SUMMARY ORDER OF THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT (JUNE 15, 2022)

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

NO PRECEDENTIAL EFFECT

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.**

No. 21-453

Appeal from a judgment of the United States District Court for the Southern District of New York (Cote, J.).

Before: Rosemary S. POOLER, Richard C. WESLEY, MYRNA PÉREZ, Circuit Judges.

* The Clerk of the Court is respectfully directed to amend the caption as set forth above.

UPON DUE CONSIDERATION, IT IS HEREBY ORDERED, ADJUDGED, AND DECREED that the order of the district court entered on February 9, 2021, is AFFIRMED.

Defendants-Appellants Vali Management Partners, DBA Avalon FA LTD ("Avalon"), Nathan Fayyer, and Sergey Pustelnik, AKA Serge Pustelnik (together, "Defendants") appeal a final judgment ordering each to pay $7.5 million in civil penalties following a jury verdict finding Defendants violated several anti-fraud and anti-manipulation provisions of the Securities Act of 1933 ("Securities Act") and the Securities Exchange Act of 1934 ("Exchange Act").[1]

Defendants argue the district court erred in three ways: first, in its jury instructions on market manipulation; second, by admitting the testimony of the SEC's two expert witnesses, Terrence Hendershott and Neil Pearson, while excluding Defendants' rebuttal expert witness, Haim Bodek's, and third, in awarding excessive and improper civil penalties. We reject all three arguments, and accordingly affirm the district court's judgment.

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[1] The jury found that each Defendant violated Section 10(b) of the Exchange Act, 15 U.S.C. § 78j, and Rule 10b-5(a), (c), 17 C.F.R. § 240.10b-5(a), (c), and Section 17(a)(1) and (3) of the Securities Act, 15 U.S.C. § 77q(a)(1), (3). The jury also found that Avalon and Fayyer violated Section 9(a)(2) of the Exchange Act, 15 U.S.C. § 78i(a)(2), (f), and that Fayyer and Pustelnik violated Section 20(e) of the Exchange Act, 15 U.S.C. §§ 78t(e), 78u(d)(1), (3), and Section 15(b) of the Securities Act, 15 U.S.C. §§ 77o(b), 77t(b), (d). Finally, the jury found that each Defendant was liable as a control person under Section 20(a) of Exchange Act, 15 U.S.C. § 78t(a).

I. Jury Instruction

We review a claim of error in jury instructions de novo, viewing the challenged instruction in the context of the jury charge as a whole. *See Warren v. Pataki*, 823 F.3d 125, 137 (2d Cir. 2016). "A jury instruction is erroneous if it misleads the jury as to the correct legal standard or does not adequately inform the jury on the law." *Velez v. City of New York*, 730 F.3d 128, 134 (2d Cir. 2013) (internal quotation marks omitted). The party challenging a jury instruction bears the "burden of showing that [its]requested [change to the jury instruction] accurately represented the law in every respect." *United States v. Dove*, 916 F.2d 41, 45 (2d Cir. 1990) (internal quotation marks omitted).

The district court's jury instruction defining "manipulative act," included that "[i]n some cases, a defendant's 'scienter,' that is, a defendant's intent to manipulate the securities market, is all that distinguishes legitimate trading from manipulative trading." Joint App'x 811.

The word "manipulative" is "virtually a term of art when used in connection with securities markets," and "connotes intentional or willful conduct designed to deceive or defraud investors by controlling or artificially affecting the price of securities." *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 199 (1976). In using the term "manipulation," there is "[n]o doubt" that "Congress meant to prohibit the full range of ingenious devices that might be used to manipulate securities prices." *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462, 477 (1977); *see also Gurary v. Winehouse*, 190 F.3d 37, 45 (2d Cir. 1999) ("The gravamen of manipulation is deception of investors into believing that prices at which they purchase and sell securities are determined

by the natural interplay of supply and demand, not rigged by manipulators."). We have therefore previously explained that "[o]penmarket transactions that are not inherently manipulative may constitute manipulative activity when accompanied by manipulative intent." *Set Capital LLC v. Credit Suisse Grp., A.G.*, 996 F.3d 64, 77 (2d Cir. 2021). This is because "in some cases"—as here—"scienter is the only factor that distinguishes legitimate trading from improper manipulation." *ATSI Commc'ns, Inc. v. Shaar Fund, Ltd.*, 493 F.3d 87, 102 (2d Cir. 2007); *see also Koch v. SEC*, 793 F.3d 147, 153–54 (D.C. Cir. 2015), *cert. denied* 577 U.S. 1235 (2016) ("[I]ntent . . . is all that must accompany manipulative conduct to prove a violation of the Exchange Act and its implementing regulations."). The district court's instruction was thus consistent with our articulation of market manipulation, and accurately informed the jury on the law.[2] *See Velez*, 730 F.3d at 134.

Equally unavailing is Defendants' contention that the charged instruction was erroneous because it did not include that the SEC "must also show the injection of false information . . . result[ed] in artificial market impact." Special App'x 88. We have found certain openmarket transactions "may constitute manipulative

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[2] Defendants also contend that the instruction was erroneous because it allowed the jury to find Defendants liable solely on the "subjective hope" that the market would move in a particular direction. But the jury instruction permitted no such finding, for the charge clearly instructed that to find Defendants liable for manipulative acts under the Exchange Act, the Defendants must have engaged in an act that "sends a false pricing signal to the market or creates a false impression of supply and demand" with "scienter," or the "intent to deceive, manipulate, or defraud." Joint App'x 810, 813.

activity when accompanied by manipulative intent," but have not required a showing of artificial market impact resulting from the injection of false information before concluding certain acts are manipulative under federal securities laws. *Set Capital*, 996 F.3d at 77. Defendants have not met their burden of showing their requested language accurately represents the law in every respect. *See Dove*, 916 F.2d at 45.

II. Expert Testimony

We review Defendants' challenge to the admissibility of expert testimony under a "highly deferential" abuse of discretion standard, sustaining the district court's decision unless it is "manifestly erroneous." *Restivo v. Hessemann*, 846 F.3d 547, 575 (2d Cir. 2017) (internal quotation marks omitted). The abuse of discretion standard "applies as much to the trial court's decisions about how to determine reliability as to its ultimate conclusion." *Kumho Tire Co. v. Carmichael*, 526 U.S. 137, 152 (1999). For expert testimony to be admissible, it must be "relevant" and "rest[] on a reliable foundation." *United States v. Williams*, 506 F.3d 151, 160 (2d Cir. 2007) (quoting *Daubert v. Merrell Dow Pharm., Inc.*, 509 U.S. 579, 597 (1993)); *see also* Fed. R. Evid. 702.[3] The party proffering the proposed expert evidence bears the burden of establishing its admissibility

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[3] "A witness who is qualified as an expert by knowledge, skill, experience, training, or education may testify in the form of an opinion or otherwise if:

(a) the expert's scientific, technical, or other specialized knowledge will help the trier of fact to understand the evidence or to determine a fact in issue;

(b) the testimony is based on sufficient facts or data;

by a preponderance of the evidence. *Williams*, 506 F.3d at 160. Contentions that an expert's assumptions are unfounded or "gaps or inconsistencies in the reasoning leading to the expert's opinion go to the weight of the evidence, not to its admissibility." *Restivo*, 846 F.3d at 577 (alterations and internal quotation marks omitted).

The district court appropriately concluded that the SEC's expert witnesses' testimony was relevant and reliable, and thus admissible. *See SEC v. Lek Sec. Corp.*, 370 F.Supp.3d 384, 404–07 (S.D.N.Y. 2019). It specifically found that Hendershott's methodology was a "conservative construct with objectively-defined steps that can be applied by any expert to any body of trades," that it "spr[ang] directly from th[e] well-accepted description of the phenomenon of layering," and that it "falls comfortably within th[e] parameter" of "intellectual rigor that characterizes the practice of an expert in the relevant field." *Id.* at 405. It further found that Pearson's "analysis was objective, detailed, well-supported by reference to academic research, and thorough" and that he was "an expert in the field . . . and used a commonly employed method for identifying and analyzing trading strategies in that field." *Id.* at 406. Upon a review of the record, we do not find the district court committed any manifest error in admitting this testimony.

(c) the testimony is the product of reliable principles and methods; and

(d) the expert has reliably applied the principles and methods to the facts of the case."

Fed. R. Evid. 702.

The district court found that the testimony of Defendants' expert witness, Haim Bodek, was "difficult to understand," that "substantial portions . . . [we]re unintelligible," and that "much of Bodek's report appears to be little more than the use of labels and jargon to confuse and to create an appearance of legitimacy." *Id.* at 416. In excluding his testimony, the district court concluded that Bodek's opinion "provides little or no analysis," that he had a "practice of making assertions without any analysis to support them," and that his opinions "which appear to lie at the heart of his analysis rest on faulty logic and would mislead the jury if admitted." *Id.* at 416–17. We might have reached a different conclusion if we were determining in the first instance whether to exclude the entirety of Bodek's testimony. But we cannot say that the district court abused its discretion or acted outside the range of permissible decisions in excluding Bodek's testimony. *See, e.g.*, *Restivo*, 846 F.3d at 575.

III. Civil Penalties

"[O]nce the district court has found federal securities law violations, it has broad equitable power to fashion appropriate remedies." *SEC v. Fowler*, 6 F.4th 255, 265 (2d Cir. 2021) (quoting *SEC v. Sourlis*, 851 F.3d 139, 146 (2d Cir. 2016)); *see also* 15 U.S.C. §§ 77t(d)(2), 78u(d)(3); *SEC v. Rajaratnam*, 918 F.3d 36, 44–45 (2d Cir. 2019) (noting deterrence function of civil penalties). We review a choice of remedies for abuse of discretion and will not "second-guess" the district court where it "adequately explain[s]" how it decided to fashion its remedy. *Fowler*, 6 F.4th at 265. "Under this standard, we will reverse only if we have a definite and firm conviction that the court below committed a clear error of judgment in the conclusion that it reached

upon a weighing of the relevant factors." *Rajaratnam*, 918 F.3d at 41 (quoting *SEC v. Bankosky*, 716 F.3d 45, 47 (2d Cir. 2013) (per curiam)).

The relevant statutes set a maximum penalty "for each . . . violation" that involves "fraud, deceit, [or] manipulation," *see* 15 U.S.C. §§ 77t(d)(2)(C); 78u(d)(3)(B)(iii), but the term "'violation' is not defined by the statutory scheme," *Fowler*, 6 F.4th at 264. In instances where the "per-trade penalty would be so substantial that [the defendant] would not be reasonably capable of paying it," fashioning a remedy to count the number of violations other than by the number of trades to "best effectuate[] the purposes of the statute" is not an abuse of discretion. *Id.* at 264– 65 (internal citations and quotation marks omitted) (affirming civil penalties assessed on a per-victim basis because the district court was able to identify conduct aimed at each individual victim); *see also SEC v. Pentagon Cap. Mgmt. PLC*, 725 F.3d 279, 288 n.7 (2d Cir. 2013) (finding no error in the district court's calculating each trade as a separate violation).

