

UNITED STATES OF AMERICA
BEFORE THE
SECURITIES AND EXCHANGE COMMISSION

In the Matters of	:	
	:	
	:	
Bear Wagner Specialists LLC	:	
Admin. Proc. File No. 3-11445	:	
Fleet Specialist, Inc.	:	
Admin. Proc. File No. 3-11446	:	
LaBranche & Co. LLC	:	
Admin. Proc. File No. 3-11447	:	
Spear, Leeds & Kellogg Specialists LLC	:	FUND ADMINISTRATOR'S
Admin. Proc. File No. 3-11448	:	MODIFIED FAIR FUND
Van der Moolen Specialists USA, LLC	:	DISTRIBUTION PLAN
Admin. Proc. File No. 3-11449	:	
Performance Specialist Group LLC	:	
Admin. Proc. File No. 3-11558	:	
SIG Specialists, Inc.	:	
Admin. Proc. File No. 3-11559	:	
	:	
Respondents.	:	

I.
INTRODUCTION

This distribution plan (“Plan”) concerns the seven Fair Funds established pursuant to the U.S. Securities and Exchange Commission’s (“Commission”) orders to house the disgorgement and civil penalties obtained as part of the Commission’s settlements with the seven New York Stock Exchange (“NYSE”) specialist firms: Bear Wagner Specialists, LLC, Fleet Specialist, Inc. (now Banc of America Specialist, Inc.), LaBranche & Co. LLC, Spear, Leeds & Kellogg Specialists LLC, Van der Moolen Specialists USA, LLC, Performance Specialist Group LLC, and SIG Specialists, Inc. (together the “Specialist Firms”). In its orders, the Commission found that from at least 1999 to 2003, the Specialist Firms violated their basic obligation to serve public customer orders over their own proprietary interests.

The Specialist Firms had a general duty to match executable public customer or “agency” buy and sell orders and not to fill customer orders through trades from the firms’ own account when those customer orders could be matched with other customer orders. Through various forms of improper conduct, the Specialist Firms violated this obligation by filling orders through proprietary trades rather than through other customer orders. The unlawful conduct took two basic forms: Specialist Firms would “interposition” by buying stock for the firm dealer’s account from the customer sell order, and then filling the customer buy order by selling from the dealer account at a higher price – thus realizing a profit for the firm account. Alternatively, Specialist Firms would fill agency orders through a proprietary trade for the firm’s account – and thereby improperly “trade ahead” of the other agency order. As a consequence, the customer order that was traded ahead of was disadvantaged by being executed at a price that was inferior to the price

received by the dealer account. By engaging in these forms of unlawful conduct the Specialist Firms caused over \$157 million in customer harm.

II. FACTS

On March 30, 2004, the Commission issued Orders Instituting Administrative and Cease-and-Desist Proceedings, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Sections 15(b)(4) and 21C of the Securities Exchange Act of 1934 (“March 30 Orders”) against the following Specialist Firms and directed them to pay disgorgement and civil penalty amounts, as follows:

<u>Specialist</u>	<u>Disgorgement Amount</u>	<u>Civil Penalty Amount</u>
Bear Wagner Specialists LLC	\$ 10,724,903	\$ 5,534,543
Fleet Specialist, Inc.	38,013,594	21,083,875
LaBranche & Co. LLC	41,646,440	21,872,320
Spear, Leeds & Kellogg Specialists LLC	28,776,072	16,496,406
Van der Moolen Specialists USA, LLC	34,926,613	22,748,491

On July 26, 2004, the Commission issued Orders Instituting Administrative and Cease-and-Desist Proceedings, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Sections 15(b)(4) and 21C of the Securities Exchange Act of 1934 (“July 26 Orders”) against the following Specialist Firms and directed them to pay disgorgement and civil penalty amounts, as follows:

<u>Specialist</u>	<u>Disgorgement Amount</u>	<u>Civil Penalty Amount</u>
Performance Specialist Group LLC	\$ 1,491,171	\$ 680,761
SIG Specialists, Inc.	2,045,571	988,018

In accordance with Sections IV.C. and IV.D. of the March 30 and July 26 Orders (collectively, the “Specialist Firm Orders”), the Specialist Firms have paid their respective amounts of disgorgement and civil penalties to the Commission.

