No. 01-1749

In the Supreme Court of the United States

MICHAEL J. MARKOWSKI AND
JOSEPH F. RICCIO, PETITIONERS

v.

SECURITIES AND EXCHANGE COMMISSION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

THEODORE B. OLSON
Solicitor General
Counsel of Record
Department of Justice
Washington, D.C. 20530-0001
(202) 514–2217

GIOVANNI P. PREZIOSO
General Counsel

MEYER EISENBERG
Deputy General Counsel

JACOB H. STILLMAN
Solicitor

SUSAN S. MCDONALD
Senior Litigation Counsel

SUSAN K. STRAUS
Attorney
Securities and Exchange Commission
Washington, D.C. 20549

QUESTION PRESENTED

Whether securities transactions that are made with the undisclosed intent to maintain the market price at an artificially high level and thereby to create the false appearance of genuine investor demand are proscribed by Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b), and Rule 10b-5, 17 C.F.R. 240.10b-5.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. C1-C8) is reported at 274 F.3d 525. The opinion and order of the Securities and Exchange Commission (Pet. App. A1-A12) are reported at 73 SEC Docket 475. The Commission's order denying petitioner's motion for reconsideration (Pet. App. B1-B3) is reported at 73 SEC Docket 1520.

JURISDICTION

The judgment of the court of appeals was entered on December 21, 2001. A petition for rehearing was denied on February 25, 2002 (Pet. App. D1). The petition for a writ of certiorari was filed on May 28, 2002 (Tuesday, following a holiday). The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

From 1990 to 1991, petitioners Michael J. Markowski, chairman and chief executive officer of Global America, Inc., a securities brokerage firm, and Joseph F. Riccio, the firm's head trader, engaged in a scheme to manipulate the market in the securities of Mountaintop Corporation—securities Global had encouraged its customers to buy and hold for future appreciation. Pursuant to the scheme, Global, which was the principal market maker for Mountaintop securities during that time, maintained high bid prices and absorbed all unwanted securities into inventory, in order to prevent the price of Mountaintop from falling and to maintain the confidence of Global's customers in the firm's investment recommendations. Pet. App. A3-A5, C2-C3, C6.

The National Association of Securities Dealers, Inc. (NASD), brought a disciplinary action against petitioners in which it found that petitioners violated Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b), and Rule 10b-5 thereunder, 17 C.F.R. 240.10b-5, by manipulating the market for Mountaintop securities and also violated various NASD rules. See Pet. App. A2. Petitioners were censured and barred from association with any NASD member firm in any capacity. In addition, petitioner Markowski was ordered to pay a fine of $300,000, and petitioner Riccio was order to pay $250,000. *Ibid.* Petitioners sought review of the NASD's decision before the Securities and Exchange Commission (SEC or Commission), which sustained the NASD's findings and the sanctions that it had imposed. *Id.* at A1-A12. The SEC subsequently denied petitioners' motion for reconsideration.

Id. at B1-B3. The court of appeals affirmed the Commission's order. *Id.* at C1-C8.

1. The NASD is a national securities association registered with the Commission under Section 15A of the Exchange Act, 15 U.S.C. 78o-3. The NASD has substantial responsibility under the Act, subject to comprehensive oversight by the Commission, for regulation of those who sell securities in the over-the-counter market. The Exchange Act requires the NASD to adopt rules to regulate the conduct of its member brokerage firms and associated persons and to enforce its rules through the imposition of disciplinary sanctions. See 15 U.S.C. 78o-3(b)(6), (7) and (8), 78o-3(h), 78s(g). Pursuant to the statute, the NASD has promulgated rules that require adherence to the federal securities laws and to specified standards of professional conduct.

Disciplinary action taken by the NASD is subject to review by the Commission on application by the aggrieved party. 15 U.S.C. 78s(d)(2), 78s(e)(1). The Commission is required to conduct a *de novo* review of the record and to make its own findings on whether the conduct in question violated the federal securities laws or the NASD rules as charged. See *Nassau Sec. Serv.* v. *SEC*, 348 F.2d 133, 135-136 (2d Cir. 1965); *Otto* v. *SEC*, 253 F.3d 960, 964 (7th Cir.), cert. denied, 122 S. Ct. 548 (2001). In addition, if the Commission finds that the sanctions imposed are "excessive or oppressive," the Commission may modify or cancel the sanctions. 15 U.S.C. 78s(e)(2). The Commission's decision is reviewable in the courts of appeals. 15 U.S.C. 78y(a).

