

UNITED STATES DISTRICT COURT  
SOUTHERN DISTRICT OF NEW YORK

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CALIFORNIA PUBLIC EMPLOYEES'  
RETIREMENT SYSTEM, On Behalf of Itself  
and All Others Similarly Situated,

Plaintiff,

vs.

THE NEW YORK STOCK EXCHANGE,  
INC., LaBRANCHE & CO., INC.,  
LaBRANCHE & CO. LLC, GEORGE M.L.  
LaBRANCHE, IV, BEAR WAGNER  
SPECIALISTS LLC, SPEAR, LEEDS &  
KELLOGG SPECIALISTS LLC, SPEAR,  
LEEDS & KELLOGG, LP, THE GOLDMAN  
SACHS GROUP, INC., VAN DER MOOLEN  
SPECIALISTS USA, LLC, VAN DER  
MOOLEN HOLDING N.V., FLEETBOSTON  
FINANCIAL CORPORATION, FLEET  
SPECIALIST, INC., PERFORMANCE  
SPECIALIST GROUP, LLC,  
SUSQUEHANNA SPECIALISTS, INC. and  
SUSQUEHANNA INTERNATIONAL  
GROUP, LLP,

Defendants.

X

Civil Action No.

COMPLAINT FOR VIOLATION OF THE  
SECURITIES EXCHANGE ACT OF 1934

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X

JURY TRIAL DEMANDED

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## OVERVIEW

1. This is a securities class action on behalf of all persons, other than defendants, who purchased and/or sold shares of publicly traded companies listed on the New York Stock Exchange (“NYSE” or “Exchange”) between October 17, 1998 and October 15, 2003 (the “Class Period”) and were damaged thereby.<sup>1</sup> The auction market was maintained throughout the Class Period by the NYSE Specialist Firms named as defendants herein. The defendants are LaBranche & Co., Inc., LaBranche & Co., LLC, George M.L. LaBranche, IV, Bear Wagner Specialists LLC, Spear, Leeds & Kellogg Specialists LLC, Spear, Leads & Kellogg, LP, The Goldman Sachs Group, Inc., Van der Moolen Specialists USA, LLC, Van der Moolen Holding NV, FleetBoston Financial Corporation, Fleet Specialists, Inc., Performance Specialists Group, LLC, Susquehanna Specialists, Inc., Susquehanna International Group, LLP (the “Specialist Firms”), and the NYSE itself (collectively the “Defendants”). During the Class Period, the named plaintiff purchased or sold approximately 3 billion shares of stock on the NYSE, mostly in large block trades through the Specialist Firms, suffering millions of dollars of damage.

2. This Complaint alleges that Defendants, in violation of the Securities Exchange Act of 1934 (the “Exchange Act”), employed devices, contrivances, manipulations and artifices to defraud, made false and misleading statements and concealed material facts and engaged in a scheme

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<sup>1</sup> The NYSE traces its origin to the 1792 Buttonwood Agreement, executed under a Buttonwood tree on Wall Street whereby 24 prominent brokers and merchants gathered on Wall Street to agree to trade securities on a common commission basis.

The specialist system for trading stock on the NYSE supposedly originated 100 years later when one of the NYSE brokers named Boyd broke his leg and took to sitting at one location, trading there only in Western Union, a “hot” stock of the day. This new approach was so profitable for Boyd that when he healed, he refused to move or change his new-found ways.

to defraud investors and acts and practices and a course of business that operated as a fraud or deceit on the members of the Class – financially advantaging Defendants.

3. Defendants (the NYSE and the Specialist Firms) have violated the Exchange Act, the rules of the Securities and Exchange Commission (“SEC”) and the rules of the NYSE in connection with the purchase or sale of securities on the NYSE. Not only to the knowledge of, but with the active participation of, the NYSE, the Specialist Firms for years have routinely engaged in wide-ranging manipulative, self-dealing, deceptive and misleading conduct. These practices include, without limitation: (i) “inter-positioning” in violation of the Specialist Firms’ “negative obligation,” where a Specialist Firm “steps in the way” of matching orders of public sellers and/or buyers of stock in order to “penny jump,” to profit to the detriment of Class members; (ii) “front-running” or “trading ahead,” where Specialist Firms take advantage of their confidential knowledge of public investors’ orders, including, without limitation “open,” “market,” “limit,” “stop,” “stop/limit,” “buy minus,” “sell plus” and “sell short” orders (collectively “Public Orders”), that will have an impact on the price of a stock and trade for their own account as principals before completing orders placed by public investors; and (iii) “freezing” the Specialist Firm’s book, where a Specialist Firm freezes its Display Book on a stock so it can first engage in trades for its own account prior to entering and then executing public investors’ orders, thus facilitating their manipulative “front-running” and “inter-positioning” activities.

4. These acts and practices were manipulative devices and contrivances in violation of the rules of the NYSE, the SEC and the Exchange Act, and a scheme and course of business that operated as a fraud or deceit on investors on the NYSE. Throughout the Class Period, Defendants misrepresented that the Specialist Firms were substantially complying with the NYSE’s rules and the Exchange Act, and that the NYSE was effectively overseeing its members, including the Specialist

Firms, while conducting the business of the NYSE in accordance with the Exchange Act, its own and the SEC's rules. In addition, Defendants failed to disclose that NYSE orders were not being filled at the best available prices, but, in fact, were being manipulated for Defendants' benefit in violation of NYSE rules designed to protect public investors, while misrepresenting that the NYSE was an honest and fair exchange where just and equitable principles of trade were followed and, due to the Specialist Firms' honest maintenance of auction markets in the stocks listed and traded on the NYSE, as fiduciaries to public investors, those investors were being treated fairly and protected by an exchange with rules and an oversight system effective to protect public investors.

5. The NYSE's deliberate failure to oversee, regulate or supervise its securities exchange or discipline its members/specialists for their blatant violations of the NYSE's rules was a key part of Defendants' fraudulent scheme and course of business. The NYSE knew that its Specialist Firms were repeatedly violating the Exchange Act and the NYSE's own rules, yet the NYSE deliberately failed to halt, expose or discipline the illegal trading practices to the extent necessary to deter, stop or prevent them. This allowed the abusive practices specified herein to flourish on the NYSE floor, as there was not only no disincentive for the Specialist Firms to discontinue their illegal practices but, in fact, the Specialist Firms, the NYSE and the top officers of the NYSE, who ran the NYSE on a day-to-day basis, were all positioned to profit by millions and even hundreds of millions of dollars due to the secret continuation of their manipulative acts and practices, and fraudulent scheme and course of business that was operating as a fraud or deceit on Class members – *i.e.*, public investors trading on the NYSE.

6. In early 2003, the SEC, which had received complaints regarding the goings on at the NYSE, learned that the NYSE was conducting a purported investigation into improper trading practices by a few of the Specialist Firms in a few stocks. Fearing that the NYSE investigation was

being improperly constrained to include only a few Specialist Firms, a few stocks, trades taking over 60 seconds to complete and only “inter-positioning,” the SEC demanded the NYSE broaden its investigation. When the NYSE refused, the SEC did its own investigation into the NYSE, which resulted in a scathing report concerning the NYSE’s conduct which “*paint[ed] a picture of a floor-trading system riddled with abuses, with firms routinely placing their own trades ahead of those by [public investors],*” revealing that the NYSE was not an honest market where fair and just trading practices were being followed in accordance with the Exchange Act, the rules of the SEC and the NYSE, and where public investors would not be cheated or taken advantage of.

7. On November 3, 2003, *The Wall Street Journal* reported the contents of the secret SEC report detailing the illegal practices of the Defendants and the NYSE’s abdication of its oversight and regulation of its members, including the Specialist Firms. *The Wall Street Journal* reported:

***The Securities and Exchange Commission, in a confidential report, blasted the New York Stock Exchange for failing to police its elite floor-trading firms and for ignoring blatant violations in which investors were shortchanged by millions of dollars in trades involving more than two billion shares over the past three years.***

***The 40-page report, dated Oct. 10 and reviewed by The Wall Street Journal, is a severe rebuke of both the floor-trading firms, known as “specialists,” and the self-regulatory structure that monitors the Big Board floor. It paints a picture of a floor-trading system riddled with abuses, with firms routinely placing their own trades ahead of those by customers -- and an in-house regulator either ill-equipped or too worried about increasing its workload to care. And it concludes that when the NYSE does act on investor abuses, the exchange often does little more than admonish the specialists in a letter or slap them on the wrist with a light fine.***

The SEC staff “is concerned that the NYSE’s disciplinary program is viewed by specialists and specialist firms as a minor cost of doing business, and that it does not adequately discipline or deter violative conduct,” the report says. It adds that the floor-trading firms “have no meaningful compliance programs for reviewing their specialists’ compliance” to various trading rules.

\* \* \*

The SEC's conclusions also could raise questions among critics about whether the NYSE underfunded its regulatory arm at the expense of hefty pay for senior executives such as Mr. Grasso, who was ousted as CEO and chairman following a public outcry over his \$187.5 million retirement nest egg.

\* \* \*

More than any other exchange, the NYSE relies on humans to oversee trillions of dollars in investor trading each year on its floor. Specialists match buyers and sellers of stock, sometimes providing capital from their firm's account to complete a trade and keep the markets orderly. As specialists have increasingly turned to trading for their own accounts as a source of profits, more attention has been focused on the question of whether they are using their inside knowledge of the market to gain at the expense of their customers.

\* \* \*

The SEC's confidential findings "*reveal serious deficiencies*" in the NYSE's surveillance and investigative procedures, *including a habit of ignoring repeat violations by specialist firms. The NYSE had "no meaningful surveillance," allowing inappropriate behavior to continue and causing "significant" customer harm, the report said. When the exchange did detect violations the response was weak, the SEC said, and "inadequate to deter future violations."*

*Catalogued in the SEC report are a series of inappropriate actions by specialists over the past three years that went unchecked and unpunished. Dozens of individual specialists routinely violated exchange rules by trading for their own accounts ahead of customer orders, giving investors inferior prices to those they gave themselves and inappropriately stepping between buyers and sellers, the report says.* In at least one area, the SEC says, the NYSE followed an unwritten policy that "a maximum of five violations could be referred" to the investigative division in any one-week period.

