . . . . (f) The obligations described . . . above exist not

[118] *See* Mkt. St. Ltd. Partners v. Englander Cap. Corp., 1993 U.S. Dist. LEXIS 8065 (S.D.N.Y. June 14, 1993). Institutional customer alleged, *inter alia*, breach of fiduciary duty by the American Stock Exchange and certain of its Specialists. *Id.* at *31. The court cited to a 1967 law review article for the premise that "[a]s broker, the specialist holds and executes orders for the public on a commission basis. When he does so, he is an agent and has a fiduciary obligation to his principal, the purchaser or seller of stock." *Id.* at *33. Judge Chin mentioned *Market Street* in a footnote but found the case to be irrelevant, as it had differing facts and had been held inapplicable by Judge Batts in *Hunt* because public customers compensate brokers, but not Specialists. *See Finnerty*, 474 F. Supp. 2d at 544 n.10.

[119] *See In re* Fleet Specialist, Inc., Securities Exchange Act of 1934 Release No. 49499, 2004 SEC LEXIS 744 at *5 (Mar. 30, 2004). The proceeding involved violations of the respondent's "basic obligation to serve public customer orders over its own proprietary interests" and provided an overview of specialists' obligations. *Id.* at *4. According to the administrative order, the specialist has two primary duties: executing customer orders at the most advantageous price and offsetting imbalances in supply and demand. *Id.* at *5.

[120] *See* NYSE LLC, Hearing Board Decision 07-055 (April 25, 2007), *available at* http://www.nyse.com/pdfs/07-055.pdf (concluding that respondent violated his agency obligations as a specialist).

> only where the member acts as agent for the account of his customer but also where retail transactions are executed as principal and contemporaneously offset.[121]

By definition, an interpositioned trade confesses the existence of a price more favorable than that which the customer received, and the interpositioning "broker," when servicing a retail order, is, save for certain instances, normally in violation.

Thus, the stockbroker analogy fails to resolve the fiduciary question, triggers codified regulatory limitations, and supports the present, unwavering SEC view of an inviolate duty (while quite likely giving rise to the same misrepresentation cause of action that Judge Chin twice denied the government). Moreover, the *Finnerty* decision's reliance on the analogy is purely academic, as Judge Chin points out that the issue was never submitted to the jury.[122]

On balance, in the face of documented lapses in Trading Floor supervision by the NYSE, prior administrative discipline against the Specialist firms, a criminal enforcement program that had been half abandoned by U.S. Attorneys, and an anonymous list of victims, Judge Chin, having refused before trial to allow Rule 10b-5 to act as a catchall, refused afterwards to eliminate one of its frequent (if not pivotal) requirements, namely, that an identifiable party was victimized.[123] Stated otherwise, in the absence of precedent, the judge may have simply been loathe to criminalize Floor behavior that has existed for decades,[124] and the supple, though often conflicted field of Rule 10b-5 holdings—along with a trial that exhibited a few prosecutorial shortcuts and presumptions—amply provided grounds for the judge's reversal.

[121] NASD Manual, Rule 2320: Best Execution and Interpositioning (2007), *available at* http://finra.complinet.com/finra/display/display.html?rbid=1189&element_id=1159000466.

[122] *See Finnerty*, 474 F. Supp. 2d at 541 ("As a consequence, the jury was required to assume . . . that the customers knew about these rules and expected the specialists to comply with them.").

[123] *See Case Highlights & Commentary*, 2007 SEC. LIT. COMMENT. 2 (stating that the defendant prevailed because the "Government failed to supply proof that investor deception was part and parcel of the scheme.").

[124] *See* Gary Weiss, *Can the Big Board Police Itself?* 3654 BUS. WK. 154 (Nov. 8, 1999). During the sentencing hearing for the eight Floor traders discussed earlier herein, testimony from the head NYSE regulator had confirmed that "until October, 1998, the NYSE felt it was not necessarily improper for a floor broker to share in the profits of someone else's trading account."

