

COMMENTARY

WHISTLEBLOWER ATTORNEYS: RECENT SEC SETTLEMENT WITH PIPELINE INC. MAY ENCOURAGE DARK POOL TRADING SUITS

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The SEC has accepted the increasingly important role that alternative trading systems play in securities transactions, and it has adopted an aggressive enforcement posture to ensure those systems' integrity.

Dark pools have captured a significant percentage of equity volume since 2007. In Oct. 2011, four years later, the SEC brought its first enforcement action against a dark pool.

The SEC's \$1 million settlement with Pipeline Trading, LLC, raised questions about the SEC's interest in alternative trading systems. A year later there is little doubt that the case marked a shift in the Commission's enforcement focus.

Just one year after Pipeline, the SEC has settled its second action against a dark pool, eBX, LLC. Also, the SEC approved an alternative trading system aimed at retail investors this past summer.

With Commissioner Elise Walter succeeding Chairwoman Mary Schapiro, nothing suggests that this vigilant stance toward alternative trading systems will change any time soon. As such, we can expect more enforcement actions with characteristics similar to Pipeline and eBX.

Pipeline and eBX operate dark

pools, a type of alternative trading system. Dark pools facilitate large trades off the main exchanges, like the NYSE. Because the trades are secret, dark pools allow institutional investors to make big trades without revealing their intentions.

In Oct. 2011, Pipeline settled an SEC enforcement action for \$1 million. The Commission accused Pipeline of securities fraud and other violations of disclosure duties.

Pipeline said it used algorithms to execute unconflicted, large block trades, according to the SEC's charges. Its brand was that of a haven from unscrupulous "predators" and "frontrunners." But Pipeline secretly was executing up to 80% of its trades through a wholly owned subsidiary that had advantages over other customers.

Some called Pipeline a bellwether, while others dismissed it as an outlier.

Then in Oct. 2012, the SEC settled an enforcement action against eBX for \$800,000. The facts closely resembled Pipeline.

eBX contracted with an outside firm to operate Level ATS, the dark pool. Just as Pipeline had done, the outside firm used its inside knowledge to fill its own orders to its advantage.

The eBX and Pipeline actions have another thing in common: the rela-

tively low damages at issue. Indeed, SEC Enforcement Director Robert Khuzami's statements in both cases reflect a focus on the alternative trading system's integrity, not how much money had been lost.

Khuzami said of the Pipeline settlement in a statement: "However orders are placed and executed, be it on an exchange floor or in an automated venue, whether dark or displayed, one principle remains fundamental -- investors are entitled to accurate information as to how their trades are executed."

Pipeline and its senior executives are being held to account because they misled their customers about how Pipeline's dark pool really worked."

After the eBX settlement, Khuzami issued this comment:

"Dark pools are dark for a reason: buyers and sellers expect confidentiality of their trading information. Many eBX subscribers didn't get the benefit of that bargain -- they were unaware that another order routing system was given exclusive access to trading information that it used for its own benefit."

Though one should be wary of reading too much into a prepared statement, the use of words like "fundamental" and "principle" are more than rhetoric. Tellingly, Khuzami em-

phasizes that Pipeline was held to account for misleading investors -- not necessarily bilking investors for their money.

In the interim, the SEC approved the New York Stock Exchange's Retail Liquidity Program on a test basis. The program is an alternative trading system with some features resembling dark pools, which is aimed at retail investors.

This was a victory for NYSE Euronext over the program's critics, and a sign that the SEC is coming to grips with the vast share of equity volume dark pools now hold.

NYSE Euronext Chief Executive Duncan L. Niederauer, wrote in *The Financial Times* that the growing prevalence of dark pools is "undermining confidence in markets for equity issuers and investors."

The same week, an NYSE Euronext executive vice president said the program was necessary to compete with what was being encouraged in the market.

The SEC appears to accept the latter, while signaling it is prepared to meet the concerns of those like Niederauer.

Committing limited resources to actions involving relatively small damages sends a powerful message that the Commission is directly confronting



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the issues alternative trading systems pose. But the message will also have indirect enforcement benefits.

Coupled with the Dodd-Frank Act's generous whistleblower reward provisions, the SEC's willingness to prosecute claims with small damages gives employees an incentive to come forward if they learn of misconduct.

The SEC is shifting its regulatory approach to accept the larger role alternative trading systems play in securities transactions, while aggressively prosecuting them for fraud.

This shift, marked by the Pipeline action, will likely lead to similar cases and could encourage dark pool whistleblowers.

LEGAL NEWS

DESCHUTES COUNTY: JERRY NICHOLS DEATH INVESTIGATION CONCLUDED

Press release

District Attorney Patrick J. Flaherty has prepared a three page report regarding the death investigation of Jerry Nichols. Jerry Nichols was involved in an incident at Saint Charles Medical Center on August 12, 2012. With the assistance of the Oregon State Police, the State Medical Examiner's Office and the Bend Police Department, the District Attorney has concluded that the use of physical force by Officer Craig was lawful and justified in this matter. The District Attorney makes that determination based upon the facts in this matter and the applicable law.