The district court acted well within its discretion in assessing civil penalties.[4] *See id.* The district court adequately explained how it calculated the number of violations and why it rejected other calculations,

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[4] We also conclude that the district court did not abuse its discretion in entering an amended judgment excising the disgorgement award and increasing civil penalties to $7.5 million per defendant. The district court acted within this Court's mandate to determine whether its "judgment . . . is consistent with [*Liu v. SEC*, 140 S. Ct. 1936 (2020)], and, if appropriate, entry of an amended judgment." Order, *SEC v. Yali Management Partners*, No. 20-1854, Dkt. 64 (2d Cir. Nov. 20, 2020); *United States v. Ben Zvi*, 242 F.3d 89, 95 (2d Cir. 2001).

noting that a single penalty for each of the two charged manipulative trading schemes "would deliver grossly inadequate deterrence for the scope of [the Defendants'] illegal activity," and that counting each transaction or series of transactions as a violation would produce a "staggering penalty" "[i]n light of the millions of transactions at issue." *SEC v. Lek Sec. Corp.*, ___ F.Supp.3d ___, No. 17-1789 (DLC), 2020 WL 1316911, at *6–9 (S.D.N.Y. Mar 20, 2020).

We have considered all of Defendants' remaining arguments and conclude they are without merit. For the foregoing reasons, we AFFIRM the order of the district court.

FOR THE COURT:

/s/ Catherine O'Hagan Wolfe
Clerk of Court

AMENDED FINAL JUDGMENT AGAINST DEFENDANTS AVALON FA LTD, NATHAN FAYYER, AND SERGEY PUSTELNIK (FEBRUARY 9, 2021)

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

v.

LEK SECURITIES CORPORATION, SAMUEL LEK, VALI MANAGEMENT PARTNERS D/B/A AVALON FA LTD, NATHAN FAYYER, AND SERGEY PUSTELNIK A/K/A SERGE PUSTELNIK,

Defendants.

Case No. 17-CV-1789 (DLC)

Before: DENISE COTE,
United States District Judge.

This matter having come before the Court following trial by jury, and the jury unanimously having found in favor of Plaintiff Securities and Exchange Commission ("SEC" or the "Commission") and against Defendants Vali Management Partners dba Avalon FA Ltd ("Avalon"), Nathan Fayyer ("Fayyer"), and Sergey Pustelnik a/k/a Serge Pustelnik ("Pustelnik") on

liability; and the Court having considered the evidence and the parties' submissions regarding remedies, and the record herein; the original final judgment having been appealed to the U.S. Court of Appeals for the Second Circuit and this case having been remanded to this Court; and this Court having considered the further submissions of the parties, the Court hereby enters this Amended Final Judgment in favor of the SEC and against each of the said Defendants.

I.

IT IS HEREBY ORDERED, ADJUDGED, AND DECREED that Defendants Avalon, Fayyer, and Pustelnik each are permanently restrained and enjoined from violating Section 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act") [15 U.S.C. § 78j(b)] and Rule 10b5 promulgated thereunder [17 C.F.R. § 240.10b-5], directly or indirectly, by using any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange, in connection with the purchase or sale of any security:

(a) to employ any device, scheme, or artifice to defraud;

(b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; or

(c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person.

IT IS FURTHER ORDERED, ADJUDGED, AND DECREED that, as provided in

Federal Rule of Civil Procedure 65(d)(2), the foregoing paragraph also binds the following who receive actual notice of this Amended Final Judgment by personal service or otherwise: (a) Each of said Defendant's officers, agents, servants, employees, and attorneys; and (b) other persons in active concert or participation with any Defendant or with anyone described in (a).

II.

IT IS HEREBY FURTHER ORDERED, ADJUDGED, AND DECREED that

Defendants Avalon, Fayyer, and Pustelnik each are permanently restrained and enjoined from violating Section 17(a) of the Securities Act of 1933 (the "Securities Act") [15 U.S.C. § 77q(a)] in the offer or sale of any security by the use of any means or instruments of transportation or communication in interstate commerce or by use of the mails, directly or indirectly:

(a) to employ any device, scheme, or artifice to defraud;

(b) to obtain money or property by means of any untrue statement of a material fact or any omission of a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; or

(c) to engage in any transaction, practice, or course of business which operates or would

operate as a fraud or deceit upon the purchaser.

IT IS FURTHER ORDERED, ADJUDGED, AND DECREED that, as provided in

Federal Rule of Civil Procedure 65(d)(2), the foregoing paragraph also binds the following who receive actual notice of this Amended Final Judgment by personal service or otherwise: (a) Each of said Defendant's officers, agents, servants, employees, and attorneys; and (b) other persons in active concert or participation with any Defendant or with anyone described in (a).

III.

IT IS HEREBY FURTHER ORDERED, ADJUDGED, AND DECREED that

Defendants Avalon, Fayyer, and Pustelnik each are permanently restrained and enjoined from violating Section 9(a)(2) of the Exchange Act [15 U.S.C. § 78i (a)(2)], directly or indirectly, by the use of the mails or any means or instrumentality of interstate commerce, or of any facility of any national securities exchange, or for any member of a national securities exchange to:

effect, alone or with one (1) or more other persons, a series of transactions in any security registered on a national securities exchange, any security not so registered, or in connection with any security-based swap or security-based swap agreement with respect to such security creating actual or apparent active trading in such security, or raising or depressing the price of such security, for the purpose of inducing the purchase or sale of such security by others.

IT IS FURTHER ORDERED, ADJUDGED, AND DECREED that, as provided in

Federal Rule of Civil Procedure 65(d)(2), the foregoing paragraph also binds the following who receive actual notice of this Amended Final Judgment by personal service or otherwise: (a) Each of said Defendant's officers, agents, servants, employees, and attorneys; and (b) other persons in active concert or participation with any Defendant or with anyone described in (a).

IV.

IT IS FURTHER ORDERED, ADJUDGED, AND DECREED that each of Defendants Avalon, Fayyer, and Pustelnik is liable for a civil penalty in the amount of $7,500,000 pursuant to Section 20(d) of the Securities Act [15 U.S.C. § 77t(d)] and Section 21(d)(3) of the Exchange Act [15 U.S.C. § 78u(d)(3)].

The SEC has already collected $5,283,598.61 from Avalon. This amount shall be applied towards the civil penalty ordered herein against Avalon, leaving $2,216,401.39 owing from Avalon for the civil penalty ordered against it. Avalon shall satisfy this obligation by paying $2,216,401.39 to the Securities and Exchange Commission within 30 days after entry of this Amended Final Judgment. Defendants Fayyer and Pustelnik each shall satisfy their obligations under this section by each paying $7,500,000 to the Securities and Exchange Commission within 30 days after entry of this Amended Final Judgment.

Defendants Avalon, Fayyer, and Pustelnik may transmit payment electronically to the Commission,

which will provide detailed ACH transfer/Fedwire instructions upon request. Payment may also be made directly from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm. Defendants Avalon, Fayyer, and Pustelnik may also pay by certified check, bank cashier's check, or United States postal money order payable to the Securities and Exchange Commission, which shall be delivered or mailed to

Enterprise Services Center
Accounts Receivable Branch
6500 South MacArthur
Boulevard Oklahoma City, OK 73169

and shall be accompanied by a letter identifying the case title, civil action number, and name of this Court; identifying by name the Defendant as a defendant in this action; and specifying that payment is made pursuant to this Amended Final Judgment.

The Defendant making such payment shall simultaneously transmit photocopies of evidence of payment and case identifying information to the Commission's counsel in this action. By making this payment, Defendant relinquishes all legal and equitable right, title, and interest in such funds and no part of the funds shall be returned to Defendant. The Commission shall send the funds paid pursuant to this Amended Final Judgment to the United States Treasury.

Each Defendant shall pay post-judgment interest on any delinquent amounts pursuant to 28 U.S.C. § 1961.

V.

The Court shall retain jurisdiction of this matter for purposes of enforcing this judgment.

/s/ Denise Cote
United States District Judge

Dated: February 9, 2021

ORDER OF THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK (FEBRUARY 9, 2021)

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

v.

LEK SECURITIES CORPORATION, SAMUEL LEK, VALI MANAGEMENT PARTNERS D/B/A AVALON FA LTD, NATHAN FAYYER, AND SERGEY PUSTELNIK,

Defendants.

Case No. 17cv1789 (DLC)

Before: DENISE COTE, United States District Judge.

DENISE COTE, District Judge:

Following a jury verdict in favor of plaintiff Securities and Exchange Commission ("SEC"), defendants Vail Management Partners dba Avalon FA Ltd ("Avalon"), Nathan Fayyer ("Fayyer"), and Sergey Pustelnik ("Pustelnik") (collectively, the "Defendants")

were ordered on March 20, 2020 to jointly and severally disgorge $4,495,564, plus prejudgment interest in the sum of $131,750 (the "March 20, 2020 Opinion"). Each Defendant was also assessed a civil penalty in the amount of $5 million and permanently enjoined from violating Sections 9(a)(2) and 10(b) of the Exchange Act, Rule 10b-5 thereunder, and Section 17(a) of the Securities Act. The March 20, 2020 Opinion further stated that "[i]n the event that no order of disgorgement may be enforced, the civil penalty assessed against each Defendant shall be increased to $7.5 million."

The Defendants appealed to the United States Court of Appeals for the Second Circuit. During the pendency of their appeal, the United States Supreme Court decided *Liu v. Securities and Exchange Commission*, 140 S. Ct. 1936 (2020), which imposed certain limitations on district courts' ability to order disgorgement in SEC enforcement actions. On November 20, 2020, the Second Circuit remanded the case to allow this Court to consider "whether its judgment in this case is consistent" with the Supreme Court's decision in *Liu. SEC v. Vali Management Partners, DBA Avalon FA LTD, et al.*, No. 20-1854 (2d Cir. Nov. 20, 2020). Following the Second Circuit's remand, the parties were ordered to file memoranda addressing the impact of *Liu* on the judgment described in the March 20, 2020 Opinion. The briefing became fully submitted on January 29, 2021.

The SEC concedes that the disgorgement remedy described in the March 20, 2020 Opinion is no longer enforceable following *Liu*, and requests that the $7.5 million civil penalty described in the March 20, 2020 Opinion be imposed against each Defendant as an alternative to the now-unenforceable disgorgement

order. Defendants object to this proposed remedy, but their objections have either been considered and rejected in the March 20, 2020 Opinion or are otherwise unpersuasive. Accordingly, it is hereby

ORDERED that Avalon, Fayyer, and Pustelnik shall each pay a civil penalty of $7.5 million.

IT IS FURTHER ORDERED that each defendant be permanently enjoined from violating Sections 9(a)(2) and 10(b) of the Exchange Act, Rule 10b-5 thereunder, and Section 17(a) of the Securities Act.

/s/ Denise Cote
United States District Judge

Dated: February 9, 2021
New York, New York

OPINION AND ORDER OF THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK (MARCH 20, 2020)

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

v.