F. Factual Miscues

While procedural obstacles may have undermined the verdict, it remains clear that a considerable part of Judge Chin's uneasiness stemmed from the government's failure to expose the jury to the realities of the Stock Exchange Floor. For example, in repeating his belief that the instances of interpositioning were "clearly and significantly overstated," the Judge added that "it appears that the Government failed to account for numerous circumstances when Finnerty was not executing trades himself—he was not on the floor or he was not at his post or he was negotiating with the crowd or otherwise engaged in non-trading activity."[125]

Indeed, Judge Chin may have felt particularly shortchanged by the government's lack of proof of customer deception in light of his express pre-trial ruling—over the defendant's motion to dismiss—that the indictment set forth allegations that would constitute securities fraud:

> By taking positions as specialists, defendants were required – under the rules of the NYSE – to match orders and to place the interests of their public customers above their own. Rather than abide by these rules, defendants allegedly made a profit for themselves, and subordinated the interests of the trading public below their own. Accordingly, this scheme or course of business worked to deceive the trading public, as investors believed that defendants were working to match orders, first and foremost, and that defendants traded for their own proprietary accounts only to maintain a fair and orderly market. If proven, then, these acts of trading ahead and interpositioning would constitute a violate of [Rule 10b-5] subsections (a) and (c).[126]

Having initially agreed with the government in October 2006 that Rule 10b-5 could withstand the expansion to Specialist self-dealing, the Judge proceeded to set the parameters for the violation; the prosecutors' ensuing failure to adhere to that guidance proved most fatal to their case. Tellingly, on the specific point of the government's "inflated" instances of interpositioning, Judge Chin explained the prosecutors' reversal of fortunes when he

[125] *Finnerty*, 474 F. Supp. 2d at 546.
[126] *Finnerty*, 2006 U.S. Dist. LEXIS 72119 at *11.

stated that he "could not assume that the Government would fail at trial to prove that Finnerty was responsible for all these instances."[127]

G. Denouement

The dismissal arguably revived the SEC's prior stances towards Specialists; their conflicted roles are necessary evils and their discipline is to be meted out by the parties at the stock exchanges who monitor their trading. Recall that even in the wake of the 1987 Crash (and some documented Specialist inactivity therein), the SEC response primarily exhorted the exchanges to take disciplinary action and reallocate stocks among Specialists.[128]

The New York Times stated that Judge Chin's reversal was "the latest blow to the pursuit of federal criminal charges against 15 New York Stock Exchange floor supervisors," adding that "[p]rosecutors had already dropped [similar] charges against seven defendants."[129] Similarly, *The Wall Street Journal* criticized the decision as "the latest setback," quoting a spokeswoman for the U.S. Attorney's office as saying "[w]e are reviewing the opinion and considering our options."[130] The law bloggers were supportive (albeit more blunt), noting that the government had offered "no proof that investors would have refused to trade if they knew a middleman was involved."[131]

CONCLUSION: ALWAYS LOOK ON THE BRIGHT SIDE

The Specialist system has invited open and harsh criticism for over seventy years. The SEC in particular has voiced its con-

[127] *Finnerty*, 474 F. Supp. 2d at 546 n.12.

[128] *See* DIV. OF MKT. REGULATION, U.S. SEC. & EXCH. COMM'N, THE OCTOBER 1987 MARKET BREAK xvii (Feb. 1988) ("In light of our findings [regarding specialist performance during the market break period], the Division believes . . . [that] the Amex and NYSE must use their powers to reallocate stock . . . where they identify specialists that exhibited a substantial or continued failure . . .").

[129] Associated Press, *U.S. Judge Voids Guilty Verdict of Big Board Specialist in G.E.*, N.Y. TIMES, Feb. 22, 2007, at C11.

[130] Chad Bray & Paul Davies, *Moving the Market: NYSE Ex-Floor Trader's Conviction Is Thrown Out In Latest Blow to U.S.*, WALL ST. J., Feb. 22, 2007, at C2 (reporting how government is having difficulty prosecuting "Specialists").

