

NEW YORK STOCK EXCHANGE LLC

NYSE HEARING BOARD DECISION 06-228
VAN DER MOOLEN SPECIALISTS USA, LLC
MEMBER ORGANIZATION

December 21, 2006

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Violated Rule 11Ac1-1(c) under Exchange Act (now designated as Rule 602(b) under Regulation NMS) and NYSE Rule 60, in that (a) marketable orders did not receive price of published quotation in effect at time order became viewable on Display Book, and (b) ITS commitments were not executed against published quotation before commitment expired; violated Rule 11Ac1-4 under Exchange Act (now designated as Rule 604 under Regulation NMS) and NYSE Rule 79A.15, in that eligible limit orders were not displayed immediately; violated NYSE Rule 440B and Section 10(a) of Exchange Act and Rule 10a-1(a) thereunder by executing short sales on minus or zero minus ticks; violated NYSE Rule 342 by failing to have written supervisory procedures specifically relating to Firm Quote Rule - Consent to censure and \$400,000 fine.

Appearances:

For the Division of Enforcement
Susan Light, Esq.
Julie Han Broderick, Esq.
Michael Bautz, Esq.
Marc Minor

For Respondent
Joseph A. Sack, Esq.
John Luttenberger
Menachem Rosensaft, Esq.

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A Hearing Officer on behalf of the New York Stock Exchange LLC (“NYSE”) considered a Stipulation of Facts and Consent to Penalty entered into between NYSE Regulation, Inc.’s Division of Enforcement (“Enforcement”) and Van der Moolen Specialists USA, LLC (“Respondent” or the “Firm”), an NYSE member organization. Without admitting or denying guilt, Respondent consented to a finding by the Hearing Officer that it:

- I. Violated Rule 11Ac1-1(c) under the Securities Exchange Act of 1934(now designated as Rule 602(b) under Regulation NMS), and NYSE Rule 60, in that;
 - a. marketable orders did not receive the price of the published quotation that was in effect at the time the order became viewable on the Display Book; and
 - b. ITS commitments were not executed against the published quotation before the commitment expired.

- II. Violated Rule 11Ac1-4 under the Securities Exchange Act of 1934 (now designated as Rule 604 under Regulation NMS), and NYSE Rule 79A.15, in that eligible limit orders were not displayed immediately (*i.e.*, as soon as practicable).
- III. Violated NYSE Rule 440B and Section 10(a) of the Securities Exchange Act of 1934 and Rule 10a-1(a) thereunder, in that the Firm executed short sales on minus or zero minus ticks.
- IV. Violated NYSE Rule 342 in that, in its supervision of specialist firm quote activities, the Firm used new surveillance technology as it became available, but did not have written supervisory procedures specifically relating to the Firm Quote Rule during the period from January 2003 through August 2005.

For the sole purpose of settling this disciplinary proceeding, without adjudication of any issues of law or fact, and without admitting or denying any allegations or findings referred to in the Stipulation of Facts and Consent to Penalty, Respondent stipulates to certain facts, the substance of which follows:*

Background and Jurisdiction

1. The Firm is a broker-dealer registered with the Securities and Exchange Commission ("SEC" or the "Commission"), pursuant to Section 15(b) of the Securities Exchange Act of 1934 (the "Exchange Act"). In addition, the Firm is an NYSE member organization and currently acts as the registered specialist for approximately 432 NYSE-listed securities.
2. The Firm is a majority-owned subsidiary of the international trading firm Van der Moolen Holding N.V., ("VDM"), which in 2001, began trading American Depository Receipts on the NYSE. The Firm was established in or about July 1999 when VDM acquired a majority interest in several NYSE specialist firms. Since that time, the Firm has acquired four other NYSE specialist firms. For the purposes of this Stipulation and Consent, the "Firm" shall refer to Van der Moolen Specialists USA, LLC and its predecessor entities.
3. By letter dated August 5, 2005, the Firm was notified in writing that Enforcement was investigating certain matters regarding certain of its specialists' quotation and execution activities on the Floor of the NYSE.

* Hearing Officer Note: The facts, allegations, and conclusions contained in paragraphs 1 to 17 are taken from the executed Stipulation of Facts and Consent to Penalty between Enforcement and Respondent. No changes have been made to the stipulated paragraphs by the Hearing Officer.

