No. 22-646 9/13/2023

In the Supreme Court of the United States

SERGEY PUSTELNIK AND NATHAN FAYYER,

Petitioners,

v.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

PETITION FOR A WRIT OF CERTIORARI

NATHAN FAYYER
PETITIONER PRO SE
3535 S. OCEAN DR., APT 1102
HOLLYWOOD, FL 33019
(732) 266-7888
NATHAN@IAMSINGULARITY.NET

SERGEY PUSTELNIK
PETITIONER PRO SE
45 RIVER DR. S., APT 3105
JERSEY CITY, NJ 07310
(212) 961-6751
SERGE@ALUMNI.HARVARD.EDU

JANUARY 4, 2023

SUPREME COURT PRESS ♦ (888) 958-5705 ♦ BOSTON, MASSACHUSETTS

QUESTION PRESENTED

Whether scienter alone may satisfy the traditionally separate artificiality requirement to establish market manipulation?

PARTIES TO THE PROCEEDINGS

Petitioners

- Sergey Pustelnik
- Nathan Fayyer

Note: Mr. Fayyer was the sole owner and director of Vali Management Partners, dba Avalon FA, LTD. Mr. Pustelnik was an principal at Lek Securities Corporation. This petition is presented in their capacity as individuals.

Respondent

- U.S. Securities and Exchange Commission

LIST OF PROCEEDINGS

U.S. Court of Appeals for the Second Circuit

No. 21-453

United States Securities and Exchange Commission, *Plaintiff-Appellee,* v. Vali Management Partners, dba Avalon FA Ltd, Nathan Fayyer, and Sergey Pustelnik, aka Serge Pustelnik, *Defendants-Appellants*

Date of Final Judgment: June 15, 2022

U.S. District Court, Southern District of New York

No. 17-1789

Securities and Exchange Commission, *Plaintiff, v.* Lek Securities Corporation, Samuel Lek, Vali Management Partners dba Avalon FA Ltd, Nathan Fayyer, and Sergey Pustelnik, *Defendants.*

Date of Final Judgment: February 9, 2021

TABLE OF CONTENTS

TABLE OF CONTENTS – Continued

Page

APPENDIX TABLE OF CONTENTS

OPINIONS AND ORDERS

TABLE OF AUTHORITIES

PETITION FOR A WRIT OF CERTIORARI

Sergey Pustelnik, Nathan Fayyer, *Petitioners Pro Se*, respectfully petition this court for a writ of certiorari to review the judgment of the United States Circuit Court of Appeals for the Second Circuit.

OPINIONS BELOW

The Opinion of the United States Court of Appeals for the Second Circuit dated June 15, 2022, is included at App.1a-9a. The Amended Final Judgment of the U.S. District Court for the Southern District of New York, dated February 9, 2021 is included at App.10a. The post-trial Opinion of the district court, dated March 20, 2020 is included at App.20a-41a. These opinions and judgments were not designated for publication.

JURISDICTION

The court of appeals filed its opinion on June 15, 2022. (App.1a-9a). Petitioners did not seek rehearing. By letter of the Clerk dated November 9, 2022, Petitioners were provided 60 additional days to file this petition. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

CONSTITUTIONAL PROVISIONS INVOLVED

U.S. Const. amend. I

> Congress shall make no law . . . abridging the freedom of speech . . . .

STATEMENT OF THE CASE

This case involves claims of securities market manipulation. It was tried by a jury, Hon. Denise Cote, presiding, and the jury ruled in favor of the Securities and Exchange Commission. The district court's opinion accompanying its original judgment is found at *SEC v. Lek Secs. Corp.*, ___ F.Supp.3d ___, 2020 WL 1316911 (S.D.N.Y. Mar. 20, 2020). App.20a. Defendants timely appealed and the court of appeals filed its opinion on June 15, 2022. App.1a-9a. The appellate court found for the *SEC*. Petitioners did not seek rehearing.