[131] *See* Posting of Maria Leone to CFO Blog, http://www.cfo.com/blogs/index.cfm/detail/8756850?f=search (Feb. 22, 2007, 15:44 EST) (summarizing defense attorneys' arguments in *Finnerty* case).

cerns over that span, but perhaps only with a string of criminal indictments in the last few years did the system's continued utility come simultaneously into both focus and peril.[132]

In the wake of the corporate scandals prompting the adoption of the Sarbanes-Oxley Act of 2002,[133] the White House formally announced the President's Ten-Point plan to return corporate responsibility and "to improve oversight of corporate America;" that plan included the credo that "each investor should have prompt access to critical information" as well as the encouragement of the Corporate Fraud Task Force within the Department of Justice to heed the "call to action" and further the goal of real-time enforcement.[134] Yet, three weeks after the completion of the *Finnerty* trial, the United States Attorney for the Southern District of New York announced that, having assessed the evidence in its Specialists cases, "the Government has concluded that continued prosecution in these [five remaining Specialist] cases are not in the interests of justice."[135]

Thus, in addition to quelling a part of the Task Force, by declining to apply Rule 10b-5 to a case of sizeable Specialist profits, the *Finnerty* decision of February 2007 dampened the death knell for the Specialist system. Whether or not all American exchanges abandon the trading model will likely be decided by considerations of execution speed, anonymous trading, globalization, and institutional clout.[136] In light of Judge Chin's bold reversal of a jury's conclusion on Specialist practices, the following conclusions seem supportable:

The *Finnerty* decision signals a split between the courts and the SEC on, among other things, the duties attending the Dual Roles of the Specialists. Notably, Judge Chin cited a separate

[132] *See* the Amicus Brief of the Securities Industry and Financial Markets Association submitted in Stoneridge Investment Partners v. Scientific-Atlanta, Inc., 2006 U.S. Briefs 43, 45 ("The threat of a criminal indictment is a serious deterrent – because even an indictment, and certainly a conviction, would amount to a professional death sentence.").

[133] *See generally* Elisabeth Bumiller, *Bush Signs Bill Aimed at Fraud in Corporations*, N.Y. TIMES, July 31, 2002, at A1.

[134] *See* President's Ten-Point Plan, http://www.whitehouse.gov/infocus/corporate responsibility/index2.html.

[135] *See* Statement On Status of Five "Specialist" Cases, United States Attorney Southern District of New York (Nov. 21, 2006), *available at* http://www.usdoj.gov/usao/nys/ pressreleases/November06/specialiststatement.pdf.

[136] In the Fall of 2007, the Boston Stock Exchange was acquired by the Nasdaq Stock Market. *See Nasdaq to Buy Boston Stock Exchange*, WALL ST. J, Oct. 3, 2007 *available at* http://online.wsj.com/article/SB119132592042046334.html.

2006 Southern District of New York case for the proposition that "specialists do not owe a fiduciary duty to their public customers,"[137] while the SEC in recent years has affirmatively stated "[w]hether acting as brokers or dealers, specialists are required to hold the public's interest above their own . . . ."[138] Indeed, it seems patently clear that the *Finnerty* prosecutors, who were cited for promising proof of customer expectations in their opening remarks, can be said to have essentially been following the script authored by the SEC's 2004 settlements.

Yet that split serves mainly to expose the weakness of the SEC's zeal. The issue remains of how the regulators and regulated alike may discern a dividing line between "reasonably necessary" principal purchases by the Specialist and self-dealing that falls outside of the catchall of 'failing to maintain an orderly market.' Simply put, is ANY level of interpositioning acceptable, or is the SEC desiring a zero tolerance policy?

As flexible as Rule 10b-5 may have been, jurists and other triers of fact do not appear ready to universally apply the industry's most feared prohibition to all instances of noteworthy profiteering. Indeed, Rule 10b-5 may prove to be problematic as a panacea in the new millennium as prosecutors attempt to criminalize nuanced industry behavior.[139] Apart from the defeats handed the government (by both juries and a jurist) in the Specialist cases, also in 2007 a federal jury acquitted six employees of a day trading firm accused of committing securities fraud by paying other firms to listen in on internal "squawk box" transmissions in order to trade ahead of large customer orders. In those cases, too, the prosecution charged Rule 10b-5 as a criminal violation, and the defense argued that no customers were harmed.[140] On the related topic of civil litigation, it bears noting that, in a three-month pe-

[137] *Finnerty*, 474 F. Supp. 2d at 543 (contemplating cases opposed to fiduciary duty of specialists).