<u>Specialist</u>	<u>Total Amount</u>
Bear Wagner Specialists LLC	\$ 16,259,446.00
Fleet Specialist, Inc.	59,097,469.00
LaBranche & Co. LLC	63,518,760.00
Spear, Leeds & Kellogg Specialists LLC	45,272,478.00
Van der Moolen Specialists USA, LLC	58,203,348.57 ¹

¹ Van der Moolen’s total payment amount included \$528,244.57 in post-judgment interest because it was allowed, pursuant to the provisions of its March 30 Order, to pay off its civil penalty amount in seven installment payments.

Performance Specialist Group LLC	2,171,932.00
SIG Specialists, Inc.	<u>3,033,589.00</u>
<u>Total</u>	<u>\$247,557,022.57</u>

Pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002, on October 13, 2004 (“October 13 Orders”), the Commission established a Fair Fund with respect to each of the Specialist Firms for the disgorgement and penalty funds described in the Specialist Firm Orders (the “Distribution Funds”), and pursuant to Rule 1105(a) of the Commission’s Rules on Fair Fund and Disgorgement Plans (“Rules”), Heffler, Radetich & Saitta, L.L.P. (“Heffler” or the “Fund Administrator”) was appointed to act as Fund Administrator of the Distribution Funds.

Pursuant to the October 13 Orders and Rule 1101(b)(1) of the Rules, Heffler opened a separate escrow account (the “Escrow Account(s)”) for each of the combined disgorgement and civil penalty amounts listed above.² The Distribution Funds are held at Citizens Bank of Pennsylvania (“Citizens Bank” or the “Escrow Agent”), a federally insured banking institution, pursuant to escrow agreements (“Escrow Agreements”) executed by the Fund Administrator and the Escrow Agent. Citizens Bank is (a) well capitalized within the meaning of Section 38(b)(1)(A) of the Federal Depository Insurance Act; (b) has a peer rating of 1; (c) has adequate insurance; and (d) is supervised by federal banking regulators. The Escrow Agreements require (a) that all funds in escrow be invested, as soon as reasonably possible and to the extent practicable, in short-term U.S. Treasury securities with maturities not to exceed six months; (b) the Escrow Agent to be appropriately bonded;³ (c) that escrowed funds be disbursed by the Escrow Agent only upon further order of the Commission, except as provided for in Section II.7 of the October 13 Orders. The costs associated with the Escrow Accounts are to be paid from the Distribution Funds. Funds to cover Heffler’s fees and expenses may be disbursed from the Escrow Accounts only upon the written authorization of the Commission’s staff. In any event, such costs and expenses shall be paid first from any interest earned by the relevant Distribution Fund, and second, if necessary, from the principal of such Distribution Fund, in accordance with Rule 1105(e) of the Rules.

Pursuant to the October 13 Orders and the Commission Orders dated April 6, 2005, and August 10, 2005, Heffler is to draw up a Distribution Plan to be approved by the Commission. As provided for in the Specialist Firm Orders, the Plan must include the disbursing of the Distribution Funds as follows: (a) to pay the costs of administering the Plan; (b) to reimburse injured customers for their loss; and (c) to pay prejudgment interest to injured customers. Pursuant to those orders, the Distribution Plan is as follows:

III. **DISTRIBUTION PLAN**

Based on the transaction data supplied to Heffler by the staff of the NYSE and the requirements outlined in the October 13 Orders, the Distribution Plan is divided into three

² The initial Van der Moolen amount deposited was \$45,775,104, and the remaining \$12,428,244.57 was paid in installments from June of 2004 through September of 2005. These payments were deposited into the Escrow Account.