LEK SECURITIES CORPORATION, SAMUEL LEK, VALI MANAGEMENT PARTNERS D/B/A AVALON FA LTD, NATHAN FAYYER, AND SERGEY PUSTELNIK,

Defendants.

Case No. 17cv1789 (DLC)

Before: DENISE COTE,
United States District Judge.

DENISE COTE, District Judge:

Following a jury verdict in its favor on November 12, 2019, plaintiff United States Securities and Exchange Commission ("SEC") seeks a permanent injunction, disgorgement jointly and severally in the amount of $4,495,564 plus prejudgment interest, and civil penalties in the amount of $13.8 million against each of the

defendants Vali Management Partners dba Avalon FA Ltd ("Avalon"), Nathan Fayyer ("Fayyer") and Sergey Pustelnik ("Pustelnik") (collectively, the "Defendants"). The Defendants oppose the imposition of any obligation to disgorge their revenue and contend that civil penalties should be limited to $300,000 for Fayyer and Pustelnik and $1,450,000 for Avalon. For the following reasons, disgorgement is ordered, jointly and severally, in the amount requested by the SEC, with interest, and civil penalties are assessed in the amount of $5 million for each defendant, subject to an increase as described below.[1]

BACKGROUND

Much of the factual background for this litigation is described in the Motion to Dismiss Opinion issued in August 2017 and the Opinion on the Motions to Exclude Expert Testimony issued in March 2019. *See Sec. & Exch. Comm'n v. Lek Sec. Corp.*, 370 F. Supp. 3d 384, 389 (S.D.N.Y. 2019) ("Daubert Opinion"); *Sec. & Exch. Comm'n v. Lek Sec. Corp.*, 276 F. Supp. 3d 49, 54 (S.D.N.Y. 2017). Familiarity with those Opinions is assumed and they are incorporated by reference.

The SEC sued Lek Securities Corporation ("Lek Securities"), its principal Samuel Lek ("Lek") (collectively, the "Lek Defendants"), and the Defendants on March 10, 2017. On the same day, the SEC obtained

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[1] The Defendants do not oppose an injunction permanently prohibiting them from violating Sections 9(a)(2) and 10(b) of the Securities Exchange Act of 1934, Rule 10b-5 thereunder, and Section 17(a) of the Securities Act of 1933. Accordingly, that relief is granted as well.

an Order freezing $5.5 million in assets held in Avalon accounts.

Lek Securities is a broker-dealer based in New York. Avalon is a foreign day-trading firm whose hundreds of traders were based primarily in Eastern Europe and Asia. Avalon relied on registered broker-dealers such as Lek Securities to trade in U.S. markets. Fayyer was Avalon's principal. Pustelnik was a co-owner of, and exercised control over, Avalon during the entire period at issue. For a large portion of that time Pustelnik was also the registered representative at Lek Securities who worked on the Avalon account.

The Lek Defendants settled with the SEC on October 1, 2019. Lek Securities was enjoined from having foreign customers that engage in intra-day trading for a period of three years, ordered to retain an independent entity to monitor compliance with the injunction on foreign intra-day trading, permanently enjoined from further securities law violations, ordered to disgorge $419,623 along with prejudgment interest in the amount of $106,269, and assessed a civil penalty of $1 million. Lek was permanently enjoined from further securities violations, barred from the securities industry for ten years, and assessed a civil penalty of $420,000.

On October 21, the SEC proceeded to trial on its claims against the Defendants. The jury rendered its verdict on November 12 and found that the Defendants violated several anti-fraud and anti-manipulation provisions of the Securities Exchange Act of 1934 ("Exchange Act") and the Securities Act of 1933 ("Securities Act"). The jury found that each Defendant violated Section 10(b) of the Exchange Act and Rules 10b-5(a) and (c) thereunder, which together prohibit manipulative practices in connection with the purchase

or sale of securities. 15 U.S.C. § 78j; 17 C.F.R. § 240.10b-5. The jury also found that the Defendants violated both Section 17(a)(1) and Section 17(a)(3) of the Securities Act, which proscribe fraudulent conduct in connection with the offer or sale of securities. 15 U.S.C. §§ 77q(a)(1) and (3). Avalon and Fayyer were also found liable for directly violating Section 9(a)(2) of the Exchange Act, which proscribes "creating active or apparent trading" in securities "for the purpose of inducing the purchase or sale of such security by others." 15 U.S.C. §§ 78i(a)(2), 78i(f). The jury found that Fayyer and Pustelnik knowingly or recklessly provided substantial assistance to each other and to Avalon to facilitate the market manipulation. 15 U.S.C. §§ 77t(b) and (d), 77o(b); 15 U.S.C. §§ 78u(d)(1) and (3), 78t(e). Finally, the jury found that Avalon and Fayyer were liable pursuant to Section 20(a) of the Exchange Act when they acted as "control persons" of Avalon and its traders in connection with their fraud and market manipulation. It similarly found Pustelnik liable as a control person of Avalon. 15 U.S.C. § 78t(a).

These myriad violations stemmed from two schemes to manipulate U.S. securities markets, each separately found by the jury. *See Lek Sec. Corp.*, 370 F. Supp. 3d at 390-93, 396-400. The first manipulative scheme, referred to as "layering," involved placing multiple orders to buy (or sell) a given stock at increasing (or decreasing) prices, to move the price of the security without intending to execute those orders. These are referred to as the loud-side orders. The loud-side orders created the appearance of an artificially inflated level of demand (or supply) for a stock. In conjunction with the loud-side orders, the trader would place a smaller number of orders on the opposite side of the market to

sell (or buy) the same stock. These are referred to as the quiet-side orders. Once the stock reached the desired price, the trader canceled the loud-side orders.

Defendants also engaged in a manipulative scheme known as the Cross-Market Strategy. That involved a trader buying (or selling) a stock in order to influence the price of a corresponding option. The trader would purchase (or sell) the stock, causing the price of the option to rise (or fall). The trader would then establish an options position that would benefit from the stock returning to its price before the trader placed the stock trades. Then the trader reversed the stock position, causing the option to revert to its prior price. Although the trader would lose money on the stock trades, the trader would recoup this amount and more through the profits from buying or selling the option at artificially set prices. The jury entered a special verdict finding that Avalon's trading constituted layering and the Cross-Market Strategy and that both schemes manipulated the securities markets.

The evidence adduced at trial demonstrated Defendants' widespread and longstanding use of layering and the Cross-Market Strategy. Defendants employed these schemes for more than five years, from 2012 through 2016.[2] During that time, they engaged in more than 675,000 instances of layering and 668 instances of Cross-Market trading. Both practices were also highly lucrative: Defendants generated over $21 million

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[2] This action was filed on March 10, 2017. The five-year statute of limitations period runs from March 12, 2012. Although the schemes preceded March 12, 2012, the revenue figures cited in this Opinion are for the manipulative trading that followed March 12, 2012.

in revenue through layering, along with $8.1 million in revenue from the Cross-Market scheme. Almost $4.5 million of this amount was retained by the three Defendants; approximately $25 million was distributed to Avalon's traders.[3]

The SEC submitted its Motion for Judgment Including Remedies on December 20, 2019. The motion became fully submitted on February 7, 2020.

DISCUSSION

"Once the district court has found federal securities law violations, it has broad equitable power to fashion appropriate remedies." *SEC v. Frohling*, 851 F.3d 132, 138 (2d Cir. 2016) (citation omitted). For the following reasons, the SEC's request for relief is granted in part.

I. Disgorgement

The SEC requests that the Defendants be disgorged of the revenue they reaped from the layering and Cross-Market schemes. Disgorgement "is a well-established remedy in the Second Circuit, particularly in securities enforcement actions." *S.E.C. v. Cavanagh*, 445 F.3d 105, 116 (2d Cir. 2006). Once a securities violation has been found, the court may order the wrongdoer to surrender the profits derived from the illegal venture. *S.E.C. v. Razmilovic*, 738 F.3d 14, 31 (2d Cir. 2013), as amended (Nov. 26, 2013).

Because disgorgement "is a method of forcing a defendant to give up the amount by which he was unjustly enriched, . . . the party seeking disgorgement

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[3] Pursuant to Avalon's contracts with its traders, Avalon retained between 1% and 14% of trading profits.

must distinguish between the legally and illegally derived profits." *Id.* (citation omitted). The proper measure of disgorgement is the profit wrongdoers made and "the size of a disgorgement order need not be tied to the losses suffered by defrauded investors." *Official Committee of Unsecured Creditors of WorldCom, Inc. v. SEC*, 467 F.3d 73, 81 (2d Cir. 2006) (citation omitted). Courts may require disgorgement "regardless of whether the disgorged funds will be paid to . . . investors as restitution." *Kokesh v. SEC*, 137 S. Ct. 1635, 1644 (2017) (citation omitted). Where a plaintiff seeks disgorgement "for combined profits on collaborating or closely related parties," a court may hold those parties jointly and severally liable for the combined profits. *S.E.C. v. AbsoluteFuture.com*, 393 F.3d 94, 97 (2d Cir.), supplemented, 115 F. App'x 105 (2d Cir. 2004).

"The district court has broad discretion not only in determining whether or not to order disgorgement but also in calculating the amount to be disgorged." *SEC v. Contorinis*, 743 F.3d 296, 301 (2d Cir. 2014) (citation omitted). Recognizing that the precise amount of a defendant's illegal proceeds might be impossible to determine, courts have held that a party seeking disgorgement need only provide "a reasonable approximation of profits causally connected to the violation." *Id.* at 305 (citation omitted). To calculate disgorgement, the district court engages in "factfinding. . . to determine the amount of money acquired through wrongdoing," and then issues "an order compelling the wrongdoer to pay that amount plus interest." *Cavanagh*, 445 F.3d at 116. Furthermore, "any risk of uncertainty in calculating disgorgement should fall upon the wrongdoer whose illegal conduct created that uncertainty." *Contorinis*, 743 F.3d at 305 (citation omitted). The

SEC bears the burden "of establishing a reasonable approximation of the profits causally related to the fraud," but once it has met this burden, "the burden shifts to the defendant to show that his gains were unaffected by his offenses." *Razmilovic*, 738 F.3d at 31 (citation omitted). A defendant may not avoid disgorgement by arguing that the gains did not "personally accrue" to him. *Contorinis*, 743 F.3d at 306.

In addition to the base disgorgement amount, an award of prejudgment interest is within the discretion of the court. *Razmilovic*, 738 F.3d at 35-36; *S.E.C. v. First Jersey Sec., Inc.*, 101 F.3d 1450, 1475-76 (2d Cir. 1996). Generally, "an award of prejudgment interest may be needed in order to ensure that the defendant not enjoy a windfall as a result of its wrongdoing." *Slupinski v. First Unum Life Ins. Co.*, 554 F.3d 38, 54 (2d Cir. 2009).

> In deciding whether an award of prejudgment interest is warranted, a court should consider (i) the need to fully compensate the wronged party for actual damages suffered, (ii) considerations of fairness and the relative equities of the award, (iii) the remedial purpose of the statute involved, and/or (iv) such other general principles as are deemed relevant by the court.