DISTRICT ATTORNEY'S REPORT

Because this matter involved the use of force by a police officer which may have contributed to Mr. Nichols' death and the State Medical Examiner determined that the "manner of death" was "homicide", this matter has been referred to the Deschutes

County District Attorney's Office for a determination whether the use of force was lawful. At the outset, it is imperative to understand the distinction between "homicide" and "criminal homicide." "Criminal homicide" is committed where a person, without justification or excuse, "intentionally, knowingly, recklessly or with criminal negligence causes the death of another person." "Criminal homicide" is murder, manslaughter, criminally negligent homicide or aggravated vehicular homicide. ORS 163.005.

"Homicide" as that term is used by the State Medical Examiner is a neutral term that refers to the act of one person being the "probable mode of production of the cause of death" and does not pronounce judgment on the moral or legal quality of the act. See ORS 146.003(9); Black's Law Dictionary, 6th Ed., p. 734. In this case, there is absolutely no evidence of criminal homicide and therefore no need to determine whether the police officer's use of force was legally justified. However, because of the understandable ambiguity caused by the use

of the term "homicide" in the State Medical Examiner's autopsy report, the District Attorney's Office is issuing this report.

CONCLUSION:

Oregon Revised Statute 161.209 defines the limitations on the use of physical force in defense of a person. This statute applies to police officers and citizens alike.

A person can use physical force upon another person for self-defense or to defend a third person from what the person reasonably believes to be the use or imminent use of unlawful physical force. The person may use a degree of force which the person reasonably believes to be necessary for the purpose of self-defense or defense of a third person. The Deschutes County District Attorney has concluded that the use of physical force by Officer Craig was lawful and justified in this matter.

The District Attorney makes that determination based upon the facts in this matter and the applicable law.

FACTS AND INVESTIGATION:

On August 12, 2012, at approximately 6:13 p.m., Jerry Nichols entered St. Charles Medical Center and complained of shortness of breath to medical staff.

While a nurse was starting an IV on him, Mr. Nichols became combative with and assaultive toward the nurse and other hospital staff who described Mr. Nichols as "out of control." Mr. Nichols' oxygen saturation was low (87% on 2 liters of oxygen).

Mr. Nichols left the emergency department, going outside to sit on a picnic table.

One of the nurses commented that Mr. Nichols was about to "code," meaning about to have a cardiac or respiratory arrest, based on his current medical status.

Hospital staff called 911. The dispatch advised available police officers that St. Charles Emergency Room had a patient who was out of control, had assaulted a nurse, was threatening to stab hospital staff and who claimed to be a professional fighter.

City of Bend Police Officer Steve Craig responded to St. Charles. Officer Craig drove his patrol car near to the place where Mr. Nichols was sitting, at which time Mr. Nichols immediately stood up and walked toward Officer Craig. Mr. Nichols verbally challenged the officer.

Officer Craig verbally tried to calm Mr. Nichols and backed away from Mr. Nichols. When he got near, Mr. Nichols tried to strike the officer. As Mr. Nichols continued advancing, Officer Craig deployed his Taser on Mr. Nichols.

The Taser was ineffective because it was too close to Mr. Nichols and it did not disable him, although it did discharge electricity.

Officer Craig then struck Mr. Nichols and attempted to subdue him. Mr. Nichols physically resisted that attempt, continued fighting on the ground for a short period and then went into cardiac arrest.

Medical staff from St. Charles successfully performed CPR on Mr.

Nichols. He was admitted to St. Charles and remained a patient there for 8 days. At that time, a decision was made to remove him from life-support and he died soon thereafter. Mr. Nichols had a number of medical difficulties prior to this event.

Those included severe chronic obstructive pulmonary disease, dementia, uncontrolled diabetes, hypertension, cardiovascular disease and he had failed to comply with his physician's directive to take certain medications. This was Mr. Nichols' fifth hospital admission since October 2011.

An autopsy was performed on Mr. Nichols at the State Medical Examiner's Office. The Medical Examiner determined that the "cause of death" was "anoxic brain injury due to chronic obstructive pulmonary disease, hypertensive and atherosclerotic cardiovascular disease and physiologic stress due to an alteration" and that the "manner of death" was homicide.

The question presented is whether Officer Craig's use of force was lawful and justified in this matter. Officer Craig reasonably believed Mr. Nichols was about to use unlawful physical force against him and the degree of force used by Officer Craig was commensurate with the threat he perceived.

Officer Craig did not know Mr. Nichols' medical history nor is there any evidence suggesting that he should have been aware of Mr. Nichols' medical history. He did know Mr. Nichols had been assaultive and threatening toward Emergency Room staff, that Mr. Nichols claimed to be a professional fighter and that Emergency Room staff were alarmed enough by Mr. Nichols' behavior that they had called 911 to request police assistance rather than relying upon hospital security staff.

Officer Craig is well-trained, experienced and disciplined in this type of situation. Officer Craig responded to the perceived threat posed by Mr. Nichols as he was trained to do. Under the circumstances presented, his use of physical force was legally justified.