³ Based on this requirement, and the fact that Heffler is using escrow accounts to maintain the Distribution Funds pending distribution, the Commission, in its October 13 Orders, waived for good cause shown the bond requirement of Rule 1105(c) of the Rules.

separate phases. The initial phase of the Plan is to identify the customers who were injured as a result of the Specialist Firms' trading violations, as previously determined by the Commission staff and the NYSE using specific criteria in connection with the Specialist Firm Orders (the "Injured Customers"). The amount of disgorgement and the specific violative trades that will be eligible for proceeds from the Distribution Funds were determined through the use of a retroactive surveillance conducted by the NYSE at the request of the Commission's Office of Compliance, Inspections and Examinations. The surveillance was designed to identify specific transactions where specialists had unlawfully traded ahead of executable customer orders, and transactions where specialists had unlawfully interpositioned themselves between two customer orders that should have been matched against one another. The surveillance looked at various types of electronic trading data, including the time an order is entered, the time it is executed or canceled, the execution price, and whether there were any intervening trades for the specialist's proprietary account. In determining which trades to include, the surveillance used certain time parameters depending on the type of trading violation and the time frame in which the trading occurred. In accordance with the terms of the Specialist Firm Orders, Heffler must look at the violative trades that have already been identified by the Commission staff and the NYSE (the "Violative Transactions") in order to identify the customers who were injured as a result of such violative trades, and the class of claimants is limited to those injured customers. The second phase is to calculate each Injured Customer's Distribution Amount (defined below), which consists of the Disgorgement Amount (defined below), the prejudgment interest, and post-judgment interest calculated through the date of distribution. The final phase is to distribute the Distribution Funds to the Injured Customers. Under the Internal Revenue Code, Heffler is required to withhold applicable taxes from payments of the Disgorgement Amount, prejudgment interest, and post-judgment interest, unless Heffler has received adequate tax documentation from, or on behalf of, the Injured Customer prior to making such payment, and, further, Heffler is required to notify the payee of such withholding, if any. The Plan for each phase is outlined further below in this Section III.

DEFINITIONS

"Clearing Member" shall mean a member firm of a clearinghouse. They are institutions through which transactions executed on the floor of the exchange are settled using a process of matching purchases and sales.

"Disgorgement Amount(s)" shall refer to the amount of loss incurred on each Violative Transaction.

"Distribution Amount" shall refer to the total amount of disgorgement, prejudgment interest, and post-judgment interest paid to Injured Customers.

"Injured Customers" means those individuals or entities whose trades were previously identified by the Commission staff and the NYSE in connection with the Specialist Firm Orders.

"Mid-Term AFR" shall mean the applicable federal rates published monthly by the U.S. Internal Revenue Service and used to calculate interest on the losses incurred by the Injured Customers. The Mid-term period is for instruments having a term in excess of three years but no greater than nine years. Interest is compounded on a quarterly basis.

"Nominee" is a brokerage firm, bank, investment firm, etc., with current or former clients that are Injured Customers.

“Violative Transactions” means the trades identified by the Commission staff and the NYSE as violating various federal securities laws and NYSE rules in connection with the Specialist Firm Orders.

IDENTIFICATON OF INJURED CUSTOMERS

Heffler began the identification process by obtaining the Violative Transactions database from the NYSE. The database was queried to obtain the total Disgorgement Amount for each of the Specialist Firms. The database included over 2.6 million transactions and included the following information for each transaction: Clearing Member number, Clearing Member name, trade date, security symbol, firm mnemonics, branch & sequence codes, turn around code, transaction type, number of shares, time of the trade, the Specialist Firm number, the Disgorgement Amount, the execution price, the CUSIP number and the principal/agency code.