First Jersey, 101 F.3d at 1476 (citation omitted). Where, as here, the case is "an enforcement action brought by a regulatory agency, the remedial purpose of the statute takes on special importance." *First Jersey*, 101 F.3d at 1476. As for the interest rate to be applied, the Second Circuit has approved the use of the "IRS underpayment rate" as the baseline interest rate because it "reflects what it would have cost to borrow the money

from the government and therefore reasonably approximates one of the benefits the Defendants received from its fraud." *Id.*

The SEC seeks disgorgement in the amount of $4,495,564 plus prejudgment interest in the amount of $131,750. Based on the Defendants' revenue analysis as well as the evidence presented during trial, those sums are a reasonable approximation of the extent to which the Defendants profited from their fraudulent activities.[4] The SEC has demonstrated that between March 2012 and September 2016, Defendants' layering scheme generated $2,457,073 in net revenue and the Cross-Market scheme generated $2,038,491 in net revenue for the Defendants.

Defendants raise several objections to the SEC's disgorgement request. First, Defendants contend that disgorgement is not an available remedy following the Supreme Court's decision in *Kokesh*. 137 S. Ct. 1635 (2017). As the Second Circuit has noted, *Kokesh* classified disgorgement as "a 'penalty' for purposes of 28 U.S.C. § 2462, which imposes a five-year statute of limitation." *United States v. Brooks*, 872 F.3d 78, 91 (2d Cir. 2017); *see also Kokesh v. SEC*, 137 S. Ct. 1635, 1644 (2017).[5] *Kokesh* did not decide whether a court is deprived of its authority to impose disgorgement. The

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[4] Assuming without conceding that they were liable for the manipulative trading activity identified by the SEC's experts at trial, the Defendants prepared a Payout Analysis to calculate the revenue from that trading that was distributed to Avalon's traders. The SEC has accepted those calculations.

[5] 28 U.S.C. § 2462 imposes a five–year statute of limitations applies to any "action, suit or proceeding for the enforcement of any civil fine, penalty, or forfeiture, pecuniary or otherwise." 28 U.S.C. § 2462.

Kokesh Court itself observed that its holding "should [not] be interpreted as an opinion on whether courts possess authority to order disgorgement in SEC enforcement proceedings or on whether courts have properly applied disgorgement principles in this context." *Kokesh* 137 S. Ct. at 1642 n.3. Until this issue is decided differently by the Supreme Court,[6] this Opinion follows the current law in the Second Circuit.

Second, Defendants argue that the SEC has failed to show which specific transactions were manipulative, and therefore which profits are properly disgorged. Defendants' objection is premised on the alleged inability of the SEC's expert witnesses, Professors Hendershott and Pearson, to identify any single trade as manipulative. Defendants misunderstand the professors' testimony and the nature of manipulative trading schemes.

The jury found that the Defendants intended to manipulate the securities markets and engaged in two distinct schemes to do so. The jury specifically found that orders Avalon placed constituted layering and the Cross-Market Strategy and that those schemes were manipulations of the securities markets. Furthermore, the jury found that Avalon did so while under the control of Fayyer and Pustelnik. Together, the

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[6] The Supreme Court recently granted certiorari to address whether, after *Kokesh*, district courts have the authority to order disgorgement. *See SEC v. Liu*, 754 F. App'x 505 (9th Cir. 2018) (unpublished), *cert. granted sub nom. Liu v. SEC*, ___ U.S. ___, 2019 WL 5659111 (U.S. Nov. 1, 2019) (No. 18-1501). Defendants have not requested a stay of this motion pending a decision in Liu. In any event, the law of this Circuit is that disgorgement is an available remedy in SEC enforcement cases. *See, e.g., Frohling*, 851 F.3d at 138-39; *Contorinis*, 743 F.3d at 301.

schemes involved hundreds of thousands of separate instances of manipulative trading. In each instance, there were multiple orders placed in the market and executed by the Defendants to achieve their goal of market manipulation. During the statute of limitations period, Professor Hendershott found 675,504 separate instances of layering. Professor Pearson found 668 separate instances of trading consistent with the Cross-Market Strategy, none of which had an alternative, legal economic rationale.

As described in detail in the *Daubert* Opinion, the SEC experts used rigorous and conservative criteria to identify the trading involved in the two schemes. *Lek Sec. Corp.*, 370 F. Supp. 3d at 391-92, 397-98. They then conducted further analyses to confirm that they had correctly identified manipulative trading. *Id.* at 392-93, 398-400. Given the conservative measures they applied, this Court has no hesitation using the numbers presented by the experts at trial. The cross examination of the SEC experts provided no basis to question these numbers and neither does the Defendants' opposition to this motion.

After identifying the trades that fit the profile of either manipulative practice, the professors calculated the gross revenue produced by the trades in each instance of market manipulation. Avalon used those figures to calculate the share of revenues it retained. Those sums are the proceeds the SEC now seeks to be disgorged. The SEC has therefore provided a "reasonable approximation" of the profits that the Defendants gained from their illegal practices. *Contorinis*, 743 F.3d at 305.

Any risk of uncertainty related to those sums falls on Defendants, who bore the burden of "show[ing] what

transactions were unaffected by [their] offenses." *SEC v. Lorin*, 76 F.3d 458, 462 (2d Cir. 1996). Defendants' conclusory assertion that the SEC failed to carry its burden to show a causal connection between illegality and disgorged profits is rejected.

In addition to disgorgement, Defendants should pay prejudgment interest to prevent them from obtaining what is essentially an interest-free loan from their illegal activity. The SEC calculated prejudgment interest running from the date of Defendants' last instance of each respective strategy through March 10, 2017, the date Avalon's funds were frozen. This sum amounts to $131,750.[7]

II. Civil Penalties

The SEC also seeks civil penalties of $13.8 million for each Defendant. Pursuant to the Securities Act and the Exchange Act, a court may impose three tiers of civil penalties.

> Under each statute, a first-tier penalty may be imposed for any violation; a second-tier penalty may be imposed if the violation involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement; a third-tier penalty may be imposed when, in addition to meeting the requirements of the second tier, the violation directly or indirectly resulted in substantial

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[7] Defendants oppose the imposition of prejudgment interest on the same ground that they resist disgorgement generally; namely, that Kokesh deprived district courts of the authority to order it. For the reasons detailed above, this argument is rejected.

> losses or created a significant risk of substantial losses to other persons.

Razmilovic, 738 F.3d at 38 (citation omitted); 15 U.S.C. § 77t(d)(2); 15 U.S.C. § 78u(d)(3). At each tier, "for each violation, the amount of penalty shall not exceed the greater of a specified monetary amount or the defendant's gross amount of pecuniary gain." *Razmilovic*, 738 F.3d at 38 (citation omitted). For individual defendants, the maximum amounts specified at the first, second, and third tier are $7,500, $75,000, and $150,000, respectively.[8] 17 C.F.R. 201.1001. Entities are liable in the maximum amount of $75,000, $375,000, and $725,000 at each tier. *Id.*

Aside from the maximum statutory restrictions, the appropriate civil penalty is within "the discretion of the district court." *Razmilovic*, 738 F.3d at 38 (citation omitted). Because monetary penalties are levied as a deterrent against securities law violations, *SEC v. Palmisano*, 135 F.3d 860, 866 (2d Cir. 1998), courts have broad discretion to fashion relief "in light of the facts and circumstances" surrounding the violations. 15 U.S.C. § 78u(d)(3). To aid this inquiry, courts in this Circuit have considered the following factors-often described as the Haligiannis factors-in assessing civil penalties:

> (1) the egregiousness of the defendant's conduct; (2) the degree of the defendant's scienter; (3) whether the defendant's conduct

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[8] These rates are adjusted periodically pursuant to the Debt Collection and Improvement Act of 1996 and associated SEC regulations. Defendants' conduct spans three rate regimes. The SEC proposes using the amounts listed in the earliest schedule of the penalty rates in which Defendants' illegal activity occurred.

> created substantial losses or the risk of substantial losses to other persons; (4) whether the defendant's conduct was isolated or recurrent; and (5) whether the penalty should be reduced due to the defendant's demonstrated current and future financial condition.

Sec. & Exch. Comm'n v. Rajaratnam, 918 F.3d 36, 44 (2d Cir. 2019); *S.E.C. v. Haligiannis*, 470 F. Supp. 2d 373, 386 (S.D.N.Y. 2007). Those factors are neither exhaustive nor "to be taken as talismanic." *Rajaratnam*, 918 F.3d at 45. Other relevant considerations include "a defendant's financial condition, a defendant's failure to admit wrongdoing, and a defendant's lack of cooperation with authorities." *United States Sec. & Exch. Comm'n v. Alpine Sec. Corp.*, 413 F. Supp. 3d 235, 245 (S.D.N.Y. 2019) (citation omitted). Finally, the "brazenness, scope, and duration" of the fraudulent conduct may dictate "a significant penalty." *Rajaratnam*, 918 F.3d at 45.

As to the unit of calculation, it is within a court's discretion to treat each fraudulent transaction as a discrete violation. *See, e.g., S.E.C. v. Pentagon Capital Mgmt. PLC*, 725 F.3d 279, 288 n.7 (2d Cir. 2013) ("[W]e find no error in the district court's methodology for calculating the maximum penalty by counting each late trade as a separate violation."); *SEC v. Milan Capital Grp., Inc.*, No. 00 Civ. 108 (DLC), 2001 WL 921169, *3 (S.D.N.Y. Aug.14, 2001) (imposing penalty for each of 200 defrauded investors).

The SEC requests maximum third-tier penalties against each defendant, calculated using the maximum penalty rate for natural persons of $150,000 per violation. The SEC requests that each month in which Defendants engaged in either manipulative practice

be treated as a separate violation. This amounts to fifty-four months for the layering scheme and thirty-eight months for the Cross-Market Strategy, for a total of ninety-two months and a total penalty per Defendant of $13.8 million.

The record demonstrates that the Defendants' conduct falls into the third tier of penalties because it involved fraud and created a significant risk of substantial losses to other investors. The Defendants do not disagree that the third-tier of penalties is the correct tier for assessing penalties against them. Nor could they. The Defendants were the central figures in two separate years-long schemes to defraud the securities market. Their manipulation was intentional. Furthermore, as the trial established, Defendants' manipulation distorted the market and caused significant losses for other traders. Layering, for instance, induced other market participants to purchase a stock at the trader's desired price, a price that was higher or lower than what the other participant otherwise would pay. Similarly, while Avalon reaped the proceeds of the artificial options prices from the Cross-Market Scheme, other investors ended up trading at unfavorable prices. Finally, both schemes fostered uncertainty in the market. As a hedge against that uncertainty, the bid/ask spreads widened and other traders had to either pay more to purchase a security or accept less to sell one.

