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## Mosul Diary

### How Iraqi Professor Overcame Doubts To Trust a General

Mr. Jomard, Strong Opponent Of Hussein and U.S. Policy, Saw a 'Fellow Human'

Using Money as 'Ammunition'

By HUGH POPE

MOSUL, Iraq—"Don't expect me to go on television to express gratitude," declared Iraqi historian Jazeel Abd al-Jabbar al-Jomard.

U.S.-led forces ousted Saddam Hussein, a man Mr. Jomard despised, and helped rebuild the scholar's looted Mosul University, Iraq's second-largest. None of that has changed the short, thickset, 51-year-old professor's vehement opposition to Washington's policy and actions in the Middle East.

But over the course of six months, a patient American general and his forces in the 101st Airborne who oversee this section of Iraq's north have slowly managed to win Mr. Jomard's trust. "I learned to see these people as my friends ... once I realized that, as individuals, they had nothing to do with U.S. policy," he said.

How Mr. Jomard made his decision to work with the occupying forces offers a window on one of the most urgent challenges America faces in Iraq: getting Iraqis to actively cooperate in the face of an increasingly effective resistance movement. The U.S. suffered its deadliest day in Iraq since March 23 yesterday. The toll included 16 soldiers killed when their Chinook helicopter crashed west of Baghdad, apparently shot down. Last week anti-U.S. forces added car bombs to their attacks on the reformed Iraqi police, the most prominent collaborators with the U.S. occupation and a key to any future U.S. exit strategy from Iraq. (See articles in column 5 and on page A3.)

Any form of collaboration carries the danger of being targeted by resistance fighters. Last Thursday, thousands of leaflets were distributed in Baghdad threatening to kill all who "have sold their souls to work with the Americans and the Jews." They also said, "We know for certain who you are," and were signed by the Fedayeen, an organization loyal to Mr. Hussein. Such pressure causes many Iraqis who want to cooperate to waver and crumble in places where the U.S. occupation isn't as adroit as it has been in Mosul. Iraqi assistants to U.S. Army personnel often wear dark glasses to avoid being recognized. A translator working for U.S. journalists justifies his job to friends by saying he is brainwashing the Americans.

Opposition to foreign intervention comes naturally to Mr. Jomard, scion of a prominent Mosul family that was a longtime nationalist opponent of Iraq's old British-backed monarchy. When the king was toppled in a bloody 1958 coup, Mr. Jomard's father became foreign minister for the first six months of the new republican regime that followed.

An expert in Christian Europe's medieval crusades against the Islamic east, Mr. Jomard spent several years of doctoral study in Scotland and is familiar with the West. Though unhappy with Mr. Hussein's regime, he expected no good to come from the U.S. invasion.

He remains offended by what he views as a U.S. failure to prevent Israel from occupying Palestinian territories. He knows that Washington supported Mr. Hussein during his murderous 1980s prime. He deeply resents the way the U.S. left Mr. Hussein in power after devastating Iraq's infrastructure in the first Persian Gulf War in 1991, and then led the effort to impose crippling sanctions on the country. "I swear that even Iraqi ants were

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## What's News—

Business and Finance World-Wide

**THE SEC BLASTED** the Big Board for failing to police its floor-trading firms. According to a confidential report, about 2.2 billion shares were improperly traded over the past three years, costing investors more than \$150 million. The findings will likely bolster critics of the NYSE's regulatory arm and advocates of an electronic-trading system.

**The SEC is examining** if Grasso engaged in "influence trading" by pressuring an NYSE floor firm to buy more AIG shares.

**Former HealthSouth executives** gave themselves over \$500,000 of company money to pay for legal fees shortly before pleading guilty to defrauding shareholders.

**The FDA plans to issue** guidelines on when drug makers must submit genetic-testing results related to their products' effects.

**Employer groups won** a battle against ergonomics rules, stalling efforts to draft guidelines for preventing repetitive-motion injuries.

**U.S. furniture makers** asked the government to impose trade duties on Chinese-made bedroom furniture, alleging unfair pricing.

**Freddie Mac said** it may owe up to \$30 million in back taxes, a fraction of the added \$4.5 billion it expects in restated earnings.

**Massachusetts and the SEC** plan to file civil fraud charges against five or more Prudential ex-employees over market-timing.