*... "Trading ahead" occurs when a specialist takes advantage of an attractive price and completes a trade for the firm's own account before one placed by a customer.*

*... [B]y "interpositioning" ... the specialists stepped between the buyer and seller -- purchasing the shares and often reselling them moments later -- for a small profit. The cost to investors could grow as the probe continues, the SEC suggests in the report*

*The SEC's staff also identified another violation in which specialists "freeze" their so-called display book of orders.* That's when specialists prevent electronic orders that arrive through the NYSE's "Designated Order Turnaround" system from immediately reaching the floor to be executed, even as other orders continue to be filled.... *The SEC said specialists were inappropriately using "freeze*

***mode” to trade ahead of certain customers and avoid obligations under a rule requiring that all orders be executed at the best price....***

The management of the specialist firms is partly to blame for the alleged trading abuses, the SEC says. These practices persisted in part because ***the specialist firms lacked internal compliance programs, instead relying primarily on the exchange’s weak surveillance and examination programs as their compliance tool, the report said.***

***The NYSE often ignored blatant examples of improper behavior. For instance, in 2001 and 2002, the NYSE’s “Member Firm Regulation” division examined each specialist firm and found “numerous violations of trading rules” including trading ahead and repeat offenses by some firms’ specialists who had committed identical violations in prior years....***

***Instead of trying to determine the extent of a firm’s violation, the regulatory division routinely closed cases “even when the examinations included evidence of recidivist conduct,” according to the SEC report.*** Take the NYSE’s examination of Van der Moolen, which found, among other trading violations, ***21 instances of trading ahead by specialists in a two-hour period in 2002 and 14 trading-ahead violations over a 2-1/2 hour period in 2001.*** The regulatory division didn’t expand its investigation to determine if more violations had occurred ....

The NYSE investigative arm also failed to take proper action, the SEC said, by not thoroughly investigating cases and often taking more than a year to make a determination about a firm’s conduct. The division would often focus on a sample that was too small to determine whether violations had occurred, the report said, and then close cases or send ineffective letters to firms that had sometimes committed serious rule violations.

Moreover, instead of reviewing all violations separately, the division often aggregated multiple violations for a single firm. That was the case with Spear Leeds, which was bought by Goldman in 2000, and cited for dozens of violations in 2000 and 2001, according to the SEC. The exchange’s investigative unit found that Spear Leeds had violated several order-handling rules and noted that the firm “had similar violations in prior examinations.” The division sent the firm a letter of admonishment and closed the case, the SEC said.

***The exchange did spot some serious violations by specialists over the years, but the SEC said the response was often to close cases without taking action or to send a letter to the firm.... The firms weren’t required by the NYSE to return the illegal profits.***

\* \* \*

In 2002, the exchange rejected the SEC’s request that it adjust its regulatory program to ensure that specialists weren’t freezing their display book for more than 30 seconds, choosing instead to use a 60-second parameter.

With increasing automation at the Big Board, it should take less time to complete a trade, the SEC argued. Longer time frames can permit more trading abuses....

The NYSE frequently issued “admonition letters” after finding violations, rather than starting enforcement cases. In an investigation into trading-quote violations by Van der Moolen, the Big Board’s investigative division consolidated 16 referrals of improper activity by the firm over 20 months and issued an admonition letter for violating the rule.

***The investigative division didn’t launch probes into the individual specialists that were responsible for the violation and didn’t investigate the 2,300 “alerts” – indicating possible trading violations – that were generated but not reviewed, the report said. Furthermore, the SEC said that when the NYSE uncovered additional alleged violations, the NYSE dismissed them as “cumulative” and then stopped reviewing quote violations generated for Van der Moolen for a “grace period” of three months.***

One NYSE surveillance system issued 640 alerts in 2001 and 2002, but the SEC said a more comprehensive system would likely have triggered more than 8,000 alerts in that time. Of the 640 alerts that were found, NYSE analysts concluded that 494 were violations. ***But in many cases, the SEC said, “analysts inappropriately concluded that a violation did not occur.”*** For example, the SEC said, analysts concluded that a violation hadn’t occurred because even though a specialist traded ahead of a customer order, he or she did so within the 60-second parameter, which also applies to trades made with the firm’s own capital.

For five years, the SEC has been pushing the NYSE to narrow that 60-second window. But the SEC noted in its report that “managers appeared to be concerned primarily with the impact on the analysts’ workload as a consequence of reducing the time parameter, not on the fact that the increase in alerts was highlighting increased patterns of illegal trading by NYSE specialists.” Earlier this summer, the SEC told the Big Board to cut the time frame to 10 seconds from 60 seconds.

Deborah Solomon & Susanne Craig, “Market Discipline: SEC Blasts Big Board Oversight of ‘Specialist’ Trading Firms – Investors Were Shortchanged \$155 Million Over 3 Years, Confidential Report Says – In 2 Hours, 21 Violations,” *Wall St. J.*, 11/3/03.

## **JURISDICTION AND VENUE**

8. The claims asserted herein arise under and pursuant to §§6(b), 10(b) and 20(a) of the Securities Exchange Act of 1934 (“Exchange Act”) [15 U.S.C. §§78f, 78j(b) and 78t(a)] and Rule 10b-5 promulgated thereunder by the SEC [17 C.F.R. §240.10b-5].



9. This Court has jurisdiction over the subject matter of this action pursuant to 28 U.S.C. §§1331 and 1367; and §27 of the Exchange Act [15 U.S.C. §78aa].

10. Venue is proper in this District pursuant to §27 of the Exchange Act and 28 U.S.C. §1391(b). Defendants maintain their principal places of business in this District and many of the acts and practices complained of herein occurred in substantial part in this District.

11. In connection with the acts alleged in this Complaint, Defendants, directly or indirectly, used the means and instrumentalities of interstate commerce, including, but not limited to, the mails, interstate telephone communications and the facilities of the national securities markets.

## **PARTIES**

### **Plaintiff**

12. Plaintiff California Public Employees' Retirement System ("CalPERS") is the largest public employee retirement system in the United States, with assets of over \$148 billion and nearly 1.4 million beneficiaries, including active and retired public employees. CalPERS, as set forth in the Certification attached hereto, purchased and/or sold almost 3 billion shares of stock on the NYSE in trades executed by the Specialist Firms during the Class Period and, as a result thereof, suffered damages.

13. Because the plaintiff tends to make regular purchases (or sales) of stocks on the NYSE in large block transactions, plaintiff is particularly susceptible to the illegal acts of stock manipulation complained of which are much easier for the Specialist Firms to commit on large transactions, as opposed to the type of rapid-fire smaller transactions of the type engaged in by day or hyperactive traders dealing in smaller transactions.

### **Defendants**

14. (a) Defendant NYSE is supposedly a non-profit New York corporation – “a private company *with a public purpose.*” It is by far the largest, most prestigious and most

important stock exchange in the world. A large percentage of securities trading in the United States occurs on the NYSE where over 2,700 public companies list their shares. The NYSE represents that it is the “*fairest, most open and best regulated securities market in the world,*” telling investors “*our regulatory oversight remained unparalleled and operated flawlessly.*” The NYSE also represents that “*Public confidence in the integrity of the market, and in professionals serving the investing public, is essential. The NYSE is committed to strong and effective regulation of its member broker-dealers and its trading floor community to protect investors.*” Each trading day, securities transactions on the NYSE involve a billion± shares – buys/sells – all in transactions executed on auction markets conducted by members of the NYSE – the Specialist Firms. The NYSE is registered as a national stock exchange with the SEC under the Exchange Act and thus required to be structured and operated to assure fair and equitable trading and the protection of public investors and to exercise oversight and enforcement obligations regarding the operation of and trading on its exchange and the activities of its members, including the Specialist Firms, to comply with these requirements.

(b) Each of the Specialist Firms and their individual specialists, who manage the auction market in specific stocks, are members of the NYSE. Members of the NYSE are firms or individuals which own a “seat” on the trading floor of the NYSE, which gives them the right to act as specialists. Specialist Firms are at the heart of the operation of the NYSE and the trading of the stocks listed on the NYSE.

(c) The NYSE (and its top officers) directly benefited from the wrongdoing alleged in this Complaint. The false image they have created of the NYSE conducting the most prestigious and most honest, *i.e.*, fairest, securities exchange in the world, causes investors to want to purchase/sell the stocks of companies listed there and causes companies to want to list their stocks

on the NYSE because of this investor preference, with these companies paying huge listing fees to the NYSE to do so. According to the NYSE's 2002 Annual Report:

#### Market Quality

The market of choice for investors and issuers ... Only the NYSE offers customers fully automated order execution and an open auction within a single business model. The NYSE's multi-functional, multi-choice platform heightens transparency, accommodates virtually any trading strategy, and facilitates optimal price discovery and flexibility. Investors enjoy fast, reliable and efficient access to unsurpassed liquidity, the narrowest spreads anywhere, and the best possible execution – including best price, the opportunity for price improvement, lowest cost, and speed and certainty of execution.

Drawn by these advantages for shareholders, 152 companies chose to list with the NYSE in 2002 – including 36 Nasdaq transfers and 33 non-U.S. companies.

(d) Also, the NYSE receives a share of the commissions generated by every stock transaction executed on the Exchange – thus, the more volume, the more revenue and the larger the salaries, benefits, perks and retirement packages for the NYSE's top executives. And the size of the profits of the Specialist Firms and the incomes of the individual specialists who work for or are partners in the Specialist Firms directly impacts the value of the NYSE "seats," *i.e.*, membership. The more the profits earned by the NYSE members, the higher the price of membership, and thus the enterprise value of the NYSE, which, during the time of the alleged wrongdoing, was considering going public, which would allow it to reap huge financial benefits based on that enterprise value. As a result of its growth, gain in market shares, heavy volume and increased listing of public companies, the NYSE's revenues exceed \$1 billion per year and, despite its "non-profit" status, it reports millions of dollars of net income each year. This is all a synergist system of profiting by the Specialist Firms and the executives of the NYSE, whereby the laws, rules and regulations meant to protect public investors from stock manipulation and insider dealing by exchange members and the fiduciary Specialist Firms are cast aside, and ongoing violations are blatantly engaged in – in fact,

encouraged and furthered – so the Specialist Firms and the NYSE executives can profit by hundreds of millions of dollars, at the expense of public investors.