Overview

4. This matter involves compliance with applicable securities laws and regulations relating to specialists' order handling obligations, and NYSE rules concerning firm quotes, ITS commitments, limit order display, and short sales.¹

Firm Quote Rule

5. Subject to certain exceptions,² NYSE specialists are required to execute orders to buy and sell stocks presented to them at a price at least as favorable as the NYSE's published bid or offer, in accordance with Exchange Act Rule 11Ac1-1 (now designated as Rule 602 of Regulation NMS) and NYSE Rule 60 (the "Firm Quote Rule").³
6. The SEC adopted Rule 11Ac1-1 in 1978, at a time when the equities market was less automated and traded in much lower volume than is the case today. In 1982, the NYSE amended its corresponding Rule 60 to provide that the specialist in a particular security is deemed to be the "responsible broker or dealer" under Rule 11Ac1-1 for most quotations disseminated by the NYSE. In 1991, the NYSE further amended Rule 60 to make the specialist the "responsible broker or dealer" for any bid or offer that the NYSE makes available to quotation vendors.⁴ Accordingly, unless an exception applies, the specialist is required to honor the NYSE's published bid or

¹ This proceeding resolves all disciplinary actions by the NYSE against the Firm involving firm quotes, ITS commitments, limit order display, and short sales during the period from January 2003 to December 2006 (the "Relevant Period").

² In entering into this Stipulation and Consent, the Firm has not undertaken to reconstruct the facts necessary to establish whether any of the exceptions to the Firm Quote Rule or the other SEC and NYSE rules cited below apply to the transactions discussed herein.

³ As noted above, Exchange Act Rule 11Ac1-1 (now designated as Rule 602 of Regulation NMS) and NYSE Rule 60 contain various exceptions, including, but not limited to, the exceptions discussed herein. First, an NYSE specialist is not obligated to execute an order at the NYSE's published bid or offer if: (a) before the order is presented, a revised bid, offer, or quotation size has been communicated to the NYSE that supercedes the published bid, offer, or quotation size; or (b) at the time the order is presented, the specialist is "in the process of effecting a transaction" in that security and, immediately after the completion of the transaction, a revised quotation is communicated to the NYSE. NYSE Rule 60.10 also provides that "No specialist shall be deemed to be a responsible broker or dealer with respect to a published bid or offer that is erroneous as a result of an error or omission made by the Exchange or any quotation vendor." Although NYSE Rule 60.20 generally requires a specialist to honor an erroneous bid or offer that has been displayed for six minutes or more, the specialist is not obligated to do so if: (a) an execution, cancellation or update of such bid or offer was in effect or in process; (b) in honoring such a bid or offer, the resulting transaction would violate applicable NYSE rules or federal regulations; (c) equipment failure prevents the specialist from monitoring such bid or offer; or (d) the price sought upon such quotation is above the current bid or below the current offer on the Floor by the amount specified in the Rule (or more).

⁴Hybrid Market implementation will increase the automation of the NYSE market, thereby significantly limiting the specialist's firm quote exposure.

offer, whether it represents the specialist's own quotation or better-priced limit orders entered by customers and disseminated by the NYSE.

7. As of May 2003, with the NYSE's introduction of its Autoquote system, the electronic display book (the "Display Book")⁵ generally updates the NYSE's published bid or offer automatically when a customer limit order improves the price or size of the displayed quotation or when a customer cancels a limit order that made up all or part of such quotation. Implementation of Autoquote dramatically increased the number of quote changes occurring in the Display Book independent of any interaction by the specialist.
8. On multiple occasions during the Relevant Period, marketable orders did not receive the price of the published quotation that was in effect at the time the order became viewable on the Display Book. Prior to the execution of that order or its cancellation, the specialist or the NYSE's Autoquote system changed the quotation.⁶

Handling of ITS Commitments

9. An Intermarket Trading System ("ITS") commitment to buy (sell) must be priced at the offer (bid) being displayed by the market center to which the commitment is sent. An inbound ITS commitment is a commitment to buy (sell) sent by another market center to the NYSE and, pursuant to Exchange Act Rule 11Ac1-1(c) (now designated as Rule 602(b) under Regulation NMS) and NYSE Rule 60, generally should be executed at the published quotation up to the full amount of the bid or offer.
10. During the Relevant Period, ITS commitments were received by the Firm at the NYSE's published bid or offer in amounts up to or exceeding the published quotation size. On multiple occasions, the ITS commitments were not executed against the published quotation before the commitment expired.