**Richard Strong stepped down** as chairman of Strong Mutual Funds, in the wake of allegations he engaged in improper trading.

**More small businesses** are switching from utilities to deregulated energy marketers to buy fixed-price, natural-gas contracts.

**PharmaStem won** a patent suit against four other umbilical-cord blood banks over the technology to store the stem-cell source.

**Microsoft has launched** a major initiative to create new Internet search technology in an effort to close the gap with Google.

**MCI won approval** for its plan to emerge from Chapter 11 in early 2004 freed of all but \$5.8 billion of its former \$41 billion debt.

**Thomson is forming** a joint venture with China's TCL to produce the French company's TVs and other video products.

**Teva agreed to acquire** Sicom, a maker of generic injectable and biotechnology drugs, for \$3.33 billion in cash and stock.

**A Clinton Group executive** quit in a dispute over how the hedge-fund firm values some securities.

**World-wide chip sales** rose 6.5% in September from August, the sharpest jump since 1990.

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**INSURGENTS DOWNED** a U.S. helicopter in Iraq, killing 16 soldiers. In the deadliest day for the U.S. military since the war, guerrillas fired an apparent missile at a Chinook ferrying troops headed for leave. At least 20 other soldiers were injured in the crash west of Baghdad. Another U.S. soldier was killed in an ambush in the capital; two U.S. contractors died in a Fallujah roadside blast. Three troops were killed in earlier weekend attacks. In the hunt for banned weapons, U.S. investigators have uncovered records of Saddam Hussein's spies and evidence suggesting the ex-dictator aimed to develop long-range delivery systems before turning to chemical arms. (Cols. 1 and 5 and Page A3)

**The Senate votes today** on the \$87.5 billion package for Iraq and Afghanistan. Sen. Roberts said the White House promised access to papers for an inquiry into prewar intelligence.

**Israel eased** travel curbs slightly, letting thousands of Palestinian workers enter from the Gaza Strip for the first time in a month. Arafat and Qureia said they are willing to resume talks with Israel.

**Sharon arrived** in Russia, where he is expected to press Putin to rein in Iran's nuclear program and call off a U.N. vote on the U.S. peace plan.

**Firefighters gained** control of California wildfires; full containment was expected today amid cooler temperatures and rain. Officials sent more than 2,000 blaze battlers home and allowed evacuees to survey damage.

**Bush's entourage was shaken** when a woman crashed a car carrying her three children into a building near a Mississippi campaign stop Saturday. Police charged her with aggravated assault on an officer.

**A judge abused** her power by barring the death penalty over the government's refusal to let Sept. 11 defendant Moussaoui question al Qaeda captives, prosecutors argued in court papers made public Friday.

**Ayatollah Khamenei** said Tehran will stop cooperating if the U.N. nuclear agency makes demands that undermine Iran's atomic program.

**Bush national-security aides** were called "arrogant and disrespectful" by a bipartisan group of lawmakers blocked from visiting North Korea.

**Afghan President Karzai** welcomed a Security Council delegation on a support-affirming visit. Insurgents abducted a Turkish engineer to bargain for Taliban prisoner releases.

**The Rev. V. Gene Robinson** was consecrated as the first openly gay Episcopalian bishop, as dissension threatened to split the church.

**The EPA Friday rejected** new restrictions on weed-killer atrazine, finding no cancer risk. It is suspected of causing mutations in frogs.

**Sri Lanka asked** Norway to organize a meeting with Tamil rebels with an eye toward peace talks early next year. Rebels seek to focus on their proposal for an interim administration.

**Abdullah Ahmad Badawi** took over as Malaysia's premier, succeeding Mahathir Mohamad after a 22-year reign that was fruitful, if turbulent.

**A U.N. envoy** is in Myanmar to assess the political situation and meet with the junta. He cut short a March visit after finding a bugging device.

**Iceland researchers** discovered a gene variant that triples a person's risk of developing osteoporosis and related bone fractures. (Page B1)

**Martin Lel of Kenya** won the New York City Marathon in 2 hours, 10 minutes and 30 seconds. Among women, Margaret Okayo of Kenya won in 2:22:31, setting a course record.

**Died: Richard Neustadt**, 84, presidential adviser and historian who helped found the Kennedy School of Government, Friday, in England. ... **Jimmy Quillen**, 87, Tennessee congressman who served from 1963 to 1997, Sunday, in Kingsport, Tenn.