15. The following individuals held the positions indicated with the NYSE during all or part of the Class Period:

<u>Individual</u>	<u>Position</u>
Richard Grasso	Chairman/CEO
Robert G. Britz	Co-President
Catherine R. Kinney	Co-President
William R. Johnston	President and Past President/Advisor to Chairman – CEO
Edward A. Kwalwasser	Director of Enforcement
Richard P. Bernard	General Counsel
Richard Edgar	Executive Vice President

The compensation and retirement packages of these NYSE executives are set by the Board Directors of the NYSE, which is beholden to a membership dominated by the Specialist Firms. These officers are to oversee, regulate, and to enforce compliance with the Exchange Act and the Rules of the NYSE. Even though the NYSE is a non-profit, quasi regulatory entity with a public purpose, it has now been revealed that these executives have been receiving lavish – indeed obscene – compensation packages. Grasso it was revealed was receiving an annual salary of millions of dollars per year and was also entitled to deferred compensation and retirement benefits in excess of \$187 million. The other top NYSE executives are entitled to \$133 million in retirement payments. The largest are Britz and Kinney, entitled to \$22 million each plus annual salaries of \$4 million each. Johnstson got \$5.8 million in 2001 as President. Kwalwasser gets a \$1.7 million salary and a \$7.7

million lump-sum payment when he retires. Edgar and Bernard each get \$1.1 million per year in salary, while Edgar gets \$9.2 million on retirement and Bernard gets \$4.8 million.

16. (a) Defendant LaBranche & Co., Inc., the parent company of defendant LaBranche & Co., LLC, is a registered broker-dealer that operates as a specialist in securities of public companies listed on the NYSE. LaBranche & Co., LLC, the largest NYSE specialist firm, serves as a specialist for the stocks of over 600 companies listed on the NYSE and accounts for about 29% of the annual trading volume on the NYSE.

(b) Defendant George M.L. LaBranche, IV, is Chairman, President and CEO of LaBranche Co., Inc. He was an active and knowing participant in the alleged unlawful conduct. Defendants LaBranche & Co., Inc., LaBranche & Co., LLC and George M.L. LaBranche, IV, are collectively referred to as “LaBranche.”

17. Defendant Spear, Leeds & Kellogg Specialists LLC (“Spear Leeds”) is a registered broker-dealer and operates as a specialist in securities of public companies listed on the NYSE. Spear Leeds is a subsidiary of defendant Spear, Leeds & Kellogg LP, which controls it. Defendant Spear, Leeds & Kellogg LP (“Spear Leeds LP”) is a wholly owned subsidiary of defendant The Goldman Sachs Group, Inc. (“Goldman”), and the parent company of Spear Leeds, which controls Spear Leeds and Spear Leeds LP. Defendant Goldman is the parent company of Spear Leeds LP. Spear Leeds, the second largest Specialist Firm, serves as a specialist for the stocks of 569 companies listed on the NYSE and accounts for about 20% of the annual trading volume on the NYSE.

18. Defendant Van der Moolen Specialists USA, LLC (“Van der Moolen”) is a NYSE specialist firm and is responsible for the trading in the stocks of more than 378 public companies listed on the NYSE, accounting for about 12.5% of annual trading volume on the NYSE. Defendant

Van der Moolen Holding N.V. (“VDM Holdings”) is the parent company of Van der Moolen and controls Van der Moolen.

19. Defendant FleetBoston Financial Corporation (“FleetBoston”) is the parent company of defendant Fleet Specialist, Inc. (“Fleet Specialist”), which controls Fleet Specialist. Fleet Specialist is one of the largest specialist firms on the NYSE, responsible for the trading in stock of some 429 NYSE-listed public companies, accounting for about 18% of the annual trading volume on the NYSE.

20. Defendant Bear Wagner Specialists LLC (“Bear Wagner”) is a registered broker-dealer and operates as a specialist in securities listed on the NYSE. Bear Wagner acts as the specialist for the stocks of some 341 public companies listed on the NYSE, and accounts for about 16% of the annual trading volume on the NYSE.

21. Defendant Susquehanna Specialists, Inc. (“Susquehanna”) is a wholly owned subsidiary of defendant Susquehanna International Group, LLP. Susquehanna is a registered broker-dealer and operates as a NYSE specialist firm, responsible for the trading of 125 stocks of public companies listed on the NYSE, accounting for about 3% of annual NYSE trading volume.

22. Defendant Performance Specialist Group LLC (“Performance Specialist”) is a NYSE specialist firm, responsible for the trading in some 151 stocks listed on the NYSE, accounting for about 1.5% of annual NYSE trading volume.

23. Defendants LaBranche, Bear Wagner, Spear Leeds, Van der Moolen, Fleet Specialist, Performance Specialist and Susquehanna (and their controlling persons/entities) are collectively referred to as the “Specialist Firms.”

24. As of the close of the 2002 fiscal year, senior executives from five of the seven Specialist Firms (or their corporate parents or affiliates) served as directors on the exchange – Robert

M. Murphy from LaBranche, Joseph A. Mahoney from Bear Wagner, Christopher C. Quick from Fleet Specialist, James E. Cayne from Bear Stearns, and Henry M. Paulson, Jr. from Goldman Sachs. The Specialist Firms play a very important role on the board of the NYSE.

25. The Specialist Firms manage the auction market in the specific securities assigned to them. They are fiduciaries to their customers and are required to maintain a fair market at all times. This means that all orders, *i.e.*, orders from public investors, have an equal opportunity to interact and receive the best price on execution.

26. All investors in companies traded on the NYSE, whether individual or institutional, are entitled to an equal opportunity to interact and receive the best price. This premise is at the heart of the auction market and at the heart of the Specialist Firms' role. The Specialist Firms manage the auction market in the stocks assigned to them to create a fair, competitive, orderly and efficient market for the protection of investors.

27. The Specialist Firms are responsible for maintaining a liquid and continuous two-sided auction market by acting as both agents and principals. Specialist Firms are required to make continuous two-sided quotations that accurately reflect prevailing market conditions. In performing this function, Specialist Firms can act as both an agent and a principal. When acting as agent, Specialist Firms match the orders of buyers and sellers, thus ensuring timely execution at the best available price. Specialist Firms have a "negative obligation" to cause public orders to be executed against each other without intervention to profit for themselves.

### **CLASS ACTION ALLEGATIONS**

28. Plaintiff brings this class action pursuant to Rule 23 on behalf of all persons who purchased and/or sold shares of stocks listed on the NYSE between October 17, 1998 and October 15, 2003, which the Specialist Firms were responsible for maintaining the trading market in, and who, as a result of Defendants' alleged misconduct, were damaged thereby (the "Class"). Excluded

from the Class are Defendants, members of their immediate families and their legal representatives, heirs, successors or assigns and any entity in which Defendants have or had a controlling interest. Plaintiff and the class members purchased or sold shares of stocks of which Defendants were specialists on the NYSE and were damaged thereby.

29. The members of the Class are so numerous that joinder of all members is impracticable. While the exact number of Class members is unknown to plaintiff and can only be ascertained through proper discovery, plaintiff believes there are hundreds of thousands of members in the proposed Class.

30. Plaintiff's claims are typical of the claims of the Class members as all Class members are similarly affected by Defendants' wrongful conduct that is complained of herein.

31. Plaintiff will fairly and adequately protect the interests of the Class members and has retained counsel competent and experienced in class and securities litigation.

32. Common questions of law and fact exist as to all Class members and predominate over any questions solely affecting individual Class members. Among the common questions of law and fact are:

(a) whether Defendants implemented the manipulative acts, devices or contrivances or engaged in the alleged fraudulent scheme and course of business;

(b) whether Defendants omitted material facts and concealed material information regarding the Specialist Firms' trading practices;

(c) whether the Exchange Act was violated by Defendants' conduct as alleged herein;



(d) whether Defendants knew or recklessly disregarded that the allegedly false statements and omissions made by them and others participating in the scheme were false and misleading;

(e) whether the trading prices of shares purchased and sold were artificially manipulated and/or distorted by Defendants' conduct; and

(f) the extent of damage sustained by Class members and the appropriate measure of damages.

33. A class action is superior to other available methods for the fair and efficient adjudication of this controversy since joinder of all members of the Class is impracticable. Further, as the damages suffered by individual Class members may be relatively small, the expense and burden of individual litigation make it virtually impossible for Class members to individually redress the wrongs done to them. There will be no difficulties in managing this action as a class action.

#### **DEFENDANTS' FRAUDULENT SCHEME AND COURSE OF BUSINESS**

##### **The NYSE and Its Specialist Firms**

34. Defendants employed devices, contrivances, artifices and manipulations, pursued a fraudulent scheme and committed acts, practices and a course of business that acted as a fraud or deceit on investors trading stocks on the NYSE.

35. As a registered national stock exchange under the Exchange Act, the NYSE is required to ensure that it operates in conformity with the Exchange Act and SEC rules and its own rules, and that its members comply with the Exchange Act, as well as the SEC's and the NYSE's own rules. The NYSE is required to observe and supervise its members, investigate when there is suspected misconduct and penalize its members when it finds they committed a violation of

applicable laws and regulations or rules in a manner sufficient to ensure substantial compliance with these applicable laws, rules and regulations.

36. Sections 6(a)-(b) of the Exchange Act, entitled “National Securities Exchanges,” state:

Sec. 6. (a) An exchange may be registered as a national securities exchange under the terms and conditions hereinafter provided in this section ... by filing with the Commission an application for registration ... containing the rules of the exchange and such other information and documents as the Commission, by rule, may prescribe as necessary or appropriate in the public interest or for the protection of investors.