A. Factual Background

1. Appellants

Sergey Pustelnik and Nathan Fayyer are U.S. citizens. From 2010-16, Avalon FA LTD ("Avalon"), was a foreign trading firm. [ECF.256:3-4]. Mr. Fayyer was Avalon's sole disclosed owner and director. [ECF.256:2]. Avalon traded through former defendant Lek Securities Corporation ("LSC"), a domestic broker-dealer. [ECF. 256:3]. From March 2011 until January 2015, Mr. Pustelnik was a Registered Representative at LSC handling the Avalon account. *See* [ECF.256:3]. The Securities and Exchange Commission ("Commission"), alleged that Mr. Pustelnik co-owned Avalon. The Commission did not allege that either Mr. Fayyer or Mr. Pustelnik engaged in any trading themselves; it alleged only that some Avalon traders did so through Avalon. *See* [ECF.1: 18-19]. Avalon had agreements with, and sub-accounts for, thousands of traders, several hundred of whom might trade on any particular day. [ECF.256:2-3]; [ECF.219:4].

2. Modern Trading

Today's stock markets are characterized by automated algorithms, high speeds, trading volumes, and order-cancellation rates. [ECF.219:5]. Traders submit orders—either "bids" to buy stocks or "offers" to sell stocks—through broker-dealers that pass them to dozens of exchanges for potential execution. *See* [ECF. 219:5]. A trader's "limit order" is its firm commitment, until canceled, to buy or sell up to a specified number of shares at a quoted price. [ECF.219:5].

Each exchange matches posted orders with incoming orders at the same price. [ECF.219:5]. Orders execute only if other traders place matching orders. [ECF.219:5]. An order remains open and executable until it is either canceled or matched. [ECF.219:5]. Accordingly, a trader cannot prevent a posted order from executing unless the trader takes positive steps, such as by using computer algorithms to cancel or change orders whenever they face execution risk. *See* [ECF.219:5].

Options markets work similarly. [ECF.219:6]. Unlike stocks, however, options are "derivative" securities—they are firm offers to buy or sell an underlying stock at a specific "strike price" by a specific time.

[ECF.219:7]. An options contract's value is derived partly from the underlying stock's price, since whether the option is valuable turns on whether the strike price is favorable compared to the stock's actual price. [ECF. 219:7-8]. An option to buy is generally worth more as a stock price rises, while an option to sell is worth more as the stock price falls. [ECF.219:8]. Options pricing is inherently speculative, since an option's price incorporates what traders believe a stock may be worth later. [ECF.547:98-99].

Day-traders and market makers submit orders to exchanges using computer software that allows them to quickly place and cancel orders. [ECF.219:5-6]. Day-traders typically take and close positions within one day. *See* [ECF.541:16-17]. Day-trading "market-makers" maintain orders on both sides of the market to provide liquidity to other investors, and those market-makers profit partly by "capturing the spread" —*i.e.*, by regularly executing sell and buy orders in the same stocks to profit from the difference between bid and offer prices. [ECF.541:104]. In short, market participants such as market makers and day traders profit from micro-fluctuations in the securities price based on current supply and demand at any instance as opposed to fundamental changes in value.

For sophisticated market participants such as day-traders and market makers, the exchanges offer dozens of special order types, or instructions that the exchange will perform, such as so-called 'hidden' and 'iceberg' orders. Hidden orders are part of the exchange's book but are not displayed to any other market participants but are eligible for execution. Iceberg orders display only a chosen amount by the trader while the exchange hides the rest. Such orders give rise to a distinction the Securities and Exchange Commission labeled as "Loud" and "Quiet" orders indicating whether the order and its quantity is displayed to other market participants. These special order types are available to all market participants.

While all market participants that place limit orders necessarily provide liquidity to the market as a whole, every participant's intent is to compete, win, and profit.

3. Relevant Trading Strategies of Avalon Traders

This case involves two trading strategies: a so-called "layering" strategy and a so-called "liquidity arbitrage" (or "cross-market") strategy. Both involved open-market orders and trades that were all facially lawful and capable of execution.

a. The "Layering" Strategy

The layering strategy involved placing both buy and sell orders for a given stock. The buy and sell orders could be reversed without changing the strategy. An Avalon trader might place multiple orders to buy in several quantities at various prices (what the Commission called "Loud-Side" orders) while also placing one or more sell hidden orders for the same stock at a different, higher price (what the Commission called "Quiet-Side" orders). [ECF.256:6]. Some of the orders on both sides of the market were typically at or inside the best bids or offers available when Avalon traders placed their orders. [ECF.219-63:13-14].