**Online Today—**  
**Eyes on the Road:** Honda's pledge to beef up safety features taps a growing consumer demand, and puts it ahead of U.S. competitors, Joe White says.

**Follow the Money:** For evidence of Johnson & Johnson's marketing muscle, see how it turned a poison-ivy salve into a hot skin-care line.

**Taking Stock:** With the economy improving, the tech sector may take a back seat to the broader market.

### For Stand-Up Guys, No Home Is Complete Without One of These

Urinals Make Slow Migration From Bar to Master Bath; 'Rose' by Any Other Name

By DAN MORSE

A year ago, Ben Jones asked his wife if he could have a urinal.

"No way. Absolutely not," Gina Jones told her husband.

The 40-year-old San Antonio-area magazine publisher kept after her. The fixture would be perfect in the first-floor bathroom of their new house, he said, near the door to the deck.

Mr. Jones then went with his wife to a plumbing-supply store where they

were shown an American Standard catalog. The showroom manager pointed out the \$91 Maybrook model and noted that it would help keep the bathroom floor dry, particularly when the Joneses entertain.

"OK," Ms. Jones, an attorney, finally told her husband, after all the cajoling, "but you're going to clean it."

The device was unveiled at a party over the Memorial Day weekend. Mr. Jones recalls the reaction from his high-fiving buddies: "You got a urinal. Awesome! How'd you talk your wife into that?"

After their long confinement to public restrooms, urinals are creeping into American homes. A big reason: big houses, with spacious new bathrooms.

Roughly 325,000 urinals are manufactured every year in the U.S., and almost all of them still go into offices, stadiums and other commercial spaces. Nobody tracks residential installations, but officials at two big makers of toilets, American Standard Cos. and Kohler Co., say they're hearing about more of them. Atlanta plumber Tom Ward says that in his first 19 years in the business he didn't install a single home urinal. In the past seven years, he has installed 10. Designers say they are incorporating more urinals into bathroom plans. They are particularly appreciated in homes with young boys.

Home urinals are popping up on TV. Ozzy Osborne has one in his California home. New York Jets running back Curtis Martin showed his off on MTV's "Cribs." He recommends urinals to all men, so their wives won't bug them about putting down the seat.

Also, they are a point of pride. "She is a 1983 Eljer with a chrome-on-brass 1968 Haws freeze-resistant flush valve ... which has been in service since 1991 when I recycled her," wrote Mike Shepherd, who submitted that caption along with a urinal photo to www.urinal.net.

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**NOTICE TO READERS—**  
Weather Watch, a daily briefing for business travelers, makes its debut today on the back page of the Money & Investing section. With data provided by AccuWeather Inc., the briefing delivers weather information on principal global business destinations and a look at expected delays at major airline hubs. Also included is "Weather to Buy or Sell," a Monday-through-Thursday look at how weather is affecting commodities such as corn, wheat, oil, sugar or electricity. On Fridays, "Events Forecast" will showcase weekend weather for selected global cities hosting festivals, tournaments or other significant events.

**Stephen King Makes For Strange Bedfellows**  
What would make three rival publishing firms collaborate? How about a seven-volume King series that needs two companion books to help confused readers? PAGE B1

**Convenience-Store Science**  
Running a convenience-store chain poses a logistical challenge. In China, a former Starbucks executive has his work cut out for him. A13

## Market Discipline SEC Blasts Big Board Oversight Of 'Specialist' Trading Firms

Investors Were Shortchanged \$155 Million Over 3 Years, Confidential Report Says In 2 Hours, 21 Violations

By DEBORAH SOLOMON AND SUSANNE CRAIG

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

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

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

The SEC report says that about 2.2 billion shares were improperly traded over the past three years, costing investors \$155 million. In the context of overall Big Board trading activity, the improper transac-

**Grasso's Actions Studied**  
The SEC is examining whether Dick Grasso improperly influenced trading, among other things, as head of the Big Board, page C11.

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## Baghdad Records Show Hussein Sought Missiles, Other Aid Abroad

U.S. investigators have unearthed Iraqi records of Saddam Hussein's agents world-wide, a treasure trove of intelligence that U.S. officials expect will help to identify foreigners paid to serve the former dictator's interests and to unravel international networks for procuring missiles and other banned weapons.