Turning to the first *Haligiannis* factor, the Defendants' conduct was egregious. Defendants engaged in market manipulation on a massive scale. Defendants' participation in layering and the Cross-Market Scheme was endemic; they recruited other traders to assist in the fraud over the course of many years and millions

of trades. Fraud of that scope and duration is plainly egregious. Nor were Defendants bit players in the schemes. Fayyer, Pustelnik, and Avalon coordinated nearly every facet of the plan to manipulate the market. The Defendants facilitated both schemes by enlisting and organizing traders, arranging technology upgrades to better execute the manipulation, and assisting traders to circumvent the meager internal controls Lek Securities implemented to detect layering. Taken together, these facts are more than sufficient to demonstrate that the Defendants' conduct was egregious.

The next factor in determining the appropriate penalty is Defendants' degree of scienter. Defendants' fraudulent behavior was intentional. As early as September 2012, they learned of a FINRA inquiry into trades they were conducting through Lek Securities.[9] Armed with this knowledge, Defendants increased their use of layering. Defendants' scienter is also illustrated by their efforts to conceal their activity and connections to the schemes. *See United States v. Triumph Capital Grp., Inc.*, 544 F.3d 149, 160 (2d Cir. 2008) ("[E]fforts to obstruct the investigation evidence a consciousness of guilt. . . . "). During the SEC administrative investigation, Defendants failed to produce highly incriminating emails despite subpoenas directing them to do so. Later, Fayyer and Pustelnik tried to conceal Pustelnik's ties to Avalon and Fayyer.

In addition to withholding incriminating information, Fayyer and Pustelnik gave false testimony under

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[9] FINRA, or the Financial Industry Regulatory Authority, is a self-regulatory organization that supervises broker-dealers. *See Fiero v. Financial Industry Regulatory Auth., Inc.*, 660 F.3d 569, 571 & n.1 (2d Cir. 2011).

oath during the SEC investigation and at trial. And, while the schemes were ongoing, they assured Lek that they were not engaging in layering, even while recruiting traders to do just that. *United States v. Anderson*, 747 F.3d 51, 60 (2d Cir. 2014) (citation omitted) (noting that "acts that exhibit a consciousness of guilt, such as false exculpatory statements, . . . may also tend to prove knowledge and intent of a conspiracy's purpose"). Defendants' specious attempts to excuse their behavior continued at trial, where Fayyer and Pustelnik testified that they thought layering was merely the legal practice of trading on both sides of the market. That contention was transparently wrong and is also belied by Defendants' written statements to their traders. Avalon explained to traders that it charged higher fees to engage in layering because traders had few other brokers who would accept such orders.

As to the third factor, as already described, Defendants' malfeasance resulted in substantial losses to other market participants who traded at unfavorable prices due to the manipulative practices. As for the fourth factor, Defendants' conduct was not intermittent; it was recurrent behavior meant to cheat the market. From 2012 to 2016, Defendants took aggressive measures to evade the securities law. Their illicit activities persisted—and indeed increased—when Defendants came under regulatory scrutiny.

The final *Haligiannis* factor, Defendants' current and future financial statuses, does not offset the need to impose a significant penalty. In opposition to the SEC's motion for remedies, the Defendants submitted affidavits describing Fayyer and Pustelnik's current assets and liquidity. Those affidavits represent that Fayyer and Pustelnik have limited resources. The

Defendants have submitted no evidence of Avalon's current financial state. Fayyer and Pustelnik have decades of their working lives ahead of them. They were instrumental in building a company that produced millions of dollars in revenue. When weighed against the clear need to assess a substantial civil penalty, Defendants' current financial position is not a bar to the imposition of significant civil penalties.

Defendants contend that the SEC's proposed civil penalties are excessive. Defendants first object that the penalties would be disproportionate to the disgorged amount, an outcome Defendants argue is inconsistent with the SEC's historical disgorgement-to-civil penalty ratio. Those general trends, however, have little to do with the penalty appropriate for the Defendants, which must be determined based on "the facts and circumstances" of the Defendants' violations. 15 U.S.C. § 78u (d)(3) & 77t(d). In particular, in this case the disgorgement sought by the SEC is only a fraction of the total profits made through Defendants' market manipulation.[10]

Defendants also argue that the disgorgement and injunctive relief the SEC seeks necessitate smaller civil penalties. Defendants conflate the aims of the different remedies available for securities law violations. As the SEC notes, disgorgement deprives defendants of their ill-gotten gains and an injunction facilitates speedier enforcement if the Defendants violate the securities laws again. Neither of those remedies carries the same

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[10] The expert testimony established that the manipulative schemes generated more than $29 million in revenue, most of which was distributed to Avalon's traders. The SEC seeks approximately $4.5 million in disgorgement.

deterrent effect as a robust civil penalty. Disgorgement and injunctive relief are meant to ensure that defendants do not profit from their illegal conduct; SEC civil penalties are, by contrast, designed to effect general deterrence and to make securities law violations a money-losing proposition. *See Rajaratnam*, 918 F.3d at 44.

Defendants' appeal to the penalties negotiated with the Lek Defendants is similarly unavailing. Defendants were responsible for recruiting traders to execute the fraudulent schemes and then took extensive steps to cover their trail. Defendants repeatedly concealed their participation in the layering scheme from the Lek Defendants during the investigation. The latter's settlement does not, therefore, limit the Court's discretion to assess harsher penalties on the Defendants.

Defendants also object to the manner in which the SEC calculated civil penalties. Defendants propose treating each scheme as a single violation, yielding civil penalties of $300,000 for Fayyer and Pustelnik, and $1,450,000 for Avalon, if the maximum fines for a third-tier violation are used. The SEC argues for a measurement that reflects the longevity of the schemes and seeks the maximum fine per month of illegality, counting each of the two schemes separately. The SEC points out that there were identifiable instances of layering and the Cross-Market Scheme in ninety-two separate months from 2012 to 2016. Defendants do not dispute the accuracy of the calculation.[11]

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[11] SEC administrative bodies have adopted a monthly definition of statutory violations where, as here, discrete instances of prohibited conduct occurred in individual months and alternative

Defendants' preferred method—a single penalty per manipulative scheme—would deliver grossly inadequate deterrence for the scope of this illegal activity. Their proposal results in penalties that pale in comparison to the extent of their misconduct, including their obstruction of justice. The breadth and duration of Defendants' violations are well established; violations of that magnitude require a correspondingly severe penalty. Defendants' proposal does not meet that requirement. It would recognize no distinction between a violator who engaged in a single episode of market manipulation and one who continued the manipulation year after year even after they were alerted that regulators were suspicious of their trading activity. It bears emphasis that the Defendants accelerated their market manipulation after regulators put them on notice of their concerns. During the investigation and litigation of this matter, the Defendants continued to obfuscate and conceal evidence of their unlawful conduct. Even now, in opposition to this motion, the Defendants attempt to excuse their behavior based on their alleged ignorance of the relevant law. A "course of conduct" measure for a civil penalty would not promote deterrence.

The other alternative measure of counting violations, wherein each transaction or series of transactions is counted as a violation, shows the reasonableness of the monthly measure. In light of the millions of transactions at issue, and the many separate instances of manipulation, using transactions or even

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metrics to measure violations could justify larger penalties. *See, e.g., J.S. Oliver Cap. Mgt., LP*, SEC Rel. No. 4431 (Jun. 17, 2016); *Phlo Corp., James B. Hovis, & Anne P. Hovis*, 90 SEC Docket 961, 2007 WL 966943, at *15 (Mar. 30, 2007).

instances of manipulation as a measure would produce a staggering penalty. A penalty measured in terms of months is a reasonable intermediate metric that fulfills the need to impose significant fines while honoring the value of proportionality.

Weighing all of the factors discussed above, a third-tier civil penalty of $5 million is assessed against each of the three Defendants. Although this penalty is significant, it corresponds to the extent and brazenness of the Defendants' conduct and the need to deter those practices in the future. It is also a fraction of the maximum tier-three penalties available and substantially less than the penalty the SEC has requested. This figure is set based at least in part on the assumption that the amount already seized by the SEC, or at least most of that amount, will be used to satisfy Defendants' duty to disgorge their profits from their schemes.[12]

CONCLUSION

The SEC's December 20, 2019 motion for remedies is granted in part. A judgment of disgorgement in the amount of $4,495,564 plus prejudgment interest in the amount of $131,750 is imposed jointly and severally against each of the Defendants: Avalon, Fayyer, and Pustelnik. Each Defendant is also assessed a civil penalty in the amount of $5 million.[13] Lastly, each

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[12] This Order relies on the Defendants' commitment, expressed in their memorandum in opposition the SEC's motion and counsel's letter of March 13, 2020, that they largely consent to the application of the $5.5 million seized by the SEC to be used to satisfy their obligation to pay disgorgement.

[13] In the event that no order of disgorgement may be enforced, the civil penalty assessed against each Defendant shall be increased to $7.5 million.

Defendant will be permanently enjoined from violating Sections 9(a)(2) and 10(b) of the Exchange Act, Rule 10b-5 thereunder, and Section 17(a) of the Securities Act.

/s/ Denise Cote
United States District Judge

Dated: March 20, 2020
New York, New York

OPINION AND ORDER OF THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK DENYING MOTION TO DISMISS (AUGUST 25, 2017)

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

v.

LEK SECURITIES CORPORATION, SAMUEL LEK, VALI MANAGEMENT PARTNERS D/B/A AVALON FA LTD, NATHAN FAYYER, AND SERGEY PUSTELNIK A/K/A SERGE PUSTELNIK,

Defendants.

Case No. 17cv1789 (DLC)

Before: DENISE COTE,
United States District Judge.

DENISE COTE, District Judge:

Broker-dealer Lek Securities Corporation ("Lek") and its principal Samuel Lek (collectively "the Lek Defendants") have moved to dismiss the securities fraud action filed against them by the Securities and Exchange Commission ("SEC"). The SEC alleges that

these defendants participated in unlawful layering and cross-market manipulation schemes.

In their motion to dismiss, the Lek Defendants do not contend that the complaint's allegations lack sufficient detail to give them fair notice of the SEC's theory of wrongdoing. Instead, they principally argue that neither the layering nor the cross-market trading described in the complaint can constitute market manipulation in violation of federal securities laws. They are wrong. For the following reasons, the motion to dismiss is denied.

BACKGROUND

The following facts are taken from the complaint. Lek is a New York based registered broker-dealer. It provides foreign trading firms, including co-defendant Vali Management Partners d/b/a Avalon FA LTD ("Avalon"), with access to U.S. securities markets. The conduct at issue in this case occurred in large part through trading in the Avalon account at Lek ("Avalon Account"). Samuel Lek is Lek's Chief Executive Officer and Chief Compliance Officer.

Samuel Lek supervised his co-defendant Sergey Pustelnik ("Pustelnik"), who referred foreign customers to Lek, including Avalon. Pustelnik later became a registered representative at Lek and worked on the Avalon Account. He received commissions and other payments from Lek on Avalon's trades through Lek.

Pustelnik is also alleged to be an undisclosed control person of Avalon. Pustelnik was significantly involved in Avalon's management and operations and shares in Avalon's revenue or profits with Avalon's

principal Nathan Fayyer ("Fayyer"), who is also a named defendant in this action.