By offering better buy and sell prices, Avalon traders could capture a narrower spread than larger market-makers typically maintained. Other market participants may react to the new prices available in the market. The strategy has economic risk because another trader could execute on the buy orders while the sell order remains unexecuted, so that the Avalon trader will have bought at a price above what was available before he placed his orders at market-improving prices. The Commission alleged below that such Loud-Side orders were unlawfully manipulative because the Avalon traders did not "intend[]" them to execute. *E.g.*, [ECF.574:5]. Yet, those traders were indisputably subjected to market risk, since many Loud-Side orders were actually executed. [ECF.250:36]. Since all of the trading consisted of legitimate, executable bids and offers, the traders had no control over which would execute. Thus, the allegation that the Avalon traders did not "intend" for their Loud-Side orders to execute was, in reality, an assertion that they hoped other market participants would not accept them and hoped that other market participants would react a certain way, and not be incentivized to accept the Quiet-Side bid or offer instead.

b. The "Liquidity Arbitrage" Strategy

The "liquidity arbitrage" strategy involved trading in stocks and related options. Avalon traders would trade stock to test its liquidity by measuring its price response to moderate trading. If the stock appeared illiquid compared to the amount of options available for that stock, the traders would "sweep" the options by buying them in bulk. *See* [ECF.218:19, 34-35]. Avalon traders did this based on their prediction that simply by accepting the options-market-makers' offers, those other traders would be faced with a substantial position based on option quantities they had perhaps had not hoped or intended to sell. The options-market-makers would therefore likely "hedge" their new position by buying or selling large amounts of the underlying stock, which, being illiquid, would naturally move in a direction favorable to the Avalon traders' options position. *See* [ECF.218:19, 34-35].

In 1973, when the *Black-Scholes* options pricing model was developed and employed for the first time, it allowed those that used it to generate profits in arbitraging offered option prices and their calculated value according to this model. As a result of all arbitrage, this pricing inefficiency has been all but depleted.

The liquidity arbitrage strategy uses a different, *Pustelnik-Fayyer* model, which does not ignore liquidity[1] of stocks and options in determining value based on the most basic economic principle of all: supply and demand. The secret sauce is that if a derivative instrument is substantially more liquid than the underlying security, a liquidity adjusted arbitrage opportunity may exist.

The strategy involved considerable risk as traders would acquire extremely large un-hedged options positions in the open market, relying on their estimations of liquidity discovered by open market transactions, and the expectation that those who offered those options would also be proportionally unhedged and react by voluntarily immediately hedging using the underlying stock. Thus, affecting the price in a favorable direction to the trader.

---

[1] The *Black-Sholes* model takes into account only the strike price of an option, the current stock price, the time to expiration, the risk-free rate, and the volatility. It ignores the current supply and demand.

4. Congressional Action

In 2010, Congress enacted the Dodd-Frank Act in part to "promote the financial stability of the United States by improving accountability and transparency in the financial system . . . " 7 U.S.C. § 6c(a)(5)(C).

Through the Dodd-Frank Act, Congress expressly prohibited a version of layering (called "spoofing") in commodities transactions only. *See* 7 U.S.C. § 6c(a)(5)(C). But although Dodd-Frank also extensively amended the securities laws, Congress added no similar prohibition for securities trading and securities market transactions. *See Russello v. United States*, 464 U.S. 16, 23 (1983). ("When Congress includes language in one provision but omits it from another provision of the same act, the exclusion is generally presumed" to be intentional"). Moreover, even in the commodities context, layering does not violate more general prohibitions unless the defendant artificially rigs the market. For example, in *United States v. Coscia*, 866 F.3d 782 (7th Cir. 2017), the trader used an algorithm that <u>prevented</u> any significant execution of decoy orders. The algorithm would cancel those orders within milliseconds or if they began to execute, and would "actively avoid[] the completion of large orders." *Id.* at 797. Thus, the *Coscia* court contrasted that case with others—similar to this one—in which bids alleged to be artificially high "<u>were actually bids</u>" that were not misleading because the defendants honored them when they were accepted. *See id.* at 797 n.64 (emphasis added).