(b) *An exchange shall not be registered as a national securities exchange unless the Commission determines that -*

(1) Such exchange is so organized and has the capacity to be able to carry out the purposes of this title and to comply, and ... *to enforce compliance by its members and persons associated with its members, with the provisions of this title, the rules and regulations thereunder, and the rules of the exchange.*

\* \* \*

(5) *The rules of the exchange are designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade ... to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest ....*

(6) The rules of the exchange provide that ... its members and persons associated with its members shall be appropriately disciplined for *violation of the provisions of this title, the rules or regulations thereunder, or the rules of the exchange*, by expulsion, suspension, limitation of activities, functions, and operations, fine, censure, being suspended or barred from being associated with a member, or any other fitting sanction.

37. Just seven Specialist Firms represent and handle the trading in stocks for all of the NYSE’s some 2,600 listed companies. LaBranche, Bear Wagner, Spear Leeds, Van der Moolen, Fleet Specialist, Susquehanna and Performance Specialist are the seven firms. LaBranche, Bear Wagner, Spear Leeds, Van der Moolen and Fleet Specialist are the five largest Specialist Firms and

manage approximately 95% of the trading volume of the NYSE. They have obtained a hugely lucrative monopoly over the trading of the stocks listed on the largest stock exchange in the world.

38. All trading of each security of a company listed on the NYSE is through an auction process, which for each listed security is managed and conducted by one of the Specialist Firms on an exclusive basis by a designated individual specialist of the Specialist Firm. A Specialist Firm is granted an exclusive franchise by the NYSE to conduct the auction market in the NYSE-listed stocks assigned to that firm. The companies whose stocks are listed on the NYSE and the trading in which is conducted by a given specialist are called “clients” of the Specialist Firm. Because the Specialist Firm exclusively runs the auction for the stock of its client, *i.e.*, the listed public company, each Specialist Firm knows of all existing Public Orders for those stocks. Some of that information is contained in the Specialist Firm’s Display Book. But in reality, there are two versions of the Display Book. The official NYSE Display Book contains all electronic orders facilitated by the SUPERDOT System.<sup>2</sup> The Specialist Firms, however, maintain another book which contains significant inside information not accessible to anyone else (the “Secret Book”). This inside information includes all information about large orders not facilitated by SUPERDOT, *i.e.*, the very type of large orders generated by CalPERS and the type of order most susceptible to the trading violations alleged herein. This Secret Book is comprised of exclusive non-public, proprietary information, known only to the specialist, and provides the specialist with uniquely valuable information regarding the overall supply and demand for the stocks in which the Specialist Firm is managing the auction market. The legal duty of the Specialist Firms is to conduct an honest, fair and equitable auction market in the

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<sup>2</sup> The Super Designated Order Turnaround System (“SUPERDOT”) is the electronic order entry system for the NYSE.

stocks it controls the trading of in accordance with the Exchange Act and the rules and regulations of the SEC and the NYSE.

39. Specialist Firms are to ensure that markets are fair, orderly and just and are responsible for maintaining a fair, liquid and continuous two-sided auction market by acting as agents and ***only where necessary to those ends as principals***. In performing this function, Specialist Firms can act as both an agent and a principal. When acting as an agent, Specialist Firms match the orders of buyers and sellers, thus ensuring timely execution at the “best” available price. Specialist Firms have a “negative obligation” to match Public Orders for execution against each other without undue intervention for their own account or benefit. When it is not possible to match buy and sell orders due to a short-term imbalance between supply and demand for a company’s shares, Specialist Firms are required to act as principal – but only then. When acting as a principal, Specialist Firms have an affirmative obligation to buy and sell securities in order to maintain price continuity with reasonable market depth.

40. As Specialist Firms manage the auction market in the specific securities assigned to them, they must conduct themselves so as to maintain a fair, just, equitable, orderly and efficient market at all times. This means that all Public Orders have an equal opportunity to interact and receive the best price on execution. All NYSE customers – *i.e.*, public investors - whether individual or institutional, ***are entitled to receive the best price***. This premise is at the heart of the NYSE’s auction market and at the heart of the Specialist Firms’ role in maintaining that market. ***The Specialist Firms’ relationship with all market participants is based on trust, and all Specialist Firms are required to honor this trust by placing their customers’ transactions before their own.***

41. The NYSE Specialist Firms are required to perform four vital functions in connection with their roles as members of the NYSE:

- ***Auctioneer*** – The specialist must manage the auction process by continually quoting the ***best*** available prices (bids and offers) on a stock throughout the trading day.
- ***Agent*** – The specialist must act as the agent to execute orders for brokers electronically routed through the SUPERDOT system. ***As an agent, the specialist assumes the same fiduciary responsibility as a broker.***
- ***Catalyst*** – The specialist must act as a catalyst by ***bringing buyers and sellers together***. The specialist uses his or her knowledge to advise interested parties of potential orders, thus, causing trades to occur that might not have occurred.
- ***Principal*** – The specialist must commit his or her own capital and buy and the sell for his or her own account ***when there is no other willing buyer or seller. The specialist is a short term trader in stocks and not a long term investor.***

42. The natural price of a stock as traded on the NYSE auction market is determined by supply and demand. Acting as a principal, the Specialist Firm may use its own capital to purchase or sell a client's stock only in order to fill temporary gaps in supply and demand. According to the NYSE, the Specialist Firm must always buy or sell against the current market trend. This means that the Specialist Firm must buy when there is selling and the stock is experiencing downward price pressure and the Specialist Firm must sell when there is buying and the stock is experiencing upward price pressure. The Specialist Firms must do this in order to make the movement upwards or downwards in a stock price more orderly to maintain a just and equitable trading market. This adds liquidity to the market and reduces short-term volatility. Specialist Firms are allowed to trade for their own account, *i.e.*, as principal, only when it is to maintain or provide liquidity in the trading market. Specialist Firms are not permitted to trade for themselves in their clients' stocks at the expense of or to the disadvantage or damage of public investors.

43. The Specialist Firms' position on the NYSE trading floor creates an inherent conflict of interest. On one hand, the Specialist Firms are charged with maintaining a "fair and orderly market" and represent as fiduciaries both buyers and sellers of a stock. On the other hand, the Specialist Firms are constantly in a position to trade for their own proprietary accounts as principals, while in possession of material non-public information regarding the supply and demand for a given

stock, in part through their knowledge of existing but unexecuted Public Orders to buy or sell the stock above or below its current price for limited or unlimited periods of time, as reflected in the Specialist Firms' Secret Book. Each Specialist Firm is uniquely positioned at the center of the trading activity in any given stock it controls the trading in and has intimate knowledge of that stock's trading pattern and the supply and demand for that stock. For this reason, stringent rules and regulations exist to control the activities of Specialist Firms – which are fiduciaries to those who trade on the NYSE – to prevent them from self-dealing or taking advantage of public investors as they conduct the auction market in the stocks for which they serve as Specialist Firms.

44. Specialist Firms reference both the NYSE Display Book and the Secret Book to keep track of all Public Orders. As orders come in on SUPERDOT they appear on the NYSE Display Book screen in real-time. The NYSE Display Book sorts the orders and displays them in price/time priority. Depending upon what large orders the Specialist Firms hold on their Secret Books, a Specialist Firm may execute an order on the specialists' proprietary account or against another order in either the NYSE Display Book or against an order presented by a floor broker, or simply match buyers and sellers and stand out of the way. The message that an order has been executed (in part or whole) is called a report. The execution report is sent back through the same avenue of origination – SUPERDOT or the floor broker. The computer screen of the NYSE Display Book shows only the buy and sell orders in existence for the subject stock that were received via SUPERDOT. However, the Specialist Firms' access to the information in their Secret Books – information about large orders – give the Specialist Firms a unique inside picture of the existing supply and demand for the stock and sensitive and very valuable non-public, time sensitive information as to whether the stock price will move up or down as new orders are received and executed. For example, through the Secret Book the Specialist Firms know if there are large orders generated through floor brokers to buy or

sell that will be triggered if the stock hits a certain price, pushing the stock up or down. The Specialist Firms alone have access to this information.

45. The Specialist Firms earn revenue from completing trades as either an agent or a principal. As an agent, a Specialist Firm will earn a small share of the commission on a trade. Trading as a principal, in addition to its commission which is also still payable, a specialist can earn much more money based upon its ability to trade in a stock at a profit, *i.e.*, to sell stock it bought at a price that is higher than it was originally acquired for or take a short position in the stock and later repurchase those shares at a lower price. A Specialist Firm's ability to earn **substantial** profits depends on two factors: (i) the frequency with which a Specialist Firm can act as a principal in transactions; and (ii) the amount of profit a Specialist Firm gets from the transactions in which it acts as a principal.

46. The Specialist Firms have remained very profitable, enjoying after-tax profits of \$397 million on revenue of \$1.65 billion and after tax-profits of \$414 million on revenue of \$1.78 billion for 2002 and 2001, respectively. The Specialist Firms' pretax profit margins have been between 51%-69% in recent years. In 2002 alone, Fleet Specialist's pre-tax profit margin was 50.9%, LaBranche's was 56% and Van der Moolen's was 61%. The Specialist Firms consistently make superior profits year-in and year-out above and beyond those of similar financial service firms, but only because of the unfair, deceptive, manipulative and illegal practices complained of herein. *The Wall Street Journal* has reported that "**Specialists remain among the most profitable business on Wall Street.**"

47. The reason for these superior profits is that the Specialist Firms regularly and intentionally violate the laws, rules and regulations controlling their operations to boost their profits at the expense of and to the damage of public investors they are supposed to protect and are

fiduciaries to. The majority of the defendant Specialist Firms' profits are derived from trading as principals rather than acting as agents. In 2002, LaBranche earned \$343 million from its principal trading revenue while it only earned \$92 million based on commissions. Similarly, in 2001, LaBranche earned \$341 million acting as a principal and \$63 million acting as an agent. As for Van der Moolen, it earned \$212.9 million in revenue based upon its principal trading activities, while it only earned a paltry \$33.4 million on commissions in 2002, meaning 86.4% of its specialists revenue was generated from its principal trading activities. Since trading as a principal by a Specialist Firm is supposed to be the exception, not the rule, these figures strongly suggest stock manipulation by the Specialist Firms to boost their profits.