A senior U.S. official familiar with the records said the documents—along with interrogations of former regime officials—

ministration had disclosed that Iraq was seeking missile technology from North Korea, not actual missile purchases.

Information contained in the files could prove troublesome for individuals, companies and countries that may be implicated in aiding Mr. Hussein's regime. U.S. officials say the documents could help establish tribunals in Iraq for people involved in crimes against the Iraqi people. Already, revelations from the files have prompted the Federal Bureau of Investigation to open new espionage and criminal probes in the U.S.

"We have the equivalent of the Stasi archives," said the senior U.S. official, referring to the East German state security service files recovered after that Communist regime's collapse. Those archives, which implicated both domestic and foreign informants and agents, sparked a series of political scandals and some legal prosecutions.

The Iraqi documents are among 25 tons of papers seized at the abandoned headquarters of the country's intelligence services days after the fall of Baghdad in April, according to U.S. officials. The records include a "complete listing of the amount of money paid for political influence" to foreigners, including politicians, business people and others, said the U.S. official familiar with the files. Mr. Hussein's overseas intelligence apparatus kept track of Iraqi exiles opposed to his regime, and Baghdad also kept lists of informants paid for their help in that regard.

"We're busy vetting" all lists of people paid by Iraq, the official said. The official declined to disclose more details. Please Turn to Page A4, Column 5

By Frederick Kempe in Baghdad, Iraq, and David S. Cloud in Washington

still haven't turned up evidence that Iraq was actively producing chemical and biological weapons or had restarted its nuclear program, as Bush officials asserted prior to the war. But the documents, as described by the U.S. official, could lend credence to more recent assertions by the Bush administration that Mr. Hussein was seeking to develop long-range missiles as a preliminary step to renewing a program of chemical and biological weapons.

U.S. officials say archives of Iraq's domestic security and foreign intelligence services, the broad reach of which hadn't previously been disclosed, could provide a revealing look at Mr. Hussein's efforts in the past decade to conduct intelligence activities and influence other countries' political stances toward Iraq. Other Iraqi government documents show for the first time Baghdad's efforts to purchase from North Korea missiles with longer ranges than allowed by United Nations sanctions. Previously, the Bush ad-

### Under Fire

Highlights of the SEC's report on the New York Stock Exchange:

- LOSSES:** Specialists allegedly short-changed investors at least \$155 million, in trades on 2.2 billion shares over three years. (Average daily volume is 1.4 billion)
- EXCHANGE DEFICIENCIES:** Didn't conduct routine checks on many trading violations; when it found wrongdoing, response was "inadequate"
- SPECIALIST-FIRM DEFICIENCIES:** Didn't have "meaningful" ways to track violations
- REMEDIES:** NYSE agreed to make improvements to curb alleged abuses, including adding staff and committing more money to regulation

tions cited by the SEC involved less than 1% of the shares traded during the period—equivalent to about 1½ days' typical trading volume.

The report cuts to the heart of public trust in the 211-year-old exchange—the world's biggest, and one of the last that still matches buyers and sellers with human traders. And it comes as the Big Board is reeling over the pay-related ouster of Chairman Dick Grasso and is being criticized for how it conducts business.

The findings are likely to bolster those who argue that the NYSE's regulatory arm should be taken out from under the exchange's control. And it is sure to raise further questions by investors over whether the specialist system should be scrapped in favor of an electronic-trading model embraced by most other exchanges. Fidelity Investments and some other institutional investors have called for an end to specialists, which are charged with assuring that trading is orderly for specific stocks. This week, the NYSE's interim chairman, John Reed, will propose major changes in the exchange's governance, including an overhaul of the NYSE's board, in a bid to reduce conflicts of interest.

The NYSE, which was given 15 days to respond to the report, declined to comment on it or to say whether it had re-

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## INSIDE TODAY'S JOURNAL

**Don't Accommodate Syria**  
The nation remains a source and transit point for anti-U.S. terrorists in Iraq. Senators should pass a bill allowing Bush to impose sanctions on Damascus. REVIEW & OUTLOOK, A14

**Pessimists With a Pedigree**  
A few respected economists from Merrill Lynch, Morgan Stanley and Goldman Sachs say the economy could be heading for a disappointment. ABREAST OF THE MARKET, C1

## MUTUAL FUNDS MONTHLY REVIEW



**With Mutual Funds in Uproar, Why Not Launch a New One?**  
**Fund Balances Rise and Fall, But Fees Always Go Higher**  
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# SEC Blasts Big Board Oversight of 'Specialists'

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sponded to the SEC. The Big Board also said it would be inappropriate to speak about a confidential SEC inspection report "that was provided to The Wall Street Journal by someone who acted unethically." The SEC also criticized the Journal for publishing the report.