Avalon is a foreign day-trading firm that uses mostly foreign traders based in Eastern Europe and Asia to conduct its trading. Avalon is not registered with the SEC. Fayyer is Avalon's sole disclosed owner and director. During the relevant period, Fayyer oversaw Avalon's trade groups and had authority to restrict or terminate their trading in the Avalon Account.

The SEC's allegations concern two schemes to manipulate U.S. securities markets. The first scheme involved Avalon's use of a trading strategy typically referred to as "layering" or "spoofing." The second was a cross-market manipulation scheme. Together, Avalon's layering and cross-market manipulation activity generated profits of more than $28 million. Lek also profited significantly from commissions and other fees it earned from Avalon's layering and cross-market manipulation activity. Between 2012 and 2016, Avalon produced more commissions, fees, and rebates for Lek than any other customer.

I. The Layering Scheme

In the alleged layering scheme, Avalon placed "non-bona fide orders" through Lek to buy or sell stock with the intent of injecting false information into the market about supply or demand for the stock. The complaint characterizes non-bona fide orders as orders that Avalon did not intend to execute and that had no legitimate economic reason. Avalon placed these orders to trick and induce other market participants to execute against orders that Avalon did intend to execute for the same stock on the opposite side of the

market, which the complaint describes as its bona fide orders. Through this scheme, Avalon obtained more favorable prices on the executions of its bona fide orders than otherwise would have been available. Between December 2010 and September 2016 Avalon engaged in hundreds of thousands of instances of layering, involving hundreds of securities traded on U.S. exchanges. The complaint describes three specific instances of layering in detail.

As described by a trader who later became one of Avalon's trade group leaders in a 2012 email to Samuel Lek, layering is a "special" trading strategy:

> For example, the bid and ask of symbol X is 90.09 and 90.14, we put buy orders in 90.10, 90.11, 90.12, 90.13 and so on, then push the price to 90.20, right now the bid and ask is 90.20 and 90.21, we put a big size short order in 90.20 to get a short position, then we cancel all of the buy orders in 90.10, 90.11, 90.12 and so on. And we put sell orders in 90.20, 90.19, 90.18, 90.17 and so on, to push the price to 90.05, then put a big size buy order in 90.05 to cover position, and cancel all of the sell orders . . . so we will put hundre[d]s of orders to push stock price and then cancel them.

(Emphasis supplied.)

As described in the complaint, Samuel Lek had ample notice that regulators considered layering a manipulative practice. Indeed, in response to the email quoted above Samuel Lek stated, "regulators have argued that your trading strategy 'layering' is manipulative and illegal. This is of concern to us even

though I do not agree with their position." Between 2012 and 2016, regulators, exchanges, and other market participants repeatedly notified the Lek Defendants that Avalon may be engaged in manipulative layering through its trading at Lek. In September 2012, the Financial Industry Regulatory Authority ("FINRA") informed Lek that Avalon's trading "appears consistent with a manipulative practice called layering." In July 2013, Bats Global Markets exchange ("BATS") advised the Lek Defendants that it was seeing a "clear-cut cross-market layering strategy" by Avalon, including "1,700 instances [of layering] over the last two days." BATS later sent Lek a letter identifying specific instances of Avalon's layering activity. Following these communications, Lek stopped sending Avalon's orders to BATS and instead routed Avalon's orders to other exchanges and venues. In November 2013, a New York Stock Exchange ("NYSE") Hearing Board found that Lek had violated various exchange rules by, among other things, failing to supervise and implement adequate risk controls for trading strategies including spoofing and layering. The Lek Defendants continued to receive numerous regulatory inquiries and warnings through 2016. Samuel Lek and others at Lek informed Pustelnik of a number of these communications.

Fayyer was also well aware of the regulatory disapproval of layering, or as he sometimes termed it, multi-key trading. He marketed Avalon to prospective traders as one of the few remaining destinations willing to allow layering and touted Avalon's relationship with Lek, one of the only brokers that still permitted layering. For example, in March 2013, Fayyer explained:

> the broker is not a cheap one, but this is because they do tolerate and protect us from

> many issues such as multi-key trading, which is not allowed anywhere pretty much anymore, and other dark pool and scalping strategies which can be described as wash orders by many other firms. So you get what you pay for here.

The Lek Defendants never instituted effective controls to prevent layering from occurring, and quickly relaxed any controls Lek did implement in response to Avalon's, Fayyer's, and Pustelnik's requests. In February 2013, Lek implemented a layering control that would block certain trading through its proprietary Q6 program ("Q6 Control"). The complaint asserts that Q6 Control was "mere window-dressing." Q6 Control was triggered when a trader traded or attempted to trade on both sides of the market with a disproportionate number of orders on one side. The difference in the number of orders between the two sides was referred to as the delta. Q6 Control was initially triggered by a delta of 10. Pustelnik encouraged Lek to relax the Q6 Control for Avalon. On February 6, 2013, Pustelnik urged a Lek officer to increase the delta on the Avalon Account to 75. Within a week of implementing Q6 Control, Lek relaxed the delta on the Avalon Account to 100. At all times thereafter the delta on the Avalon Account remained between 50 and 100.

II. The Cross-Market Manipulation Scheme

In a cross-market manipulation scheme that it began to execute in August 2012, Avalon purchased and sold U.S. stock at a loss to move the prices of corresponding options, so that Avalon could make a profit by trading those options at prices that it would not otherwise have been able to obtain. The profits

that Avalon achieved through its options trading more than offset the losses it sustained on its allegedly manipulative trading of stock. The SEC alleges that Avalon engaged in over 600 instances of cross-market manipulation through Lek between August 2012 and December 2015. The complaint describes in detail a specific example of Avalon's cross-market manipulation activity.

The Lek Defendants and Pustelnik were well aware that regulators objected to Avalon's cross-market trading activity as potentially manipulative. For example, within a week of Avalon initiating its cross-market strategy through Lek, FINRA advised the Lek Defendants that it viewed the trading as potentially manipulative. In June 2014, FINRA again requested that Lek "continue to review activity [of the cross-market strategy] and address any potential manipulative activity involving both option and stock trading in the same underlying effected by the same account holder." Fayyer was also aware of regulatory inquiries involving Avalon's cross-market manipulation activity.

The Lek Defendants and Pustelnik not only permitted Avalon to engage in cross-market manipulation activity through Lek but took steps to advance it. For instance, at the request of Fayyer and Pustelnik, Lek undertook significant work and expense to improve the speed of its options trading technology.

PROCEDURAL HISTORY

The SEC filed this action on March 10, 2017. That same day, it obtained an *ex parte* temporary restraining order ("TRO") against Avalon. On March 29, the Court denied Avalon's request to modify the

TRO. *SEC v. Lek Sec. Corp.*, 17cv1789 (DLC), 2017 WL 1184318 (S.D.N.Y. Mar. 29, 2017).

At a conference held with all of the parties on March 13, a schedule was set for discovery and pretrial proceedings. The SEC and Avalon agreed to a preliminary injunction hearing to begin on August 2.

On July 7, the SEC and Avalon filed their preliminary injunction papers, which included the direct testimony of the SEC's hearing witnesses and its hearing exhibits. Avalon declined to offer any witnesses at the hearing, but presented legal arguments in opposition to the motion. On July 28, Avalon withdrew its opposition to the SEC's motion for a preliminary injunction. A July 31 preliminary injunction continued the March 10 freeze of Avalon's assets pending trial.

Meanwhile, the Lek Defendants filed this motion on dismiss on June 2. It became fully submitted on July 31. Discovery in this action is scheduled to conclude on May 18, 2018.

DISCUSSION

When deciding a motion to dismiss under Rule 12(b)(6), a court must accept all factual allegations in the complaint as true and draw all reasonable inferences in the non-moving party's favor. *Loginovskaya v. Batratchenko*, 764 F.3d 266, 269-70 (2d Cir. 2014). "To survive a motion to dismiss under Rule 12(b)(6), a complaint must allege sufficient facts which, taken as true, state a plausible claim for relief." *Keiler v. Harlequin Enters. Ltd.*, 751 F.3d 64, 68 (2d Cir. 2014). A claim has facial plausibility when the factual content of the complaint "allows the court to draw the reasonable inference that the defendant is liable for

the misconduct alleged." *Tongue v. Sanofi*, 816 F.3d 199, 209 (2d Cir. 2016) (citation omitted). A complaint must do more, however, than offer "naked assertions devoid of further factual enhancement." *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009) (citation omitted).

Rule 9(b) of the Federal Rules of Civil Procedure imposes a heightened pleading standard on complaints alleging fraud. *ATSI Commc'ns., Inc. v. Shaar Fund, Ltd.*, 493 F.3d 87, 99 (2d Cir. 2007). Under Rule 9(b), parties alleging fraud must "state with particularity the circumstances constituting fraud." Fed. R. Civ. P. 9(b). "Malice, intent, knowledge, and other conditions of a person's mind," however, "may be alleged generally." *Id.* Because market manipulation claims can involve facts that are "solely within the defendant's knowledge," the Second Circuit has recognized that the plaintiff "need not plead manipulation to the same degree of specificity as a plain misrepresentation claim." *ATSI*, 493 F.3d at 102. A plaintiff alleging market manipulation need only "plead with particularity the nature, purpose, and effect of the fraudulent conduct and the roles of the defendants." *Id.* The complaint must set forth, to the extent possible, "what manipulative acts were performed, which defendants performed them, when the manipulative acts were performed, and what effect the scheme had on the market for the securities at issue." *Id.* (citation omitted). "General allegations not tied to the defendants or resting upon speculation are insufficient." *Id.*

The SEC asserts five claims against the Lek Defendants.[1] First, the SEC alleges that the Lek

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[1] As addressed below, they appear in claims 6, 8, 9, 3, and 11 of the SEC's complaint.

Defendants violated § 20(e) of the Securities Exchange Act of 1934 ("§ 20(e)" and "Exchange Act"), 15 U.S.C. § 78t(e), by aiding and abetting Avalon's, Fayyer's, and Pustelnik's violations of § 10(b) of the Exchange Act ("§ 10(b)"), 15 U.S.C. § 78j(b), and Rule 10b-5(a) and (c) promulgated thereunder ("Rule 10b-5"), 17 C.F.R. § 240.10b-5(a) and (c). Second, the SEC alleges that the Lek Defendants violated § 15(b) of the Securities Act of 1933 ("§ 15(b)" and "Securities Act"), 15 U.S.C. § 77o(b), by aiding and abetting Avalon's, Fayyer's, and Pustelnik's violations of §§ 17(a)(1) and (3) of the Securities Act ("§ 17(a)"), 15 U.S.C. §§ 77q(a)(1) and (3). Third, the SEC alleges that the Lek Defendants violated § 20(e) by aiding and abetting Avalon's violations of § 9(a)(2) of the Exchange Act ("§ 9(a)(2)"), 15 U.S.C. § 78i(a)(2). Fourth, the SEC alleges that the Lek Defendants violated § 17(a)(3) of the Securities Act. Finally, the SEC alleges that Lek is liable for Pustelnik's violations of § 10(b) and Rule 10b-5 under § 20(a) of the Exchange Act ("§ 20(a)"), 15 U.S.C. § 78t(a).