After its initial review of the database, Heffler reconciled the total Disgorgement Amounts on the database to the Disgorgement Amounts paid by the Specialist Firms (for example, the Disgorgement Amount of \$38,013,594 paid by Fleet Specialist, Inc. (“Fleet”) equaled the total transactional Disgorgement Amounts listed on the Fleet portion of the database). This reconciliation confirmed the receipt of all transactions and the proper Disgorgement Amounts, per transaction. The database was then indexed by Clearing Member so each could be contacted with requests for specific information on Injured Customers. A total of 168 different Clearing Member firms were identified in the database.

Before contacting the Clearing Member firms to identify Injured Customers, it was determined in consultation with the staff of the Commission that a claim form was not required to be sent to or filed by an Injured Customer. The staffs of the Commission and the NYSE calculated the Disgorgement Amount for each transaction and the database received from the staff of the NYSE identified the trade date, number of shares, type of trade, purchase or sale price, the Disgorgement Amount and the Clearing Member handling the trade. As such, there was no need for an Injured Customer to file a claim form and submit supporting documentation for their transaction(s) and document eligibility pursuant to Rule 1101(b)(4) of the Rules. Rule 1101(b)(3) of the Rules regarding notice to potential claimants was also not required.

From the main database, files containing specific transactions were generated for delivery to each Clearing Member, either by first-class mail, over-night service or by e-mail. These transaction data files included all the information by transaction provided by the NYSE, except for the Disgorgement Amounts. Each file was delivered to the Clearing Member with correspondence that included a cover letter from the Fund Administrator outlining the data requested, a copy of the Commission’s Order, and the Fund Administrator’s format requirements for submitting the name and address of the Injured Customers.

Upon receipt of a Clearing Member’s response data file and before the file is accepted and downloaded into the main database, the file is reviewed for proper file formatting. Any improper format issues are corrected to insure the appropriate grouping of Injured Customers and the issuance of distribution checks (for example, names and addresses are not properly filtered for the database or the same person’s name is spelled differently in the response file). In addition to the format review, the share amounts for each trade per the response file are reconciled back to the main database. Since one transaction could represent a block of trades from more than one Injured Customer, the shares submitted by the Clearing Member are reconciled to the total from the main database, to confirm that all Injured Customers related to each transaction were

identified. (For example, a Nominee submitted a transaction for 1,000 shares but it was for two of their customers. One customer had 600 shares and the other had 400 shares.)

Responses from the Clearing Members identified Nominees as well as Injured Customers. In instances where a Nominee was identified as party to the transaction, the entire process of notification, as identified above, was repeated in an attempt to identify the individual Injured Customers. Heffler has identified over 2,500 Nominees that are or have been contacted to request information regarding the Injured Customers.

The process of identifying the Injured Customers for all 2.6 million transactions will continue until all Clearing Members and Nominees have responded to Heffler's request for names, addresses and share amounts or until such time that all efforts have been exhausted. Heffler continues to correspond, by telephone and in writing, with each of these Clearing Members and Nominees to determine the status of its outstanding requests and the timeframe for a response.

CALCULATION OF INJURED CUSTOMERS' DISTRIBUTION AMOUNTS

The Disgorgement Amounts with respect to each of the 2.6 million Violative Transactions were determined by the Commission staff and the NYSE, and calculated by the NYSE, in connection with the Specialist Firm Orders. If a Clearing Member or Nominee identified one Injured Customer for a particular transaction, the total Disgorgement Amount was assigned to that Injured Customer. If multiple Injured Customers were identified for one transaction, the Disgorgement Amount was allocated to each Injured Customer pro-rata, based on the number of shares. (For example, in the case above, two Injured Customers were party to one transaction with customer A having 600 shares and customer B having 400 shares. If the Disgorgement Amount and the interest (both prejudgment and post-judgment) for this one transaction totaled \$50.00, then customer A would receive a distribution of \$30.00 and customer B would receive \$20.00.)