Limit Order Display Rule

11. Subject to certain exceptions, Exchange Act Rule 11Ac1-4 (now designated as Rule 604 of Regulation NMS) and NYSE Rule 79A.15 state in pertinent part that NYSE specialists shall immediately display customer limit orders in the published quotation, when (a) the order is at a price that would improve the NYSE's published bid or offer in such security or (b) the order is priced equal to the NYSE's published bid or offer and the national best bid or offer for such security and the size of the order represents more than a de minimis change in relation to the size associated with the NYSE's published bid or offer in such security.

⁵ The Display Book is an electronic workstation provided by the NYSE to specialist firms for use by their specialists at their post panels and is operated by means of a customized keyboard containing function, letter, number, and arrow keys. The Display Book allows specialists to, among other things, receive and process orders, disseminate trade and quote information, report transactions, research order and execution status, and manage positions.

⁶ The quote may have changed for various reasons, including, but not limited to, to reflect prevailing market conditions or updates, or as a result of cancellations or NX trades.

12. On multiple occasions during the Relevant Period, eligible limit orders were not displayed immediately (*i.e.*, as soon as practicable).

Short Sale Rule

13. Subject to certain exceptions, NYSE Rule 440B and Section 10(a) of the Exchange Act and Rule 10a-1(a) thereunder, in relevant part, prohibit NYSE members, including specialists, from executing a short sale⁷ below the price of the last sale or at the last price if it was lower than the last different price.⁸
14. On multiple occasions between January 2005 and December 2006, the Firm executed short sales on minus or zero minus ticks.

Written Supervisory Procedures

15. In its supervision of specialist firm quote activities, the Firm used new surveillance technology as it became available, but did not have written supervisory procedures specifically relating to the Firm Quote Rule during the period from January 2003 through August 2005.

Additional Factors Considered

16. In determining to resolve this matter on the basis set forth herein, Enforcement took into consideration that the Firm and the other NYSE specialist firms assisted the NYSE by proposing enhancements and protective measures to the NYSE's systems and technology, which the NYSE later implemented or intends to implement.
17. Enforcement further considered that the activity described herein did not appear to have been undertaken with the intent to benefit the Firm.

⁷ As defined by NYSE Rule 440B.10, a short sale is "any sale of a [non-exempt] security, which the seller does not own or any sale that is consummated by the delivery of a security borrowed by, or for the account of, the seller."

⁸ NYSE Rule 440B and Exchange Act Rule 10a-1 contain various exceptions. For example, NYSE Rule 1003 provides that if a transaction has been agreed upon in the auction market, and an execution involving an auto ex order is reported at a different price before the auction market transaction is reported, any tick test applicable to the auction market transaction will be based on the last reported trade prior to the execution of the auto ex order. In addition, as stated in NYSE Information Memo 01-04 (dated February 27, 2001), "the specialist will be deemed not to be in violation of Rule 10a-1 under the [Exchange Act] or Rule 440B whenever he or she would be required to take the contra side of an auto ex execution on a minus or zero minus tick, and has an existing short position, or would be creating a short position by virtue of such execution. In such instance, the specialist would not be deemed to be engaging in manipulative behavior to influence the price of the subject security because the specialist is simply being required to trade at a price set by other market participants." The Firm has not undertaken to reconstruct the facts necessary to establish whether these or any other exceptions from the short sale rule applied to the transactions discussed herein.

DECISION

The Hearing Officer, in accepting the Stipulation of Facts and Consent to Penalty, found Respondent guilty as set forth above.

PENALTY

In view of the above findings, the Hearing Officer imposed the penalty consented to by Respondent of a censure and a fine in the amount of \$400,000.

For the Hearing Board

Peggy Kuo - Chief Hearing Officer