SEC Chairman William Donaldson, who headed the Big Board in the early 1990s, has been critical of the exchange's governance over the past several months, saying he wants to see some separation of the NYSE's regulatory and business operations. However, Mr. Donaldson hasn't called for a complete split of the regulatory and market operations and has suggested that the NYSE's specialist system should continue to operate alongside newer, electronic marketplaces.

An SEC spokeswoman declined to com-

ment on the report and wouldn't discuss Mr. Donaldson's reaction to its contents.

The SEC's conclusions also could raise questions among critics about whether the NYSE underfunded its regulatory arm at the expense of hefty pay for senior executives such as Mr. Grasso, who was ousted as CEO and chairman following a public outcry over his \$187.5 million retirement nest egg. At the request of the SEC, the NYSE recently assigned 25 to 30 enforcement lawyers and 20 market-surveillance analysts to cases. The exchange's market-surveillance group also will hire nine additional staff members and is getting a \$3 million annual budget increase.

Prepared by the SEC's office of compliance, inspections and examinations, the report recommends overhauling everything from the way the Big Board monitors its trading floor to how it sanctions those

who violate the rules. According to the report, the SEC began its investigation after an April 17 article in the Journal about an NYSE investigation into whether specialists traded ahead of customers.

### Possible Action

Now, the SEC's enforcement division is looking into the issues raised in the inspection report to determine whether to bring an enforcement action against the Big Board for failing to fulfill its self-regulatory duty, according to people familiar with the matter. Such a move would be only the second time in recent memory that the SEC has taken action against the NYSE for failing to adequately police its floor. In 1999, the SEC found that the NYSE failed to enforce compliance with federal securities laws and NYSE rules in the case of a non-Big Board brokerage firm, Oakford Corp.,

which the SEC accused of participating in an illegal-trading scheme. Two weeks ago, the SEC took action against the Chicago Stock Exchange for lax oversight.

The SEC itself has faced pressure for more vigorous enforcement recently. In the past year, the securities-industry watchdog has lost ground to New York Attorney General Eliot Spitzer, who launched his own probes of overly enthusiastic Wall Street research and improper trading at mutual funds.

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

The SEC report comes as the NYSE continues its own probe into specialist trading. The Big Board recently alleged that the five largest specialists may have short-changed investors by more than \$100 million over three years through improper trading. The NYSE is sending out unvarnished data on trades to the specialists who in turn will analyze the data and come back to the exchange to argue which trading was proper and which wasn't.

Under investigation by the NYSE are LaBranche & Co.; Fleet Specialist, a unit of FleetBoston Financial Corp.; Bear Wagner Specialists LLC, which is minority-owned by Bear Stearns Cos.; Spear, Leeds & Kellogg, a unit of Goldman Sachs Group Inc.; and Van der Moolen Specialists USA, a unit of Van der Moolen Holdings NV.

Spokespeople or senior executives from LaBranche and Bear Stearns didn't return calls for comment. A senior executive from Van der Moolen Specialists declined to comment. Spokesmen for Goldman and Fleet Specialists also declined to comment.

The NYSE's investigation, which began last fall in response to a foreign-listed company's complaint about trading in its stock, had inched along for months until, at the behest of the SEC, it was broadened to include several trading violations.

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

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

Customers lost out on \$128 million over the three-year period because specialists traded ahead of 1.9 billion customer orders representing 1.6 billion shares, the SEC said. "Trading ahead" occurs when a specialist takes advantage of an attractive price and completes a trade for the firm's own account before one placed by a customer.

Specialists also cost investors another

\$27 million during the same three-year period by "interpositioning," or failing to match orders, 253,785 times in transactions totaling 332 million shares. Instead, the specialists stepped between the buyer and seller—purchasing the shares and often reselling them moments later—for a small profit. The cost to investors could grow as the probe continues, the SEC suggests in the report.