[138] *In re* Fleet Specialist, Inc., Exchange Act Release No. 49499, 2004 SEC LEXIS 744 at *6 (Mar. 30, 2004) (highlighting numerous obligations of specialists).

[139] *See* Jenny Anderson, *As Lenders, Hedge Funds Draw Insider Scrutiny*, N.Y. TIMES, Oct. 16, 2006, at A1 (reporting SEC's investigation of possible insider trading based on leaks from a private conference call between Movie Gallery and its lenders regarding the poor state of the movie rental industry).

[140] *See* Jenny Anderson, *6 Former Workers at a Day Trading Firm Are Acquitted*, N.Y. TIMES, May 11, 2007, at C2. A mistrial was granted on the conspiracy charge, giving the government the opportunity to re-try that aspect of the case. Moreover, the SEC complaint against the firm and the employees premised on the same behavior is still pending.

riod last year, the Supreme Court raised the pleading bar for securities class actions,[141] and the SEC itself entertained the idea of mandatory arbitration for disputes between shareholders and issuers.[142] Thus, the temperature proved far from hot for expanding the reach of Rule 10b-5 (and its storied pleading requirements) into new and untapped areas of litigation.

Ironically, by dropping the "trading ahead" (*i.e.*, insider trading) charge, the prosecutors may have unwittingly provided Judge Chin with the means of dismissing the victory in applying Rule 10b-5, for highlighted customer expectations would have been irrelevant to a conviction based in part on an insider trading violation, which requires no specified victims.[143]

The specific case for casting interpositioning as a Rule 10b-5 violation has been complicated by the now court-defined need to present evidence to juries of the presence of a fiduciary duty, and the evidence of someone being hoodwinked.[144] Of course, whenever forced to confront a new, technical practice, prosecutors are charged with the duty of readily explaining customs and trading practices to both judges and newcomers alike. Such a charge apparently became daunting in the present case, the decision for which clearly and repeatedly noted shortcomings through statements such as "[t]he record is not clear, but it appears that the specialist firms do not charge a commission or fee for their service in matching trades,"[145] and "[i]ndeed, the issue of whether

[141] *See* Tellabs, Inc. v. Makor Issues & Rights, Ltd., 127 S. Ct. 2499, 2513 (2007) (holding that plaintiffs in private securities fraud actions must plead with particularity the facts giving rise to the alleged violation and the facts demonstrating a "strong inference" of defendant's scienter).

[142] *See* Kara Scannell, *SEC Explores A Wider Role For Arbitration—Agency May Consider Letting Firms Head Off Lawsuits by Investors*, WALL ST. J., April 16, 2007, at A1 (describing the SEC's intention to expand the concept of mandatory arbitration as "limiting shareholders' ability to sue in court").

[143] It bears noting that in other applications of the prohibition to technical areas (*e.g.*, internet fraud; insider trading), the federal judiciary and Congress have waived this requirement. *See, e.g., Mandaci*, 2004 U.S. Dist. LEXIS 19143, at *23. Under 17(a) of the Securities Act, the SEC need not prove defendant's scienter in order to enjoin the party from using a device to defraud in the offer or sale of securities in interstate commerce or by the use of the mail. *See also* Securities and Exchange Act of 1934, §20A (codified at 15 U.S.C. § 78t-1(a) (2007)). Section 20A of the Act establishes contemporaneous liability to all market participants on the other side of the violating buyer or seller. *Id.*

[144] *See supra* note 94.

[145] *Finnerty*, 474 F. Supp. 2d at 544. Later on, Judge Chin amplified his disappointment with the government's case: "I continue to have questions as to the process by which specialists dealt with customers, what customers expected, how specialists were compensated, and how the specialist firms earned income." *Id.* at 545–46.