In their motion to dismiss, the Lek Defendants largely make blanket objections that apply across the board to each of the five claims against them. Those objections are addressed at the conclusion of this Opinion. They also make two claim-specific objections. The first is to the third claim described here: the claim that they violated § 20(e) by aiding and abetting Avalon's violation of § 9(a)(2). The second is to the claim against Lek for its control of Pustelnik. These components of the defendants' motion are addressed in the context of the discussion of § 9(a)(2) and § 20(a).

III. Claim under § 20(e) of the Exchange Act for Aiding and Abetting Avalon's, Fayyer's, and Pustelnik's Violations of § 10(b) and Rule 10b-5

Section 20(e) of the Exchange Act establishes liability for those who aid and abet others in securities violations. 15 U.S.C. § 78t(e). Section 20(e) provides:

> any person that knowingly or recklessly provides substantial assistance to another person in violation of a provision of this chapter, or of any rule or regulation issued under this chapter, shall be deemed to be in violation of such provision to the same extent as the person to whom such assistance is provided.

15 U.S.C. § 78t(e) (emphasis supplied). To survive a motion to dismiss a claim of aiding and abetting liability, the SEC must allege: "(1) the existence of a securities law violation by the primary (as opposed to the aiding and abetting) party; (2) knowledge of this violation on the part of the aider and abettor; and (3) substantial assistance by the aider and abettor in the achievement of the primary violation." *SEC v. Apuzzo*, 689 F.3d 204, 211 (2d Cir. 2012) (citation omitted).

Substantial assistance, in turn, requires that the aider and abettor "in some sort associated himself with the venture, that he participated in it as in something that he wished to bring about, and that he sought by his action to make it succeed." *Id.* at 206 (citation omitted).

Section 10(b) and Rule 10b-5 thereunder prohibit manipulative practices in connection with the purchase and sale of securities. Section 10(b) states:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange-
>
> . . .
>
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, or any securities-based swap agreement any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

15 U.S.C. § 78j(b) (emphasis supplied).

Rule 10b-5, in turn, provides in pertinent part:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
>
> (a) To employ any device, scheme, or artifice to defraud,
>
> . . .
>
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

17 C.F.R. § 240.10b-5 (emphasis supplied).

To prevail on a claim of market manipulation under § 10(b) and Rule 10b-5, the SEC must demonstrate that the defendant engaged in manipulative acts with scienter in connection with the purchase or sale of securities on any facility of a national securities exchange. Unlike private plaintiffs, the SEC is not required to prove investor reliance, loss causation, or damages. *SEC v. Boock*, 09cv8261 (DLC), 2011 WL 3792819, at *21 (S.D.N.Y. Aug. 25, 2011); *SEC v. Credit Bancorp, Ltd.*, 195 F. Supp. 2d 475, 490-91 (S.D.N.Y. 2002).

In determining whether an act is manipulative, the Second Circuit requires "a showing that an alleged manipulator engaged in market activity aimed at deceiving investors as to how other market participants have valued a security." *Wilson v. Merrill Lynch & Co., Inc.*, 671 F.3d 120, 130 (2d Cir. 2011) (citation omitted). "The gravamen of manipulation is deception of investors into believing that prices at which they purchase and sell securities are determined by the natural interplay of supply and demand, not rigged by manipulators." *Id.* (citation omitted). In determining whether activity falls outside the natural interplay of supply and demand, courts generally consider whether it sends "a false pricing signal to the market." *Id.* (citation omitted).

While market manipulation has traditionally encompassed practices such as wash sales, matched orders, or rigged prices, manipulation is not limited to these practices. *Id.* It more broadly includes those practices "that are intended to mislead investors by artificially affecting market activity." *Id.* (citation omitted). For instance, the Second Circuit has noted

that "trading engineered to stimulate demand can mislead investors into believing that the market has discovered some positive news and seeks to exploit it; the duped investors then transact accordingly." *ATSI*, 493 F.3d at 101.

In considering whether an act injects false pricing signals into the market, courts recognize that one of the fundamental goals of the federal securities laws is to promote transparency-that is, "to prevent practices that impair the function of stock markets in enabling people to buy and sell securities at prices that reflect undistorted (though not necessarily accurate) estimates of the underlying economic value of the securities traded." *Id.* at 100 (citation omitted). As the Supreme Court has repeatedly recognized, the "fundamental" purpose of the securities laws is "to substitute a philosophy of full disclosure for the philosophy of caveat emptor." *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462, 477 (1977) (citation omitted); *see Basic Inc. v. Levinson*, 485 U.S. 224, 230 (1988). In passing securities laws, "Congress meant to prohibit the full range of ingenious devices that might be used to manipulate securities prices." *Santa Fe Indus.*, 430 U.S. at 477.

Market manipulation can be accomplished through otherwise legal means. As the Second Circuit has noted, "in some cases scienter is the only factor that distinguishes legitimate trading from improper manipulation." *ATSI*, 493 F.3d at 102. Nor does manipulative conduct need to be successful in order to violate the securities laws. As the D.C. Circuit has noted, "intent—not success—is all that must accompany manipulative conduct to prove a violation of the Exchange Act." *Koch v. SEC*, 793 F.3d 147, 153-54 (D.C. Cir. 2015);

see also United States v. Weaver, 860 F.3d 90, 97 (2d Cir. 2017) (rejecting argument that liability under criminal mail and wire fraud statutes required fraudulent scheme to be successful).

At least one district court has found that a complaint against defendants engaged in layering sufficiently alleged manipulative conduct in violation of § 10(b) and Rule 10b-5. *CP Stone Fort Holdings, LLC v. Doe(s)*, No. 16 C 4991, 2017 WL 1093166, at *4 (N.D. Ill. Mar. 22, 2017). Another district court has accepted a plea agreement in which a defendant engaged in layering pled guilty to a conspiracy to commit securities fraud in violation of 18 U.S.C. § 371. Plea Agreement, *United States v. Milrud*, No. 2:15-cr-00455-JLL (D.N.J. Sept. 10, 2015). The SEC has consistently found layering and spoofing activity to violate § 10(b) and Rule 10b-5. *See In the Matter of the Application of Terrance Yoshikawa for Review of Disciplinary Action Taken by NASD,* SEC Release No. 53731, 87 S.E.C. Docket 2580, 2006 WL 1113518, at *7 n.36 (Apr. 26, 2006) (describing the SEC's history since 1998 of finding spoofing/layering to violate § 10(b) and Rule 10b-5).

Liability for securities fraud under § 10(b) and Rule 10b-5 also requires proof of scienter, which the Supreme Court has defined as an "intent to deceive, manipulate or defraud" or "knowing or intentional misconduct." *Ernst & Ernst v. Hochfelder,* 425 U.S. 185, 194 n.12, 197 (1976); *see Grandon v. Merrill Lynch & Co.*, 147 F.3d 184, 194 (2d Cir. 1998). The Second Circuit has held that reckless conduct—*i.e.* "conduct which is highly unreasonable and which represents an extreme departure from the standards of ordinary care" —satisfies the scienter requirement. *SEC v. Obus*,

693 F.3d 276, 286 (2d Cir. 2012) (citation omitted). Mere negligence, however, is insufficient. *Id.* "Proof of scienter need not be direct, but may be a matter of inference from circumstantial evidence." *Wechsler v. Steinberg*, 733 F.2d 1054, 1058 (2d Cir. 1984) (citation omitted).

The SEC has adequately alleged that the Lek Defendants violated § 20(e) by aiding and abetting Avalon's, Fayyer's, and Pustelnik's violations of § 10(b) and Rule 10b-5. The complaint alleges primary violations of § 10(b) and Rule 10b-5 by Avalon, Fayyer, and Pustelnik with particularity. It describes at length and in detail two manipulation schemes, either one of which if proven at trial would violate § 10(b). The complaint is also replete with allegations of scienter by Avalon, Fayyer, and Pustelnik.

The SEC also adequately pleads the Lek Defendants' knowledge of Avalon's manipulative activity and substantial assistance. The Lek Defendants received multiple warnings concerning Avalon's layering and cross-market manipulation activity. The activity at issue was conducted in large part through the Avalon Account. In addition, the Lek Defendants actively facilitated Avalon's layering and cross-market manipulation activity by relaxing Q6 Control for Avalon and upgrading Lek's options trading technology in response to Fayyer's request.

IV. Claim under § 15(b) of the Securities Act for Aiding and Abetting Avalon's, Fayyer's, and Pustelnik's Violations of § 17(a)(1) and § 17(a)(3)

Section 15(b) of the Securities Act likewise establishes aiding and abetting liability. 15 U.S.C. § 77o(b). It provides:

> For purposes of any action brought by the Commission under subparagraph (b) or (d) of section 77t of this title, any person that knowingly or recklessly provides substantial assistance to another person in violation of a provision of this subchapter, or of any rule or regulation issued under this subchapter, shall be deemed to be in violation of such provision to the same extent as the person to whom such assistance is provided.

15 U.S.C. § 77o(b) (emphasis supplied). Because the operative language in § 15(b) is nearly identical to that in § 20(e), the standard for aiding and abetting liability is the same under both statutes. *See, e.g.*, *SEC v. Wey*, 15cv7116 (PKC), 2017 WL 1157140, at *21 (S.D.N.Y. Mar. 27, 2017).

Section 17(a) of the Securities Act prohibits fraud in the offer or sale of a security, and provides in pertinent part:

> (a) Use of interstate commerce for purpose of fraud or deceit
>
> It shall be unlawful for any person in the offer or sale of any securities . . . by the use of any means or instruments of transportation or communication in interstate commerce or by use of the mails, directly or indirectly
>
> (1) to employ any device, scheme, or artifice to defraud, or
>
> . . .
>
> (3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

15 U.S.C. § 77q(a) (emphasis supplied).

To plead a violation of § 17(a), the SEC must allege that the defendant engaged in manipulative acts in connection with the offer or sale of securities. *See SEC v. Pentagon Capital Mgmt. PLC*, 725 F.3d 279, 285 (2d Cir. 2013). Scienter is a required element for a violation of § 17(a)(1). *Aaron v. SEC*, 446 U.S. 680, 697 (1980). No showing of scienter is required, however, under § 17(a)(3). *Id.*; *Pentagon Capital*, 725 F.3d 279 at 285.

For the reasons stated above, the SEC adequately alleges that the Lek Defendants violated § 15(b) of the Securities Act by aiding and abetting Avalon's, Fayyer's, and Pustelnik's violations of §§ 17(a)(1) and 17(a)(3) of the Securities Act. The Lek Defendants' motion to dismiss this claim is also denied.