The SEC's staff also identified another violation in which specialists "freeze" their so-called display book of orders. That's when specialists prevent electronic orders that arrive through the NYSE's "Designated Order Turnaround" system from immediately reaching the floor to be executed, even as other orders continue to be filled. Most customers are unaware of this practice. The SEC said specialists were inappropriately using "freeze mode" to trade ahead of certain customers and avoid obligations under a rule requiring that all orders be executed at the best price. The SEC has directed the NYSE to file a rule change to provide for enforcement of this violation.

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

### 'Numerous Violations'

The NYSE often ignored blatant examples of improper behavior. For instance, in 2001 and 2002, the NYSE's "Member Firm Regulation" division examined each specialist firm and found "numerous violations of trading rules" including trading ahead and repeat offenses by some firms' specialists who had committed identical violations in prior years. The Big Board referred some violations to its investigative division, but many others were ignored, the SEC said.

Instead of trying to determine the extent of a firm's violation, the regulatory division routinely closed cases "even when the examinations included evidence of recidivist conduct," according to the SEC report. Take the NYSE's examination of Van der Moolen, which found, among other trading violations, 21 instances of trading ahead by specialists in a two-hour period in 2002 and 14 trading-ahead violations over a 2½ hour period in 2001. The regulatory division didn't expand its investigation to determine if more violations had occurred and simply referred the 35 violations to the investigations department, according to the SEC report.

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

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

The exchange did spot some serious violations by specialists over the years, but the SEC said the response was often to close cases without taking action or to send a letter to the firm. From January 2001 to

June 2003, the SEC says, NYSE imposed a total of \$604,000 in fines against specialists and specialist firms for both minor rule violations and other improper conduct. Included in that total was \$8,500 in fines levied against the firms for 462 trading-ahead violations found by NYSE investigators in 2001 and 2002. The firms weren't required by the NYSE to return the illegal profits.

The NYSE now is taking action to address the problems. In addition to adding enforcement attorneys and market-surveillance analysts to cases, the NYSE agreed to "ensure that its regulatory budget is fully funded to meet all regulatory needs." The exchange will also file a proposed rule with the SEC that governs the use of "freeze mode" and agreed to put in place a system to inhibit specialists from trading ahead of customer orders. In the report, the NYSE notes that some violations already have "significantly decreased."

In early October, SEC staff members met with Mr. Reed, the NYSE's interim chairman, to discuss the report and ways in which the SEC could improve its oversight and disciplinary functions. The staff told the exchange to refer all important trading-rule violations directly to the NYSE's enforcement division, rather than to its investigative division. The SEC also is recommending that the regulatory division develop and adopt procedures to review "the adequacy of specialist firm compliance programs" and refer all repeat violators for formal disciplinary action. And the SEC wants the exchange to create a surveillance system that detects any orders that remain unexecuted.

In addition to criticizing whoever leaked the report, an NYSE spokesman said in a statement: "It is equally inappropriate for The Wall Street Journal to disclose at this early stage of an iterative inspection process. Disclosure now also compromises a confidential regulatory proceeding and damages the personal of the specialist firms and their right before any charges have been filed or any defenses offered."

"Moreover, by making confidential regulatory information public, the disclosure may chill future inspections; may compromise the NYSE's surveillance, investigative and enforcement processes; and may interfere with our Enforcement Division's ability to bring the specialist investigation to a timely and effective resolution that serves the public interest."

The spokesman added that that the NYSE is committed to effective regulation of the market and will take whatever steps are necessary to ensure investor confidence.

### Sore Subject

The SEC often has locked horns with the exchange over how to fix the perceived inadequacies. In 1998, for example, the SEC found that the exchange's tools to police trading-ahead violations were inadequate. While the exchange took some steps to fix the problem, it resisted the SEC's recommendation to do more. NYSE managers, according to the report, argued that doing more would increase the workload for its investigators. In 2002, the exchange rejected the SEC's request that it adjust its regulatory program to ensure that specialists weren't freezing their display book for more than 30 seconds, choosing instead to use a 60-second parameter.