Finnerty owed a fiduciary duty to the public customers was never resolved."[146]

Concomitantly, internal exchange enforcement, despite the trend towards merging and consolidating exchange regulatory units,[147]remains more important than ever.[148] If Rule 10b-5's pleading requirements prove too onerous, then marketplace-trading rules such as NYSE Rule 104 will have to serve as the primary deterrent to overly-opportunistic Specialist trading.[149] Such cases, with their ever-increasing fines and attendant notoriety, are much more likely than the SEC's suggestion of a forced reshuffling of stocks assigned to Specialists.[150] Meaningful deterrence will surely be emphasized by those stock exchanges seeking prolonged lives for specialist-centered trading models.[151]

The change in the past two years at the NYSE from 80% human trading to 80% electronic trading, whatever its primary motivation, has resounded the calls for a Big Bang on the west side

[146] *Id.* at 543.

[147] In January 2007, NASD members voted to approve the consolidation of the regulatory arms of the NYSE and NASD. Press Release, NASD, NASD Member Firms Embrace Streamlined, More Efficient Regulation (Jan. 21, 2007), http://www.finra.org/PressRoom/NewsReleases/2007NewsReleases/P018334. That merger of internal enforcement units was formally approved by the SEC in July 2007. Press Release, SEC, SEC Gives Regulatory Approval for NASD and NYSE Consolidation (July 26, 2007), http://www.sec.gov/news/press/2007/2007-151.htm.

[148] *See* NYSE, Inc., Exchange Hearing Panel Decision 04-127 (Aug. 11, 2004), *available at* http://www.nyse.com/pdfs/04-127.pdf. Finnerty, who had given partial testimony to NYSE investigators in August 2003, was censured and barred from NYSE membership until such time as he fully cooperates. *Id.*

[149] In late 2007 the NYSE formally altered the Specialist compensation structure, proposing in separate releases to implement a revenue sharing program, eradicate Specialist commissions, and implement a revised system of payments based upon the provision of market liquidity. *See* SEC Release No. 34-56337 (Sept. 6, 2007) *and* SEC Release No. 34-56591 (Oct. 9, 2007).

[150] *See* Amber Anand, Sugato Chakravarty, & Chairat Chuwonganant, *Cleaning House: Stock Reassignments on the NYSE* 1 AFA CHI. MEETINGS PAPER (Mar. 2006), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=888574 ("Thus, even though the NYSE follows an elaborate matching process of new listings with the 'right' specialist firms, it rarely reallocates stocks.").

[151] In addition to its highly publicized switch to a "Hybrid Market," the NYSE cut its staff members by more than a third in 2006, while gradually closing two trading rooms of its storied Floor. In May of 2007, one Floor member openly warned of automation hurrying the Floor's extinction. *See* Luke Jeffs, *NYSE Broker Warns Against Demise of Floor*, FIN. NEWS ONLINE US, May 21, 2007, *available at* http://www.financialnews-us.com/index.cfm?page=usaboutus&uid=2807-1109-900619-781332. In October 2007, the NYSE formally petitioned the SEC to redefine "Crowd" as the remaining rooms on the storied Floor from which Floor brokers are able to conduct business. SEC Release No. 34-56621 (Oct. 15, 2007).

of the Atlantic.[152] Thus, while the Specialist system, to quote the Broadway show *Spamalot,* is "not dead yet," its practitioners might do well to refrain from inviting further prosecutorial scrutiny of over-participation in the market. One could say that this select group should enjoy the privileged position tradition has afforded them, and—heeding another showstopper from the musical—look on the bright side of life, for as long as the market (and the courts) keep the curtain from falling.

[152] *See* Susan Harrigan, *Big Board's Trade-off: Style is Yielding to Speed*, NEWSDAY, Mar. 19, 2007, at A34 ("Large customers' demands for faster and cheaper trading, as well as brutal new competition from all-electronic markets, have revolutionized the way business is done at the Big Board, the linchpin of the metropolitan's area's vast financial industry.").