V. Claim under § 20(e) of the Exchange Act for Aiding and Abetting Avalon's Violations of § 9(a)(2)

The governing standard regarding § 20(e) is recited above. Section 9(a)(2) prohibits a series of securities transactions that create active trading in a security, or raise or depress the price of a security, for the purpose of inducing others to purchase or sell the security. 15 U.S.C. § 78i(a)(2). It provides:

> (a) Transactions relating to purchase or sale of security
>
> It shall be unlawful for any person, directly or indirectly, by the use of the mails or any means or instrumentality of interstate commerce, or of any facility of any national

> securities exchange, or for any member of a national securities exchange-
>
> . . .
>
> (2) To effect, alone or with 1 or more other persons, a series of transactions in any security registered on a national securities exchange, any security not so registered, or in connection with any security-based swap or security-based swap agreement with respect to such security creating actual or apparent active trading in such security, or raising or depressing the price of such security, for the purpose of inducing the purchase or sale of such security by others.

Id. (emphasis supplied). Section 9(a)(2), of course, does not proscribe all market transactions that raise or lower the price of a security. *Chris-Craft Indus., Inc. v. Piper Aircraft Corp.*, 480 F.2d 341, 383 (2d Cir. 1973). Rather, its purpose is to "outlaw every device used to persuade the public that activity in a security is the reflection of a genuine demand instead of a mirage." *Crane Co. v. Westinghouse Air Brake Co.*, 419 F.2d 787, 794 (2d Cir. 1969) (citation omitted).

Courts have held that a "series of transactions" includes not only completed purchases or sales but also bids and orders to purchase or sell securities. *See SEC v. Malenfant*, 784 F. Supp. 141, 145 (S.D.N.Y. 1992); *Spicer v. Chicago Bd. Options Exch., Inc.*, No. 88 C 2139, 1990 WL 172712, at *2 (N.D. Ill. Oct. 30, 1990), *aff'd sub nom. Spicer v. Chicago Bd. of Options Exch., Inc.*, 977 F.2d 255 (7th Cir. 1992). In considering the legislative history of § 9(a)(2), the SEC has concluded that Congress "clearly intended its prohibition against

manipulation to extend beyond the actual consummation of purchases or sales." *In the Matter of Kidder Peabody & Co., et al.*, SEC Release No. 3673, 18 S.E.C. 559, 1945 WL 332559, at *8 (Apr. 2, 1945); *see In the Matter of Biremis*, 105 S.E.C. 862, 2012 WL 6587520, at *2 (Dec. 18, 2012); Lewis D. Lowenfels, Sections 9(a)(1) and 9(a)(2) of the Securities Exchange Act of 1934: An Analysis of Two Important Anti-Manipulative Provisions Under the Federal Securities Laws, 85 NW. U. L. Rev. 698, 707-08 (1991). Proof of a violation of § 9(a)(2) requires evidence of "manipulative motive and willfulness," which are normally inferred from the circumstances of the case. *Crane Co.*, 419 F.2d at 794.

The SEC adequately alleges that the Lek Defendants violated § 20(e) by aiding and abetting Avalon's violations of § 9(a)(2). The SEC alleges a primary violation by Avalon through the series of securities transactions in which it conducted both its layering and cross-market trading schemes. Each of these schemes was designed to create a false impression of supply or demand for securities and to induce other market participants to purchase or sell securities. As previously described, the SEC also adequately alleges that the Lek Defendants had knowledge of Avalon's layering and cross-market activities and provided Avalon substantial assistance.

In a claim-specific objection, the Lek Defendants argue that the complaint fails to allege a primary violation of § 9(a)(2) in connection with the layering scheme because cancelled bids and offers are not "transactions." As previously described, courts and regulators have found that a "series of transactions" that create "actual or apparent" active trading encompasses not only executed trades but also bids and orders

to purchase or sell securities. The Lek Defendants' motion to dismiss this claim is denied.

VI. Claim under § 17(a)(3) of the Securities Act

The complaint also alleges that the Lek Defendants themselves violated § 17(a)(3) of the Securities Act. Section 17(a)(3) and the relevant standards for applying that law have already been described.

The SEC has adequately alleged that the Lek Defendants themselves engaged in a course of business that operated as a fraud. They provided Avalon with access to U.S. securities markets, thereby enabling Avalon to conduct its layering and cross-market trading schemes. The Lek Defendants' motion to dismiss this claim is denied.

VII. Claim under § 20(a) of the Exchange Act

The final claim at issue here is the claim that Lek controlled Pustelnik and is liable for his violations of § 10(b) and Rule 10b-5. Section 20(a) of the Exchange Act imposes derivative liability on entities that control individuals who violate the Exchange Act. *In re Vivendi, S.A. Sec. Litig.*, 838 F.3d 223, 238 n.6 (2d Cir. 2016). It provides:

> (a) Joint and several liability; good faith defense
>
> Every person who, directly or indirectly, controls any person liable under any provision of this chapter or of any rule or regulation thereunder shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable (including to

> the Commission in any action brought under paragraph (1) or (3) of section 78u(d) of this title), unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action.

15 U.S.C. § 78t(a) (emphasis supplied).

The statutory language identifies two components to a control person claim: (1) a primary violation by a controlled person and (2) direct or indirect control of the primary violator by the defendant. It also provides for an affirmative defense of good faith. The concept of "culpable participation," which is a regular fixture of the Second Circuit's jurisprudence, describes that degree of control which is sufficient to render a person liable under § 20(a). *In re WorldCom, Inc. Sec. Litig.*, 294 F. Supp. 2d 392, 415 (S.D.N.Y. 2003); *cf. Fed. Hous. Fin. Agency v. Nomura Holding Am., Inc.*, 104 F. Supp. 3d 441, 575-78 (S.D.N.Y. 2015) (analyzing trial evidence of the nature of the controlled entity, the status of the alleged controlling entity, and the actions taken by the controlling entity on behalf of the controlled entity) (Section 15 of the Securities Act). "[T]here is no required state of mind for a defendant's culpable participation in a Section 20(a) offense." *In re WorldCom, Inc. Sec. Litig.*, 294 F. Supp. 2d at 415; *see In re WorldCom, Inc. Sec. Litig.*, 02cv3288 (DLC), 2005 WL 638268, at *13 (S.D.N.Y. Mar. 21, 2005).

Control over a primary violator may be established by showing that the defendant possessed "the power to direct or cause the direction of the management and policies of the primary violators, whether through the ownership of voting securities, by contract, or otherwise." *In re Lehman Bros. Mortg.-Backed Sec. Litig.*,

650 F.3d 167, 185 (2d Cir. 2011) (citation omitted). Once the plaintiff makes out a prima facie case of liability under § 20(a), the burden shifts to the defendant "to show that he acted in good faith, and that he did not directly or indirectly induce the act or acts constituting the violation." *SEC v. First Jersey Sec., Inc.*, 101 F.3d 1450, 1473 (2d Cir. 1996) (citation omitted).

The SEC adequately pleads its claim under § 20(a). The SEC has alleged primary violations of § 10(b) and Rule 10b-5 by Pustelnik. The SEC also adequately alleges that Lek exercised control over Pustelnik. The complaint alleges that Pustelnik became a registered representative at Lek, that Samuel Lek supervised Pustelnik, and that Pustelnik received commissions and other payments from Lek on the trades that Avalon placed through Lek.

In response, Lek principally contends that the SEC fails to allege it controlled Pustelnik because Pustelnik acted outside the scope of his employment, operated as a secret owner of Avalon, and lied to Lek about Avalon's layering activity. This argument does not suggest that the pleading of control person liability is inadequate. Instead, it describes a defense of good faith that Lek will have the opportunity to present at trial. Lek's motion to dismiss this claim is denied.

VIII. The Lek Defendants' General Arguments

In their motion to dismiss, the Lek Defendants principally present arguments addressed to the SEC's overarching theory of liability. They argue that Avalon's layering and cross-market trading activity do not constitute market manipulation. With respect to Avalon's layering activity, they argue that even Avalon's non-bona fide orders were "live, real, and actionable"

orders that were subject to market risk and therefore could not create a false impression of supply and demand or send a false pricing signal. They contend that the "logical inference" from the alleged facts is that Avalon wanted its bids and offers executed. Likewise, the Lek Defendants argue that Avalon's cross-market trading activity did not inject false information into the market because the trading involved "real buyers" and was "reactive" to bids and offers for stock and options placed by others in the market. They argue as well that Avalon's stock trades were undertaken to hedge its risk from its options trading.

These arguments largely present factual assertions which are inappropriate for a motion to dismiss. This is particularly true when it comes to the intentions of either the Avalon defendants or the Lek Defendants. The complaint contains sufficiently detailed allegations to support its assertions as to each defendant's mens rea. Whether the SEC will present sufficiently compelling evidence of scienter and whether any defendant offers a credible defense on this ground must await trial.

To the extent that the Lek Defendants argue that the entry of an order in the open market may never constitute manipulative conduct, they are wrong. Moreover, this argument largely misses the mark. It ignores the thrust of the SEC's claim, which concerns coordinated patterns of trading, indeed voluminous trading, designed to mislead the market.

The Lek Defendants' argument regarding the legality of Avalon's trading also overlooks the SEC's substantial allegations of manipulative intent. As the Second Circuit has recognized, manipulative conduct may appear perfectly legal on its face. "[I]n some cases scienter is the only factor that distinguishes legitimate

trading from improper manipulation." *ATSI*, 493 F.3d at 102. Here, the complaint is replete with allegations of scienter.[2]

The Lek Defendants next argue that the SEC fails to allege their scienter in connection with the aiding and abetting claims. They emphasize that Lek implemented Q6 Control and deny that it was mere window-dressing, despite the complaint's factual allegations that support its characterization that it was only that. They also point out that they were assured by Pustelnik that Avalon was not engaged in manipulative conduct. They assert as well that the receipt of regulatory inquiries is insufficient to show scienter. Again, these factual arguments may be raised at trial; they do not suggest that the pleading is deficient. The SEC will have the burden of proving that the Lek Defendants acted with the requisite scienter, and the defendants may contest that evidence. All that matters at this stage is whether the complaint meets the requirements imposed by Rule 9(b), and it does.

Finally, the Lek Defendants argue that the SEC fails to plead that they provided substantial assistance to Avalon. They represent that the brokerage services that they provided to Avalon were "routine services" that broker-dealers regularly provide to all customers. Providing brokerage services—and with those services

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2 The Lek Defendants do not argue that the complaint fails to plead scienter with respect to Avalon, Fayyer, and Pustelnik. They briefly argue, however, that it fails to plead the scienter of Avalon's day traders. The SEC claims that Avalon, Fayyer, and Pustelnik are the principals who have violated § 10(b). It is facts supporting their liability under the securities laws that must be pleaded, and the complaint meets that burden.

entrée to U.S. securities markets—constitutes substantial assistance to a market manipulator. *See, e.g.*, *Graham v. SEC*, 222 F.3d 994, 1004 (D.C. Cir. 2000). If done with the requisite knowledge, it is a violation of §§ 20(e) and 15(b). In any event, the complaint also describes other acts taken specifically by the Lek Defendants to substantially assist Avalon's schemes.

CONCLUSION

Lek and Samuel Lek's June 2, 2017 motion to dismiss the complaint is denied.

/s/ Denise Cote
United States District Judge

Dated: August 25, 2017
New York, New York