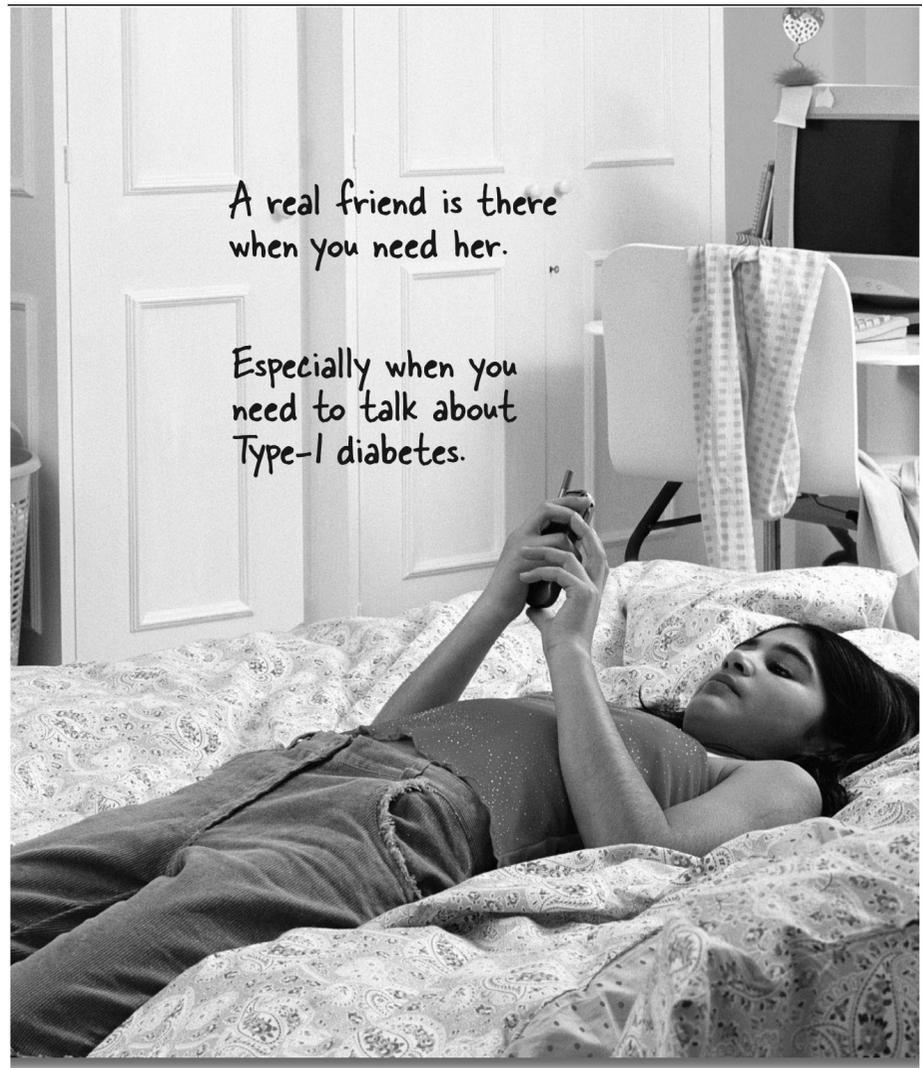
With increasing automation at the Big Board, it should take less time to complete a trade, the SEC argued. Longer time frames can permit more trading abuses. But the exchange's regulatory staff told the SEC that producing reports using the broader parameters wasn't likely to identify any additional specialists who had violated rules. "The NYSE stated that many of the specialist firms have merged with existing firms and that many of the specialists who may have violated the law have since retired," the SEC said in the report. And the exchange said it might not have the resources to generate surveillance reports using historical trade data.

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

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

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

For five years, the SEC has been pushing the NYSE to narrow that 60-second window. But the SEC noted in its report that "managers appeared to be concerned primarily with the impact on the analysts' workload as a consequence of reducing the time parameter, not on the fact that the increase in alerts was highlighting increased patterns of illegal trading by NYSE specialists." Earlier this summer, the SEC told the Big Board to cut the time frame to 10 seconds from 60 seconds. NYSE officials seemed to play down the SEC report in a conference call last month to discuss the widening of the specialist probe. Edward Kwalwasser, the Big Board's regulatory chief, said in the call: "We have received an oversight report that went into a lot of different things and we received it yesterday so it hasn't taken us anywhere." Mr. Kwalwasser yesterday declined to comment through a spokesman.



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