48. In late 2002 or early 2003, information became public indicating that some Specialist Firms were being investigated. This adverse publicity and the fact that they knew their manipulative activity and scheme to defraud had been detected and would be exposed caused the Specialist Firms to sharply curtail their illegal behavior. As a result, the defendant Specialist Firms have seen a sharp downturn in their principal trading revenue. This downturn worsened in the 3rdQ 2003. LaBranche reported principal trading revenue for the 3rdQ 2003 of \$45 million compared to principal trading revenue for the 3rdQ 2002 of \$93.8 million, **a decrease of 52%**. LaBranche further admitted in a recent press release that its "principal trading revenues for September of 2003 were the lowest for any month since October of 1999." Van der Moolen similarly reported principal trading revenue for the 3rdQ of 2003 of EUR 24.5 million compared to principal trading revenue for the 3rdQ of 2002 of EUR 59.1 million, **a decrease of 59%**. Additionally, Fleet Specialists saw **a decrease in revenue of 43%** for the same period, dropping from \$137 million for the 3rdQ of 2002 to \$78 million for the



3rdQ of 2003.<sup>3</sup> These sharp decreases came at a time of continuing higher NYSE trading volume. Again, these figures are strongly suggestive of manipulation to boost profits during the Class Period.

49. Since the revelations of the apparent wrongdoing by the Specialist Firms at the NYSE, the price of a NYSE seat has plunged from \$2 million on November 5, 2003 to as low as \$1.3 on October 21, 2003. This sharp decline in the value of a NYSE seat is due to sophisticated buyers now realizing that the profitability of NYSE membership *had been bloated due to illegal conduct that cannot continue now that it has been discovered and exposed.*

### **Specialist Firms' Affirmative and Negative Obligations**

50. Specialist Firms act as principals when they trade for their own firm accounts. The NYSE is supposed to strictly regulate how and when Specialist Firms can and must trade using their own firm accounts. The NYSE regulations that govern the trading conduct of Specialist Firms are referred to as “Affirmative Obligations” and “Negative Obligations.” Affirmative Obligations require Specialist Firms to offer capital (or liquidity) in certain circumstances, while Negative Obligations require Specialist Firms to refrain from trading in other circumstances.

#### **Affirmative Obligations**

51. The primary Affirmative Obligation of a Specialist Firm is to ensure a reasonable and efficient market always exists in the stocks they act as a Specialist Firm for. When other investors are unwilling to trade, Specialist Firms must step up and trade. Specialist Firms have an Affirmative Obligation to ensure that public investors can always trade some meaningful quantity. Specialist

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<sup>3</sup> Although they are part of publicly traded companies, Bear Wagner and Spear Leeds do not provide information about their revenues or profits related to their trading activities. Performance Specialist and Susquehanna are not publicly traded companies and thus financial information about these two companies is not readily available.

Firms are also required to maintain price continuity and smooth the price movement of a particular stock. Specialist Firms are commonly evaluated by the spread in the quoted bid and ask prices.

### **Negative Obligations**

52. The Specialist Firms' Negative Obligations restrict them from trading their own firm's principal accounts in certain circumstances to provide an opportunity for Public Orders to be executed against each other within the current market and without undue Specialist Firm intervention. The Negative Obligation rules operate on the principle that Specialist Firms should not take liquidity which is otherwise available to public investors.

53. The NYSE order precedence rules require Specialist Firms to give priority to Public Orders at the same price or better. These rules forbid Specialist Firms from trading their own accounts unless there are no investors willing to trade at that price or at a better price.

54. NYSE Exchange Rule 104.10(3) provides that transactions on the NYSE affected by a member acting as a specialist for his own account must constitute a course of dealings reasonably calculated to contribute to the maintenance of price continuity with reasonable depth, and to minimize the effects of temporary disparity between supply and demand, immediate or reasonably to be anticipated. NYSE Exchange Rule 104.10(4) provides, in part, that "[a] specialist's quotation, made for his own account, should be such that a transaction effected thereon, whether having the effect of reducing or increasing the specialist's position, will bear a proper relationship to preceding transactions and anticipated succeeding transactions."

### **"Inter-Positioning"/"Penny-Jumping"**

55. Defendants engaged in manipulative acts, contrivances and practices, a scheme to defraud and course of business that operated as a fraud or deceit on public investors when, with the knowledge or reckless disregard of the NYSE, the Specialist Firms had Public Orders on their Secret Books or received contemporaneous market orders that should have been executed against other

Public Orders, but instead the Specialist Firms intervened and traded for their own firm accounts as principals to the disadvantage and damage of public investors in violation of their “negative obligation” not to do so.

56. Under the NYSE rules, Specialist Firms are required to provide an opportunity for Public Orders to be executed against each other within the current market and without the Specialist Firms’ intervention. In other words, the Specialist must “*stand out of the way*” when a natural match has or can occur between public buyers and sellers. A typical example is the following:

Current market in ABC: 10,000 shares bid at \$89.00 and 10,000 shares offered for sale at \$89.06.

10:00:01 am – Customer X sends order through DOT to: BUY 10,000 ABC at market.

(Specialist holds the order, waiting for market intelligence, front running opportunity.)

10:00:04 am – Customer Y sends order through DOT to: SELL 10,000 ABC at market.

10:00:12 am – Specialist takes customer X order, and using his own account SELLS (since customer X was a buyer) 10,000 shares at \$89.05.

10:00:14 am – Specialist takes customer Y order, and using his own account BUYS (since customer Y was a seller) 10,000 shares at \$89.01.

57. The specialist may claim that he provided each client with a \$.01 “price improvement,” but what the specialist should have done is to fill both orders *concurrently* at \$89.03 (midpoint giving both sides of a public auction market a fair and orderly execution) of their “market” orders. *Instead, the specialist got in the way and skimmed \$.04 per share for himself on the transaction which took 10 seconds on SUPERDOT, or \$400 on this \$890,000 transaction – the equivalent to \$2,400 per minute and \$144,000 per hour.*

58. In the above example, the Specialist Firm intervened after initially receiving a buy order from a public investor. The Specialist Firm is equally able to intervene when first receiving a sell order, as reflected in the following example:

Current market in XYZ: 30,000 shares bid at \$25.00 and 40,000 shares offered at \$25.06.

1:00:01 pm – Investor X sends an order through DOT to SELL 20,000 shares of XYZ at market.

(Specialist for XYZ delays the order to gather market intelligence)

1:00:10 pm – Investor Y sends an order through DOT to BUY 20,000 shares of XYZ at market.

1:00:14 pm – Specialist takes X's SELL order, and using his own firm account BUYS 20,000 shares of XYZ from X at \$25.01.

1:00:15 pm – Specialist takes Y's BUY order, and using his own firm account SELLS 20,000 shares of XYZ to Y at \$25.05.

59. Like the previous example, the Specialist Firm unnecessarily intervened and skimmed \$.04 per share for itself on this \$500,000 transaction – an \$800 profit in 15 seconds – equal to \$3,200 per minute - \$192,000 per hour.

60. This type of market manipulation and fraud is commonly referred to among Specialist Firms as “*pennying*” and is hugely profitable to the Specialist Firms. There are almost one billion shares of stock traded on the NYSE each day. Because of the huge volume on the NYSE, “pennying” by “inter-positioning” creates millions of dollars of illicit profits for the Specialist Firms which manipulate the market in this way. This “inter-positioning” is a violation of the NYSE’s negative obligation rule.

61. “Inter-positioning” or “pennying” became much more frequent with the utilization of small fractions and the ultimate decimalization of trading on the NYSE. In 1997 and 2000, the NYSE moved away from trading stocks in fractions of eighths to sixteenths and then from fractions

to penny decimals. Under the old 1/8-1/16 system, the Specialist Firms would pocket more from each inter-positioning manipulation – thus they had to do it less often to create the same level of profits they claimed to have earned. Decimalization required that Specialist Firms engage in “inter-positioning” much more frequently to generate the illegal profits they had become used to. However, under decimalization, their illegal behavior would be less noticeable given there would only be a few pennies profit per share involved in each trade as opposed to the previous 1/8th and 1/16th of a point. Basically, it gave Specialist Firms greatly increased low-risk chances to step in, inter-position and profit at the expense of public investors.<sup>4</sup> The defendant Specialist Firms’ activities alleged above violate their “negative obligation” rule.

#### **“Front-Running”**

62. Defendants further engaged in contrivances and manipulative acts, practices and a scheme to defraud and continued their course of business that operated as a fraud or deceit on public investors when they took advantage of their possession of material non-public information by first trading for their own account in a “client’s” stock, before completing Public Orders in violation of their duty to not engage in “front-running.”

63. Specialist Firms are prohibited from taking advantage of their possession of material non-public information concerning transactions in stocks where they control the trading by first trading for their own account before completing investors’ orders, insuring instant risk-free profit by re-selling or re-buying immediately afterwards. This type of contrivance, manipulation and fraud is

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<sup>4</sup> Specifically, the NYSE converted seven securities to decimalization on August 28, 2000, 57 additional securities on September 25, 2000, and 94 more securities on December 5, 2000. All remaining securities on the NYSE began trading in decimals on January 29, 2001.

known as “front-running.” While similar to inter-positioning, “front-running” is far more significant, as a Specialist Firm can generate even larger illegal profits by “front-running.”