5. Regulators' Actions Before This Case

The term "layering" has long been used to describe non-manipulative trading strategies such as passive market making. [ECF.539:90]; [ECF.541:182]. "Layering the book" meant that traders would place a series of orders at different prices, *i.e.* in "layers". *See, e.g.*, [ECF.219-41:3-4]. Only recently has "layering" referred to a species of manipulation, but there is no statute, regulation, or rule applicable to stocks that define manipulative layering. *See* [ECF.543:55]; [ECF.547:152]. Likewise, regulators and exchanges have described it in contradictory terms or so generally that the only consistent element involves orders a trader does not "intend" someone else to execute. *See* [ECF.1:11].

Regulators have looked at many factors to determine in their own view, what is allegedly manipulative layering. One exchange operator required substantial numbers of orders placed on one side of the market and a corresponding change in the National Best Bid and Offer ("NBBO") quote. [ECF.219-150:2]. The Financial Industry Regulatory Authority ("FINRA"), has used a different approach incorporating available shares, the "size of the spread," the depth of market, shares by price level, and volume by price level. [ECF.219-26:14]. Given this confusion, appellants' primary broker-dealer, LSC, sought input from regulators and exchanges regarding trades the regulators would consider manipulative layering instead of mere passive market-making. [ECF.219:79, 88-89]. But the regulators and exchanges refused to provide concrete criteria. *E.g.*, [ECF.219-21:3]; [ECF.219-18:12].

In 2012, FINRA expressed concerns to LSC regarding Avalon's liquidity arbitrage strategy. [ECF.219: 99-100]. LSC consulted with counsel and appellants and explained to FINRA that the strategy was actually a form of arbitrage that traded on options-market-makers' decisions to quote too much liquidity. [ECF. 219-165:4-5]. LSC asked FINRA whether it could share any additional information "suggesting that Avalon has placed inaccurate information into the marketplace." [ECF.219-165:4-5]. There is no evidence that FINRA ever provided any information at all.

B. Procedural History.

1. The Commission's Claims.

In 2017, the Commission filed its complaint against appellants and the Lek Defendants. [ECF.1:46-55]. Although the claims included ones for direct liability, control-person liability, and aiding and abetting, central to each was the Commission's contention that the Avalon traders' layering and liquidity arbitrage strategies unlawfully manipulated the securities markets.

The Commission's claims focused on open-market actions wholly lawful in themselves that purportedly became manipulative based solely on the traders' subjective intent. The Commission's "layering" theory involved the placement of a sequence of orders on one side—*e.g.*, the "buy" side—as well as a narrower, and smaller set of orders on the other side—*e.g.*, the "sell" side—for the same stock. No law, rule or regulation prevents placement of trades in that pattern. *See* [ECF. 218:15-16]. In the Commission's view, however, this trading was manipulative if the trader "intend[ed]" for only the "Quiet-Side" orders to execute, since that intent renders the executable, open-market "Loud-Side" orders purportedly "fake." [ECF.535:60-61]; [ECF.1:11-12].

But if the trader offers the same trades in the same sequence with the intent to capture the spread and profit on the difference between its buy and sell orders, the trading would simply be market-making. *See* [ECF.541:104]; *see also* [ECF.89:21-22]. Thus, under the Commission's theory, the trader's subjective intent to capture the spread would render this manipulative layering harmless market-making, even though the trading was otherwise identical. As even the Commission's own "layering" expert expressly admitted at trial, the Loud-Side orders were "not literally fake," because "they're orders that are sent to the market" that "could have traded and . . . sometimes did." [ECF. 539:185]; [ECF.541:209-210]; [ECF.543:72].