The calculation of prejudgment and post-judgment interest is based on the Mid-Term AFR for the years 1999 through 2006, compounded quarterly. The prejudgment interest is calculated on each transaction starting from the date of the transaction and ending on the date of the Specialist Firm Orders. The post-judgment interest is calculated on each transaction starting from the day following the entry of the Specialist Firm Orders and ending on the date of distribution. For example, if the date of the transaction was July 1, 1999, the Specialist Firm Order is dated March 30, 2004, and the date of distribution is May 1, 2006, prejudgment interest would be calculated using the AFR for the periods from July 1, 1999 through March 30, 2004, while post-judgment interest would be calculated using the AFR for the periods from March 31, 2004 through May 1, 2006. The prejudgment and post-judgment interest amounts are then added to the Disgorgement Amount to determine the Distribution Amount for each transaction. If there are multiple transactions associated with one Injured Customer, the Distribution Amounts from all matched transactions will be combined so only one distribution check will be issued.

INITIAL AND SUBSEQUENT DISTRIBUTIONS TO INJURED CUSTOMERS

Heffler is recommending that an initial distribution be made in this matter, followed by distributions on a rolling basis. Each distribution list will be submitted to the Commission for approval once a significant number of Injured Customers are identified. Heffler is making this recommendation because the identification phase of the Plan is currently ongoing and a number

of Clearing Member/Nominee requests are still outstanding. An Injured Customer may receive a distribution from more than one distribution cycle.

Before a distribution is made to Injured Customers, the Fund Administrator will submit a report to the Commission seeking approval in accordance with Rule 1101(b)(6) of the Rules. This report will include the name of each Injured Customer along with their Disgorgement Amount, prejudgment interest amount, post-judgment interest amount, and the Distribution Amount. Upon approval, the database of approved Injured Customers will be submitted to the U.S. Postal Service's National Change of Address vendor to standardize the addresses for postal rate discounts and to update mailing addresses. Each updated database of Injured Customers and Distribution Amounts will then be sent to the Escrow Agent, who is also serving as the Disbursing Agent, for printing and mailing of distribution checks. Each distribution will be funded from the applicable Escrow Fund by a transfer of funds into a distribution checking account held by the Escrow Agent. Under the Internal Revenue Code, Heffler is required to withhold applicable taxes from payments of the Disgorgement Amount, prejudgment interest, and post-judgment interest, unless Heffler has received adequate tax documentation from, or on behalf of, the Injured Customer prior to making such payment, and, further, Heffler is required to notify the payee of such withholding, if any.

A distribution check will be mailed, by first-class mail, to each approved Injured Customer with an attached cover letter. The cover letter will give a brief description of the Fair Fund and an explanation of the Distribution Amount, which will include the Disgorgement Amount, and the amount of the prejudgment interest and post-judgment interest. Each distribution check will be clearly marked "Must be negotiated within 180 days of issuance" and any check not negotiated within the 180-day period, except in the case of returned checks, name changes and pursuant to the Verification Procedure described below, will be deemed abandoned and the funds will remain in the Escrow Account until such time as the Commission, in accordance with Section IV.E. of the Specialist Firm Orders, determines the appropriate use of such funds. Injured Customers with distribution checks greater than \$500, that are not negotiated within 90 days from the date of the distribution, will be sent a reminder letter via first-class mail requesting them to cash the check or, if not received, request the distribution check to be reissued.

Distribution checks returned to the Fund Administrator as undeliverable will be sorted in two categories and the Injured Customer's data file will be appropriately marked in Heffler's main database. If the Post Office provides a forwarding address, Heffler will change the main database and re-mail the distribution check. If no forwarding address is provided, the name and old address will be sent to a credit bureau for updated addresses. Any updated addresses received will be used to re-mail the distribution checks. Any checks re-mailed will include a cover letter indicating the payee has 180 days from the date of the letter to negotiate the check.