64. A typical example of “front-running” is the following: In order to buy a large block of a stock, a public investor places an order to buy 100,000 shares of ABC stock at \$41.10, slightly above the current market price of \$39.90-\$40.00. The Specialist Firm’s Secret Book shows this large original order will trigger other large “stop market” buy orders respectively at \$40.05 and \$40.25. The specialist utilizes the 100,000 share \$41.10 limit order to opportunistically delay executing all other buy orders while immediately executing all of the public sell orders. In this example, the specialist, by immediately executing public sell orders against its own principal account (*i.e.*, the specialist buying stock for its own account) is able to purchase 10,000 shares at \$40.03 and 5,000 shares at \$40.02. The specialist, having just purchased a total of 15,000 shares for its own principal account, now resumes executing public orders to immediately trigger the large “stop market” buy orders. The specialist then trades the stock at \$40.05 creating a domino buy effect (“buy stop” market order triggered), then next trades the stock at \$40.25, thus again triggering a domino buy effect. The specialist, seeing sell orders in his Secret Book starts to concurrently sell his 15,000 share “front-run” buy order at \$40.55 against the 100,000 share original \$41.10 “stop limit” orders. Thereby, in no longer than a minute or so, the specialist profited \$0.52 per share, amounting to \$5,200, on the 10,000 share purchase, and \$0.53 per share, amounting to \$2,650, on the 5,000 share purchase, for a total illegal profit of \$7,850. A front-runner Specialist Firm, in essence, buys the shares and then flips them, at a higher price, to the investor it is trading ahead of, or other investors.

65. At bottom, front-running involves a Specialist Firm buying or selling for its own account as a principal, based upon non-public material information, *i.e.*, the information in the

Specialist Firm's Secret Book. Large block initiated transactions, like those most frequently engaged in by the named plaintiff in this action, a long-term investor in public companies listed on the NYSE, are particularly vulnerable to manipulation by the Specialist Firms – either “pennying” or “front-running,” due to the initiated large size (not frequency) of the transactions.

66. NYSE Information Memo No. 80-38 expressly prohibits front-running. The Memo provides, in part, that members and member organizations “should not trade in options or in underlying securities by taking advantage of their possession of material, non-public information concerning block transactions in these securities.” This type of conduct is “inconsistent with just and equitable principles of trade” and a member who violates this rule may face disciplinary proceedings under NYSE Rule 476. *See also* NYSE Exchange Rule 105 (g), “Prohibition Against Front-Running of Blocks.” The Specialist Firms’ activities alleged herein and the NYSE’s knowing tolerance and connivance violate the prohibition against front-running.

#### **“Freezing the Book”**

67. The Specialist Firms use their Secret Book to keep track of all Public Orders. They also manipulate electronic orders entered through electronic SUPERDOT orders which are reflected on the NYSE Display Book to their own advantage at the expense of their customers. Specialist Firms “freeze” the NYSE Display Book orders, thereby preventing the electronic orders from immediately reaching the floor to be executed. Thereby, they are able to first complete a trade for themselves, either by “front-running” or “inter-positioning” before unfreezing the order and completing the public investor’s order. This freeze mode enabled the Specialist Firms to engage in “front-running” and to “interposition” in violation of the rule that all Public Orders be executed at the best price. This freezing manipulation tactic is also a violation of a Specialist Firm’s duty as an auctioneer, which requires the Specialist Firm to continuously post the best available bids and offers for a stock throughout the day.

## **FALSE AND MISLEADING STATEMENTS**

68. During the Class Period, Defendants made repeated public statements concerning the operations of the NYSE and its specialist system which were intended to and did, individually and in combination, create the public impression that the NYSE was overseeing and operating its exchange in accordance with laws, regulations and its own rules and that, due to substantial compliance with the Exchange Act and SEC and NYSE rules, the NYSE was an honest and fair place to buy or sell stocks – an exchange where just and equitable principles of trade prevailed, thus concealing the ongoing acts of stock price manipulation, their scheme to defraud public investors and their acts, practices and course of business that was operating as a fraud or deceit on these public investors.

69. Spear Leeds described its obligations as follows:

### **What is the role of a Specialist?**

Specialists are responsible for maintaining a liquid and continuous two-sided auction market by acting as both an agent and a principal. Specialists ensure that markets are fair, orderly and competitive.

### **What are the primary responsibilities of a Specialist?**

Specialists are required to make continuous two-sided quotations that accurately reflect prevailing market conditions. In performing this function, Specialists can act as both an agent and a principal.

When acting as agent, Specialists match the orders of buyers and sellers, thus ensuring timely execution at the best available price. Specialists have a Negative Obligation to provide an opportunity for public orders to be executed against each other without undue intervention.

Occasionally, it's not possible to match buy and sell orders due to a short-term imbalance between supply and demand for a company's shares. Under those circumstances, Specialists will act as principal.

When acting as principal, Specialists have an Affirmative Obligation to buy and sell securities in order to maintain price continuity with reasonable market depth.

70. Bear Wagner described its obligations as follows:

Specialists manage the auction market in the specific securities allocated to them. They must maintain a fair, competitive, orderly and efficient market at all



times, even in those market conditions considered extreme. This means that all customer orders have an equal opportunity to interact and receive the best price on execution. Bear Wagner Specialists prides itself on our ability to maintain exceptional markets in the stocks we trade in all market conditions, even in the most difficult and volatile periods of market activity.

71. Fleet Specialist described its obligations as follows:

All customers, whether individual or institutional, must have an equal opportunity to interact and receive the best price. This premise is at the heart of an auction market and at the heart of the specialist's role. Our specialists focus on cushioning volatility. They act like shock absorbers to ensure trade-to-trade price continuity in either direction. A specialist sells on the upswing and buys on the downturn in order to create a fair, competitive, orderly and efficient market for the protection of shareholders.

72. LaBranche described its obligations as follows:

When assigned a particular stock, the specialist firm agrees to specific obligations. The specialist firm's role is to maintain, as far as practicable, trading in the stock that will be fair and orderly. This implies that the trading will have reasonable depth and price continuity, so that, under normal circumstances, a customer may buy or sell stock in a manner consistent with market conditions. A specialist firm helps market participants achieve price improvement in their trades because the best bids and offers are discovered through the auction process.

73. Performance Group described its obligations as follows:

Specialists must maintain a fair, competitive, orderly and efficient market. This means that all customer orders have an equal opportunity to interact and receive the best price. It also means that once auction trading begins, a customer should be able to buy or sell a reasonable amount of stock close to the last sale. Therefore, a specialist works to avoid large or unreasonable price variations between consecutive sales. The results: almost 98% of all trades take place at 1/8th point or less from the last sale.

74. Susquehanna described its obligations as follows:

The fundamental responsibility of a specialist on the New York Stock Exchange is to manage efficiently the trading of a company's shares, rapidly pairing off buyers and sellers while seeking the fairest possible execution for all parties involved. In the service of its listed companies, a specialist must also serve as a liquidity provider and a source of stability, at the same time offering information, insight and market commentary.

75. The NYSE describes the operation of its specialist system as follows:

## The Specialist

A key feature of the NYSE auction market is the role of the assigned dealer, generally known as the specialist. Specialists are required to perform several specific functions:

- They maintain current bid and asked prices for their assigned stocks. This information is transmitted worldwide, keeping all market participants informed of the total supply and demand for any NYSE-listed stock.
- They act as agents, executing orders entrusted to them by a trading floor broker, such as the limit order ....
- When there is a temporary shortage of either buyers or sellers, specialists will buy or sell for their own accounts, against the trend of the market. In recent years, 88 percent or better of specialist trades have been counter to the market trend, helping to balance the immediate supply and demand for a stock. Such activity is not typical of most other markets....
- They act as catalysts, bringing buyers and sellers together, so that offers to buy can be matched with offers to sell.

***The absolute obligation of the specialists is to place and execute public investor orders ahead of their own – to yield at all times to public orders.***

\* \* \*

In recent years, the NYSE has adopted important new measures to assure the continued integrity and competitiveness of its marketplace.... Recognizing the imperative of increasing this participation, the NYSE, together with other exchanges and the Securities and Exchange Commission, as addressed specific investor concerns about owning stocks in today's complex investment environment.

This includes the rules and regulations necessary to impose some practical limits on volatile price movements within a trading session. It also includes better access to the market in times of unusual activity.

To handle increased volume, the NYSE has strengthened its professional and technological resources. In addition, the flow of information available to investors has been steadily improved, and electronic technology now makes it possible to receive orders, execute trades and report back to investors in less than 30 seconds, a time frame unheard of 10 years ago.

New human and technological resources have been devoted, as well, to surveillance and enforcement activities, ***ensuring that the NYSE market remains the fairest and most open in the world.***

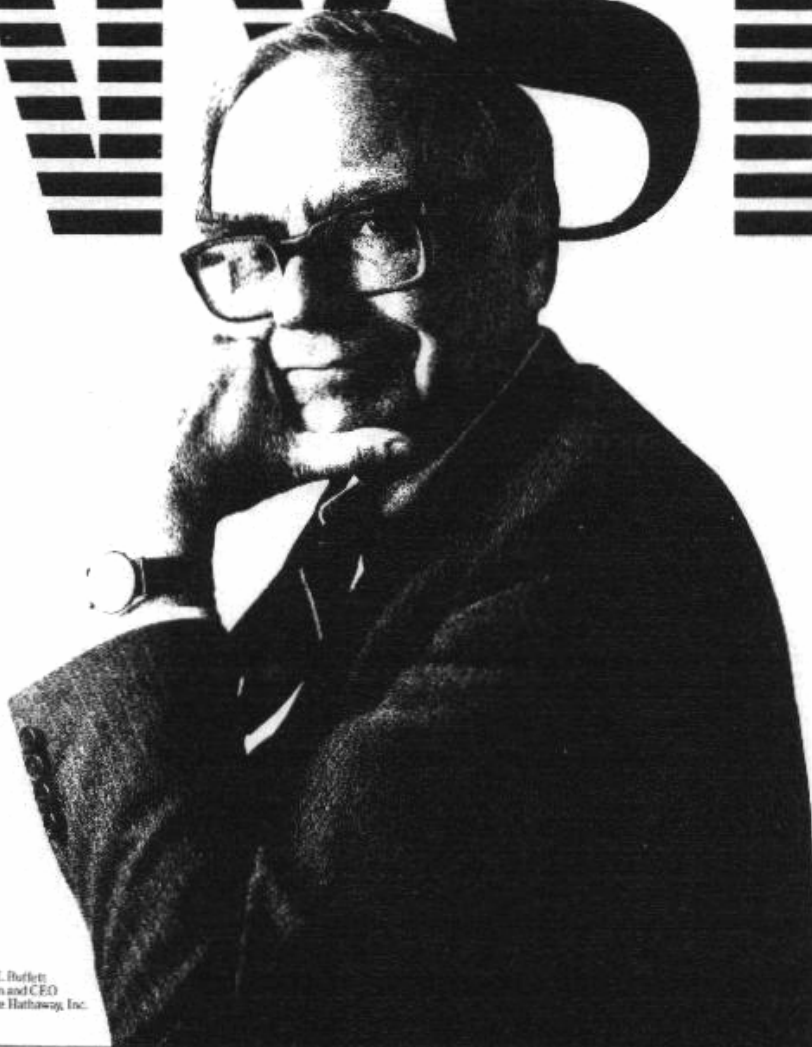
76. An example of how the NYSE creates a public image of honest and trustworthy stock trading that investors can rely on is shown by the following advertisement which the NYSE ran after Berkshire Hathaway listed its shares on the NYSE:

## **"Berkshire Hathaway listed on the NYSE to reduce shareholder transaction costs."**

"When we switched from the OTC to the NYSE, we had high expectations of reducing our transaction costs. Those expectations have been exceeded. A much narrower spread has prevailed on the NYSE than in the over-the-counter market, and we couldn't be more pleased. We wanted the best market that we could obtain for our shareholders. The NYSE is that market."

The most liquidity. The highest visibility. The fairest pricing. The broadest access to the greatest number of investors. Just a few of the reasons why so many outstanding companies list their shares on the NYSE.

# NYSE



Warren E. Buffett  
Chairman and CEO  
Berkshire Hathaway, Inc.

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77. Similarly, the NYSE ran an advertisement representing that it provided publicly traded companies with “visibility, credibility, and security” when Vivendi Universal became listed on the Exchange. Quoting Vivendi’s chairman and CEO, the NYSE said

***Our New York Stock Exchange listing supports the achievement of this objective by giving our shares visibility, credibility, and security in the crucial U.S. capital markets and all around the world.***

78. The affairs of the NYSE including its oversight and regulatory functions, are managed on a day-to-day basis by a number of top executives at the NYSE which in recent years have included those identified at ¶15. While the NYSE is technically a non-profit entity, its operations generate huge amounts of revenue and have provided a source for very lucrative pay packages for the top executives of the NYSE, the size of which directly correlates to the size of the revenues of the NYSE, as well as the profitability of the Specialist Firms, which dominate the NYSE’s Board of Directors. Because these executives’ continued employment at the NYSE and the size of their compensation is determined by the board of the NYSE and the Specialist Firms play an important role on that board, the opportunity for synergistic self-dealing by the top executives and the Specialist Firms is evident.

79. These officers of the NYSE are to oversee, regulate, and to enforce compliance with the Exchange Act and the Rules of the NYSE. Even though the NYSE is a non-profit, quasi regulatory entity with a public purpose, it has now been revealed that these executives have been receiving lavish – indeed obscene – compensation packages as set forth in ¶15.

80. Thus, before and during the Class Period, the NYSE knowingly tolerated and, in fact, actively encouraged and participated in the acts of manipulation, the scheme to defraud and the course of business which operated as a fraud or deceit on public investors on the NYSE as alleged herein because the NYSE as well as its top executives had a direct financial interest in the successful continuation of that scheme.

81. Also, the NYSE receives a share of the commissions generated by every stock transaction executed on the Exchange – thus, the more volume, the more revenue and the larger the salaries, benefits, perks and retirement packages for the NYSE’s top executives. And the size of the profits of the Specialist Firms and the incomes of the individual specialists who work for or are partners in the Specialist Firms directly impact the value of the NYSE “seats,” *i.e.*, membership. The more the profits earned by the NYSE members, the higher the price of membership, and thus the enterprise value of the NYSE. As a result of its growth, gain in market shares, heavy volume and increased listing of public companies, the NYSE’s revenues exceed \$1 billion per year and, despite its “non-profit” status, it reports millions of dollars of net income each year. This is all a synergist system of profiting by the Specialist Firms and the executives of the NYSE, whereby the laws, rules and regulations meant to protect public investors from stock manipulation and insider dealing by exchange members and the fiduciary Specialist Firms are cast aside and ongoing violations are blatantly engaged in – in fact, encouraged and furthered – so the Specialist Firms and the NYSE executives can profit by hundreds of millions of dollars, at the expense of public investors.

82. Because the NYSE is required by law to oversee the operation of its exchange and the conduct of its members, including the Specialist Firms, because it is subject to some degree of public scrutiny and SEC oversight, and because it receives from time to time complaints of trading misconduct from sophisticated investors, the NYSE could not completely openly abandon its oversight and regulatory functions, for to do so would have, in fact, exposed the ongoing fraudulent scheme and course of business resulting in SEC intervention and brought the scheme to an end. Therefore, to actually further the fraudulent scheme and course of business, the NYSE has continued to conduct its regulatory activities and take disciplinary action against certain members and even Specialist Firms, but has done so in a deliberately constrained and contracted manner in order to give

the public illusion of meaningful oversight, discipline and therefore compliance with the Exchange Act and the NYSE's own rules, while, at the same time, it has sufficiently constrained its regulatory activities such that the wrongdoing on the NYSE floor by the Specialist Firms could flourish. This conduct, together with the NYSE's repeated public pronouncements over the years about the honesty and fairness of the NYSE, that public investors could safely trade there without fear of being disadvantaged and public companies should list their stocks there because of the prestige and honesty of the NYSE, which attracts investors from all over the world, has allowed the NYSE to maintain an image of integrity, honesty and legal compliance, allowing the fraudulent scheme and course of business to continue undetected.

83. However, during 2003, a series of events unfolded which resulted in an unraveling of the scheme. Certain complaints regarding trading in stocks became so frequent and serious that top NYSE officials were having increasing difficulty in covering them up with their constrained enforcement program. The public revelation of the NYSE Board's gross dereliction in allowing and approving the stupendous Grasso pay package, as well as that of the other top NYSE executives – whereby officers of a non-profit corporation with a public purpose were pocketing hundreds of millions of dollars – together with a change of leadership at the SEC, resulting in much more skeptical evaluation of the NYSE's representations and promises regarding its compliance with the Exchange Act and its own rules, brought the fraudulent scheme and course of business to an end. When the SEC discovered that the NYSE was conducting an investigation of alleged illegal trading practices, but deliberately constraining the scope of the inquiry and investigatory methodology in a manner that would minimize the amount of wrongdoing uncovered by the investigation, and when the NYSE refused to expand the investigation as requested by the SEC, the SEC undertook its own investigation.

84. While the actual report generated by the SEC as the result of its investigation remains secret, its contents have become widely known and, as described in great detail in *The Wall Street Journal* article set forth at ¶7, the report is a scathing indictment of the NYSE's utter failure to adequately and properly oversee, regulate and discipline the Specialist Firms and how this has resulted in widespread continuous violations of the Exchange Act and the NYSE's rules by the Specialist Firms, as detailed herein.

85. Under various provisions of the Exchange Act, including §6, the NYSE as a securities exchange registered with the SEC under the Exchange Act, has obligations to operate its securities exchange in the public interest and for the protection of investors, assuring that fair, equitable and just principles of trade prevail. Acting deliberately, fraudulently and in bad faith, the NYSE, both before and during the Class Period, has failed to discharge these legal obligations and violated them as set forth in detail in the charging allegations of this Complaint.

86. The conduct of the NYSE complained of herein resulted not from ordinary or even gross negligence, but rather from its knowing and active furtherance and participation in the wrongdoing alleged for its own economic gain, as well as the economic gain of its top officers and the Specialist Firms which play an important role on its Board.

## COUNT I

### **For Violation of §10(b) of the Exchange Act and Rule 10b-5 (Against All Defendants)**

87. Plaintiff incorporates and realleges each and every allegation contained in ¶¶1-86.

88. During the Class Period, Defendants engaged in acts and practices to deceive and damage investors, including contrivances and manipulations, and participated in a fraudulent scheme and course of business which was intended to and did operate as a fraud or deceit on the investing public, including plaintiff and other Class members, causing plaintiff and Class members to purchase



or sell shares on the NYSE at distorted prices, enriching Defendants and damaging the Class. In furtherance of this unlawful scheme and course of business, Defendants took the actions set forth herein.

89. Defendants (i) employed devices, schemes, and artifices to defraud; (ii) omitted to state material facts necessary to make the statements made not misleading; and (iii) engaged in acts, practices, and a course of business which operated as a fraud and deceit upon the purchasers and sellers of shares on the NYSE, including plaintiff and other Class members, in an effort to enrich themselves through undisclosed and manipulative trading tactics by which they wrongfully appropriated assets and otherwise distorted the pricing of their securities in violation of §10(b) of the Exchange Act and Rule 10b-5. All Defendants are sued as primary participants in the wrongful and illegal conduct and scheme charged herein, each committed manipulative acts, deceptive practices, or made false and misleading statements.

90. The Defendants had actual knowledge of the illegal practices and falsehoods set forth herein, or acted with reckless disregard for the truth in that they failed to ascertain and to disclose the true facts, even though such facts were available to them. Defendants' material misrepresentations and/or omissions were done knowingly or recklessly and for the purpose and effect of concealing the truth.

91. As a result of Defendants' misconduct, the trading prices of the securities purchased or sold on the NYSE by public investors were artificially manipulated and distorted during the Class Period. In ignorance of the true facts and the improper conduct of Defendants during the Class Period, plaintiff and other Class members purchased and/or sold shares on the NYSE at artificially distorted and manipulated prices and were damaged thereby.

92. At the time of the illegal practices, plaintiff and other Class members were ignorant of them. Had plaintiff and other Class members known of the truth concerning these unlawful activities, which were not disclosed by Defendants, plaintiff and other Class members would not have purchased or sold stock on the NYSE at the distorted prices which they paid. Plaintiff and Class members who traded on the NYSE during the Class Period relied on the integrity of the market in the securities of the public corporations listed and traded on the NYSE.