Similarly, the so-called "cross-market" or "liquidity arbitrage" strategy involved nothing but open-market executions with unaffiliated parties distinguishable from lawful arbitrage based only on the traders' purported intent. Arbitrage realizes profit from a mismatch in the value of an asset across different markets that other market participants have not recognized. [ECF.550:53]. The "cross-market" strategy arbitraged a mismatch in the liquidity between options and equities markets that arose from options-market-makers' decisions to quote too many options for illiquid underlying stocks. [ECF.218:19]; [ECF.404:17]. The initial stock trades gauged the underlying stock's liquidity, and then the options sweep capitalized on the options-market-makers' offers that were, in effect, mispriced considering the illiquidity of the stock. [ECF.218:36]; [ECF.404:15-17]. Capitalizing on another market participant's poor decisions is not manipulation. Because arbitrage is well-recognized as a legitimate—and even market-improving—practice, whether the "cross-market" strategy was manipulative as the Commission claimed, thus, based on whether Avalon traders were subjectively hoping to "manipulate" prices or were instead merely capitalizing on the options-market-makers' own, poor decisions to offer too many options for certain stocks. *See* [ECF.1:33-35]; [ECF.404:16]. If the traders' intent (hope) was that the stock trades would affect options prices through the option-market-makers' actions, the strategy would be manipulative under the Commission's theory; but if their intent was simply to capitalize on an ill-advised glut of options, it would not be.

2. Pretrial Proceedings and Trial

The district court denied dismissal and summary judgment. In relevant part, the court held that the Commission's allegations survived dismissal because, in the court's view, "manipulative conduct [that] appear[s] perfectly legal on its face" may nonetheless be unlawful manipulation based entirely on a defendant's "scienter"—its subjective intent. [ECF.101:28] (*ATSI Comm'cns, Inc. v. Shaar Fund, Ltd.*, 493 F.3d 87, 102 (2d Cir. 2007). On summary judgment, the district court reached the same conclusion under the same logic. [ECF.351:5-6].

The court's summary judgment denial also rested in part on its treatment of the parties' expert witnesses. The Commission proffered two: Terrence Hendershott to support its layering claims, and Neil Pearson to support its liquidity arbitrage claims. *See* [ECF.349:5-13, 21-31]. Hendershott's core opinion was that Avalon traders had engaged in trading "consistent with layering" roughly 675,000 times, based on criteria he developed solely for this case to identify "layering loops," a term he also developed specifically for this case. [ECF.210-1:12-14]. Pearson similarly opined that Avalon traders had used "cross-market loops," a term he likewise coined for this case, based on a handful of admittedly "crude" criteria also developed for this case. [ECF.213-1:24-26]. Both then performed "further analyses" to determine whether their identified "loops" were consistent with manipulation. [ECF.210-1:14-19]; [ECF.210-5:8-10]; [ECF.213-1:27-38]; [ECF.213-8:22-24]. The Lek Defendants sought to exclude both experts as unreliable. *See* [ECF.208]; [ECF.211]. The district court denied both motions, and later denied appellants' motions in limine raised on the same bases. [ECF.349]; [ECF.560:24, 29, 38].

But the district court largely granted the Commission's motions to exclude all of the rebuttal experts' appellants and the Lek Defendants proffered. While the court curtly accepted the Commission's experts as reliable, [ECF.349:40-47], it found the rebuttal opinions mostly unreliable even though they focused on applying the Commission's own legal theory to its own cited examples of purportedly manipulative trades. *See* [ECF.349:48-79]; [ECF.350].

After the Lek Defendants settled, [ECF.466:1-7]; [ECF.467], appellants proceeded to trial. The district court's decisions excluding appellants' experts, [ECF. 349:70-79]; [ECF.351], meant that appellants were limited to cross-examining the Commission's experts, who presented the only concrete testimony identifying appellants' purportedly manipulative trading. And while Mr. Fayyer and Mr. Pustelnik testified on their own behalf, neither was even alleged to have engaged in any of the accused trading themselves and the Commission proffered no Avalon traders as witnesses. *See* [ECF.1:18-19]; [ECF.479:9-17].

The district court later denied appellants' objection to a key jury instruction. Appellants were found liable for various violations, including engaging in "manipulative" practices in violation of Section 10(b) of the

Exchange Act and its rules. *See* 15 U.S.C. § 78j; 17 C.F.R. § 240.10b-5; [ECF.527]. But all the claims turned on whether the two accused trading strategies were manipulative, and that analysis required the Commission to prove appellants were responsible for a "manipulative act." *See* [ECF.526-1:9]; [ECF.556:103-104]. The district court therefore incorporated its own definition of a "manipulative act" for the Section 10(b) claims, [ECF.526-1:14-15], into the instructions for each of the other claims submitted to the jury.