Heffler proposes December 31, 2006, as the date of termination of the Distribution Funds under Rule 1101(b)(5) of the Rules, although such date may be subsequently amended in light of Heffler's recommendation for periodic distributions, which is based on future responses received from Clearing Members and Nominees. The Fund Administrator will continue to work with the various Clearing Members and Nominees to identify Injured Customers. When the Fund Administrator determines that efforts to identify the Injured Customers have been exhausted, a final report will be submitted by the Fund Administrator to the Commission listing its recommendations to finalize and close out these matters. The final distribution will occur within 30 days of the last Injured Customer being identified or the Commission approving the finalization and closing of these matters. Section IV.E. of the Specialist Firm Orders state that

the Commission shall determine the appropriate use for the benefit of the investors of any funds left in the Distribution Fund following all payments.

What constitutes a Violative Transaction and the Disgorgement Amount assigned to each Violative Transaction has been previously determined in connection with the Specialist Firm Orders, and is, therefore, final and not subject to challenge. The prejudgment interest and post-judgment interest are calculations based on the Disgorgement Amount using the Mid-Term AFR in effect during the applicable periods.

VERIFICATION PROCEDURE FOR INJURED CUSTOMERS

By April 1, 2006, Heffler will establish on its website a procedure whereby any person who (a) has not received a Distribution Amount and who wishes to determine whether they have been identified as an Injured Customer, or (b) has received a Distribution Amount but wishes to ascertain whether such Distribution Amount accurately reflects the Disgorgement Amount with respect to such Injured Customer's Violative Transaction(s), may so inquire by submitting electronically or telephonically certain identifying information (such as their last name or, in the case of an entity, the legal name of such entity, and the last four digits of the social security number or tax identification number, and any information that such person believes should be considered in determining the Distribution Amount available to such person.). Heffler will consider the information and then respond electronically or in writing to the person or entity making the inquiry informing them, with respect to (a) above, whether or not they are an Injured Customer, and if they are an Injured Customer, providing information as to what procedures the Injured Customer must follow (such as providing Heffler with their full name, address, and proof of identity) to receive a Distribution Amount, and, with respect to (b) above, whether the Distribution Amount paid was the proper amount, and, if not, then including a distribution check for the shortfall between the Distribution Amount paid and the re-calculated Distribution Amount.

OTHER MATTERS

In cases where the Injured Customer is unable to endorse the distribution check as written (*e.g.*, name changes from divorce, IRA Custodian changes or recipient is deceased), and the Injured Customer or their lawful representative requests the re-issuance of a distribution check, supporting documentation must be provided to the Fund Administrator to support the requested change. The data submitted will be reviewed to determine the authenticity and propriety of the change request. Any properly documented change request that is accepted will result in the check being re-issued. No check will be re-issued unless the documentation submitted is accepted as proper.

The Fund Administrator shall file on a timely basis all required federal, state and local tax returns and estimated payments with respect to the Distribution Funds. Copies of all filings will be submitted to the Commission's Office of Financial Management and to the Associate Regional Director of the Northeast Regional Office. Tax payments, if any, shall be made in accordance with the provisions of the Commission's orders governing such payments.

The Fund Administrator shall file an accounting of the Distribution Funds during the first ten days of every calendar quarter to the Associate Regional Director pursuant to Rule 1105(f) of

the Rules.⁴ The quarterly reports will be issued until a final accounting is made to the staff of the Commission and approved by the Commission.

The Distribution Funds will be subject to an independent audit if the funds have not been entirely distributed by June 30, 2007, or such other date as ordered by the Commission. An independent auditor will be selected by the Fund Administrator and must be someone not unacceptable to the staff of the Commission. The independent auditor will audit the Distribution Funds and deliver a copy of the audit report directly to the Commission's Office of the Secretary, for approval by the Commission. The Fund Administrator will mail a copy of the audit report to the Associate Regional Director.

⁴ Some filings may occur more than 10 days after the close of the quarter due to the timing of the receipt of the statement from the Escrow Agent.