93. By virtue of the foregoing, Defendants have violated §10(b) of the Exchange Act, and Rule 10b-5. As a direct and proximate result of Defendants' wrongful conduct, plaintiff and the other Class members suffered damages in connection with their purchases and/or sales of the shares of stock on the NYSE during the Class Period.

## **COUNT II**

### **For Violations of §6(b) of the Exchange Act (Against Defendant NYSE)**

94. Plaintiff incorporates and realleges each and every allegation contained in ¶¶1-93.

95. Under various provisions of the Exchange Act, including §6, the NYSE is a securities exchange registered with the SEC under the Exchange Act. Thus, the NYSE has obligations to operate its securities exchange in the public interest and for the protection of investors, assuring that fair, equitable and just principles of trade prevail. Acting deliberately, fraudulently and in bad faith, the NYSE, both before and during the Class Period, failed to discharge these obligations (and violated them) as set forth in this Complaint.

96. Section 6(a) and (b) of the Exchange Act, entitled "National Securities Exchanges," states:

National Securities Exchanges

Sec. 6. (a) An exchange may be registered as a national securities exchange under the terms and conditions hereinafter provided in this section ... by filing with

the Commission an application for registration in such form as the Commission, by rule, may prescribe containing the rules of the exchange and such other information and documents as the Commission, by rule, may prescribe as necessary or appropriate in the public interest or for the protection of investors.

(b) An exchange shall not be registered as a national securities exchange unless the Commission determines that

(1) Such exchange is so organized and has the capacity to be able to carry out the purposes of this title and to comply, and ... to enforce compliance by its members and persons associated with its members, with the provisions of this title, the rules and regulations thereunder, and the rules of the exchange.

\* \* \*

(5) The rules of the exchange are designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest ....

(6) The rules of the exchange provide that: ... its members and persons associated with its members shall be appropriately disciplined for violation of the provisions of this title, the rules or regulations thereunder, or the rules of the exchange, by expulsion, suspension, limitation of activities, functions, and operations, fine, censure, being suspended or barred from being associated with a member, or any other fitting sanction.

97. The conduct of the NYSE complained of results not from ordinary or even gross negligence but rather from the NYSE's knowing and active furtherance and participation in the wrongdoing alleged for its own economic gain, as well as the economic gain of its top officers and the Specialist Firms which dominate the membership of the NYSE.

98. Section 6 of the Exchange Act and the NYSE's rules and procedures adopted pursuant thereto were specifically enacted and promulgated to protect public investors who trade on the NYSE. Such individuals and institutions – the members of the Class – are the direct intended beneficiaries of the prohibitory and protective rules embodied in §6 of the Exchange Act and the rules and regulations promulgated by the SEC and NYSE thereunder. The volume of trading on the

NYSE reflects the collective reliance of public investors – the members of the Class – on the existence of the Exchange Act, its prohibitory and protective provisions, and the rules and regulations of the NYSE pursuant thereto. The NYSE trading volume also reflects reliance of public investors on the repeated collective false assurances of the NYSE of the integrity of trading in the markets maintained by the Specialist Firms on the NYSE and the assurances that those markets are fair and un-manipulated by the Specialist Firms and the trading volume for this reflects the public purpose of the NYSE, which exists and acts to protect public investors and prevent the very type of illegal conduct complained of in this Complaint.

99. As a direct and proximate result of the NYSE's deliberate and bad faith violation of §6 of the Exchange Act, the members of the Class have been damaged, while the NYSE and its top executives have improperly profited and been enriched.

### **COUNT III**

#### **For Violations of §20(a) of the Exchange Act (Against All Defendants)**

100. Plaintiff incorporates and realleges ¶¶1-99.

101. This Claim is brought pursuant to §20(a) of the Exchange Act against all Defendants as control persons. The Specialist Firms are controlled by their corporate parents. The Specialist Firms control the individual specialists. The NYSE controls the Specialist Firms.

102. Each of the Defendants acted as a controlling person within the meaning of §20(a) of the Exchange Act for the reasons alleged herein. By virtue of their ownership, operational management and/or regulatory control, each of the Defendants had the power to influence and control and did influence and control, directly or indirectly, the conduct of their controlled persons. The defendant controlling persons had the power and ability to prevent these unlawful market

manipulation activities, the fraudulent scheme and the course of business that operated as a fraud or deceit on investors trading stock on the NYSE.

103. Defendants each violated §10(b) and Rule 10b-5 by their acts and omissions as alleged in this Complaint. By virtue of their positions as controlling persons, the Defendants are liable pursuant to §20(a) of the Exchange Act. As a direct and proximate result of Defendants' wrongful conduct, plaintiff and other Class members suffered damages in connection with their purchases and sales of shares of stock on the NYSE during the Class Period.

#### **COUNT IV**

##### **Breach of Fiduciary Duty and/or Aiding and Abetting Breach of Fiduciary Duty (Against All Defendants)**

104. Plaintiff incorporates all prior allegations except it does not incorporate or reallege any allegation of false statements, misrepresentations or non-disclosures. No false statements or concealments are incorporated into or alleged in this claim for relief. This claim for relief is based solely on the *conduct of the Defendants*.

105. The Specialist Firms manage the auction market in the specific securities assigned to them. All orders from public investors are to have an equal opportunity to interact and receive the best price on execution.

106. All investors in companies traded on the NYSE, whether individual or institutional, are entitled to an equal opportunity to interact and receive the best price. This premise is at the heart of the auction market and at the heart of the Specialist Firms' role. A Specialist Firm manages the auction market in the stocks assigned to it to create a fair and orderly market for the protection of investors. They are fiduciaries to their customers and are required to maintain a fair market at all times.

107. Specialist Firms are responsible for maintaining a liquid and continuous two-sided auction market by acting as both agents and principals. Specialist Firms are required to make continuous two-sided quotations that accurately reflect prevailing market conditions. Specialist Firms have a “negative obligation” to cause Public Orders to be executed against each other without intervention to profit for themselves.

108. All trading of each security of a company listed on the NYSE is through an auction process, which is managed by a Specialist Firm on an exclusive basis by a designated individual specialist of the Specialist Firm. A Specialist Firm is granted an exclusive franchise by the NYSE to conduct the auction market in the NYSE-listed stocks assigned to that firm. Because the Specialist Firm exclusively runs the auction for the stock of its client, *i.e.*, the listed public company, each Specialist Firm knows of all existing Public Orders, including all existing bids and offers and open, limit and market orders for those stocks recorded in the Specialist Firms’ Secret Book. This is exclusive non-public, proprietary information, known only to the specialist and provides the specialist with uniquely valuable information regarding the supply and demand for the stocks the Specialist Firm is managing the auction market in. The duty of the Specialist Firms is to conduct an honest, fair and equitable auction market in the stocks it controls the trading of in accordance with the Exchange Act and the rules and regulations of the SEC and the NYSE.

109. As Specialist Firms manage the auction market in the specific securities assigned to them, they must maintain a fair, just and equitable market at all times. This means that all Public Orders have an equal opportunity to interact and receive the “best price” on execution. All NYSE customers – *i.e.*, public investors whether individual or institutional, are entitled to receive the “best price.” This premise is at the heart of the NYSE’s auction market and at the heart of the Specialist Firms’ role in maintaining that market. The Specialist Firms’ relationship with all market

participants is based on trust, and all Specialist Firms are required to honor this trust by placing their customers' transactions before their own.

110. The Specialist Firms' position on the NYSE trading floor creates an inherent conflict of interest. On one hand, the Specialist Firm is charged with maintaining a "fair and orderly market" and represents as a fiduciary both buyers and sellers of a stock. On the other hand, the Specialist Firm is constantly in a position to trade for its own proprietary accounts as a principal, while in possession of material non-public information regarding the supply and demand for a given stock, in part through its knowledge of existing but unexecuted Public Orders, including "open stop" or "limit" orders to buy or sell the stock above or below its current price for limited or unlimited periods of time, as reflected in the Specialist Firm's proprietary "Secret Book." Each Specialist Firm is uniquely positioned at the center of the trading activity in any given stock it controls the trading in and has intimate knowledge of that stock's trading pattern and the supply and demand for that stock. For this reason, stringent rules and regulations exist to control the activities of Specialist Firms – which are fiduciaries to those who trade on the NYSE – to prevent them from self-dealing or taking advantage of public investors as they conduct the auction market in the stocks for which they serve as a Specialist Firms.

111. Because they operate in a position of trust and confidence toward their "customers," *i.e.*, traders on the NYSE, and execute their trades for them when they cannot watch and are not watching, and because they are required by law and rule to place the interests of their customers ahead of their own. The Specialist Firms owed plaintiff and the Class members a fiduciary duty in the execution of their orders on the NYSE. The Specialist Firms' conduct as alleged herein violated that duty.

112. The NYSE knowingly aided and abetted the Specialist Firms' violation of their fiduciary duties by its conduct, as alleged herein.

113. As a direct and proximate result of Defendants' conduct, plaintiff and Class members have been damaged.

### **PRAYER FOR RELIEF**

WHEREFORE, plaintiff prays for relief and judgment, as follows:

A. Determining that this action is a proper class action, appointing plaintiff as Lead Plaintiff and its counsel as Lead Counsel for the Class and certifying it as Class representative under Rule 23;

B. Awarding compensatory damages in favor of plaintiff and the other Class members against all Defendants, jointly and severally, for all damages sustained as a result of Defendants' wrongdoing, in an amount to be proven at trial, including interest thereon;

C. Restitution of investors' monies of which they were defrauded or disgorgement of Defendants' ill-gotten gains;

D. Awarding plaintiff and the Class their reasonable costs and expenses incurred in this action, including counsel fees and expert fees; and

E. Such other and further relief as the Court may deem just and proper.



**JURY DEMAND**

Plaintiff hereby demands a trial by jury.

DATED: December 15, 2003

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