Crucially, the court instructed the jury that it could find a "manipulative act" based solely on a finding of "scienter," *i.e.*, an "intent to manipulate the securities market," [ECF.556:107], even when the act consists entirely of otherwise legitimate open-market trades. *Id.* Appellants objected, arguing that this instruction "conflates the two separate elements" of manipulation <u>and</u> scienter and that "manipulation can[not] be shown simply if the defendant intends to "manipulate the market." Rather, the Commission "must also show the injection of false information that results in artificial market impact." [ECF.554:4]. But the district court refused to alter the instruction. [ECF.554:162].

The jury found for the Commission on all counts. [ECF.527]. The district court then entered a final judgment enjoining appellants from violating securities laws, holding them jointly and severally liable for disgorgement of $4,627,314 (including interest), and imposing a civil penalty of $5,000,000 on each defendant, for a total award of $19,627,314. [ECF.580].

3. Initial Appeal and Remand

Appellants appealed that judgment to the United States Court of Appeals for the Second Circuit, but the

Commission—without cross-appealing—immediately sought a remand. It argued that *Liu v. SEC*, 140 S.Ct. 1936 (2020), called its disgorgement award into question, such that the district court should reconsider it. *Mot. to Remand, SEC v. Lek Securities Corp. ("Lek I")*, No. 20-1854 (2d Cir. July 24, 2020). The United States Court of Appeals for the Second Circuit, then remanded "for a determination of whether [the district court's] judgment in this case is consistent with [Liu], and, if appropriate, entry of an amended judgment." Order, *Lek I* (2d Cir. Nov. 20, 2020).

On remand, the Commission did not defend the disgorgement award and instead sought only to increase the civil penalties—an issue that was not the subject either of appellants' initial appeal or the Appellate Court's limited remand order disposing of it. [ECF. 589:1-2, 5-9]. The district court granted that request and entered an amended final order eliminating the disgorgement remedy completely but increasing the penalties against each appellant to $7.5 million, for a total award of $22.5 million. [ECF.593]. Thus, through a remand of appellants' appeal to correct a legal error the Commission itself had created, the district court imposed total penalties that were larger than the initial.

On appeal, the *SEC* prevailed on all issues.

REASONS FOR GRANTING THE PETITION

Free markets require regulatory certainty.

The layering strategy involved placing bids and offers on securities exchanges, while the liquidity arbitrage strategy involved open market executions in options and securities markets. The ultimate test for manipulation for both of these strategies became whether the traders intended to affect the price in a certain way that would cause other market participants to voluntarily react in a favorable way to the trader using nothing else but otherwise legitimate market orders.

This new scienter-only standard is applicable to all types of activity in securities and options markets by virtually every type of investor.

Finally, orders communicated in the public markets are free speech that is protected by the First Amendment of the United States Constitution. If scienter, a culpable state of mind, is the only element that differentiates legitimate free market activity from unlawful manipulation, then any participant may be impeached for wishing and hoping for a favorable result for their orders.[2] Without more, free speech in the form of public market orders cannot be restricted. The current standard does exactly that.

---

2 It also immediately exposes to liability all market participants employing exchange order types such as "hidden" and "iceberg" orders whose only purpose is to understate the actual demand for a security. It also implicates every exchange offering and honoring such order instructions.

CONCLUSION

For the foregoing reasons, appellants respectfully request that this Court issue a writ of certiorari to review the judgment of the United States Circuit Court of Appeals for the Second Circuit.

Respectfully submitted,

SERGEY PUSTELNIK
PETITIONER PRO SE
45 RIVER DR. S. APT 3105
JERSEY CITY, NJ 07310
(212) 961-6751
SERGE@ALUMNI.HARVARD.EDU

NATHAN FAYYER
PETITIONER PRO SE
3535 S. OCEAN DR. APT 1102
HOLLYWOOD, FL 33019
(732) 266-7888
NATHAN@IAMSINGULARITY.NET

JANUARY 4, 2023

BLANK PAGE

APPENDIX TABLE OF CONTENTS

Opinions and Orders