2. Petitioner Markowski ran Global as its chairman and chief executive officer and was its majority shareholder. Petitioner Riccio was Global's head trader. Pet. App. A2. Global was an underwriter and market maker for the securities of high risk start-up com-

panies. Global's promotional brochure represented Global as "'a full-service investment banker' with a program for the 'support of emerging growth companies,' for the benefit of investors, 'that goes *well beyond* the traditional underwriting process.'" *Id.* at A3. Global's Compliance Officer, Gary Boccio, testified to his understanding of the firm's sales philosophy: "You [the investor] buy these stocks for [the] long term. We will support those companies and then your net worth will increase." *Id.* at A4.

In June 1990, Global was the sole underwriter on a firm commitment basis for the initial public offering of Mountaintop, a company that marketed Alaskan vodka. Pet. App. A3. At the time of the offering, Mountaintop was not profitable. *Ibid.* The public offering sold out the first day, and sales were made almost entirely to Global's customers. *Ibid.*

In the aftermarket trading of Mountaintop securities, Global dominated the market, and there was little or no demand for the securities other than from Global: Global was the principal market maker, the largest seller and purchaser, and regularly paid the highest prices. Pet. App. A3 & n.8, C2. Further, petitioner Riccio admitted that, although there was no demand for Mountaintop securities on the open market, "Global made the sole high bid for days, even months, on end." *Id.* at C7. Global was able to dispose of many of the Mountaintop securities that it bought by selling them to large institutional clients of petitioner Markowski (*ibid.*), but since more securities constantly came on the market, Global still accumulated a large inventory (*id.* at A4).

James Shanley, Global's chief operating officer, testified that Mountaintop securities opened "too high" and remained at high levels only because Global was

"always supporting the stock." Pet. App. C7. Boccio testified that, when he urged reduction of Global's inventory of Mountaintop, petitioner Markowski responded that "he didn't want to show we had any weakness in the stocks." *Ibid.* Petitioner Riccio admitted that he kept Global's bids high because he feared the consequences of a drop in price, including the customer complaints it would generate. *Ibid.* When Global withdrew as a market maker for Mountaintop, the market for Mountaintop collapsed, and "Mountaintop's price dropped precipitously—about 75% in one day." *Id.* at C3.

3. On September 7, 2000, the SEC sustained the findings of the NASD's National Adjudicatory Council, which had found that petitioners violated Section 10(b), Rule 10b-5, and certain NASD conduct rules in connection with Global's activities in Mountaintop and that petitioner Markowski violated NASD rules in his operation of the firm. Pet. App. A1-A12.

The Commission found that petitioners engaged in market manipulation by abusing Global's control position as principal market maker for Mountaintop. Pet. App. A5. Petitioners supported the price of Mountaintop at an artificial level by entering high bids that did not reflect genuine demand and by absorbing all unwanted securities into inventory. *Id.* at A4. The Commission found that "Global's pricing did not reflect genuine demand but merely [petitioners'] desire to maintain high price levels." *Id.* at A5. Global's quotations for Mountaintop were "published with the manipulative purpose of keeping Mountaintop prices at an artificially high level." *Id.* at A6. "Rather than destroy their customers' confidence, [petitioners] chose to keep Mountaintop prices high by manipulating the market for Mountaintop securities." *Id.* at A5. The Commis-

sion sustained the sanctions the NASD had imposed on petitioners—a censure, a bar from association with any NASD member firm, and fines of $300,000 for Markowski and $250,000 for Riccio. *Id.* at A8-A9.[1]

Petitioners filed a motion for reconsideration, which the SEC denied. Pet. App. B1-B3. The Commission reiterated its conclusion that petitioners "deliberately maintained unwarranted price levels for Mountaintop by entering high bids that did not reflect genuine demand and by absorbing all unwanted Mountaintop securities into inventory." *Id.* at B2.

4. The United States Court of Appeals for the District of Columbia Circuit affirmed the Commission's order. Pet. App. C1-C8. The court rejected petitioners' argument that their scheme could not properly be deemed "manipulative" within the meaning of Section 10(b) because it did not consist of "wash sales" or "matched sales"—which, as the court described, are transactions in which "the targeted securities are 'traded' back to the sellers themselves or among known parties to give a false appearance of sales and market interest." *Id.* at C4. The court concluded that the Commission had reasonably interpreted Section 10(b) also to proscribe manipulation accomplished through trades that, although they involve "real customers, real

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[1] The Commission also found petitioner Markowski responsible for other violations not disputed here: violating Global's agreement with the NASD to limit the firm's inventory and refusing to submit to an NASD investigative interview. Pet. App. A6-A8. In addition, Markowski had earlier been disciplined by the NASD for refusing to turn over documents during the NASD's investigation into Global's activities. *Id.* at A9 & n.19. The Commission sustained the NASD's action, and the Commission's decision was affirmed by the court of appeals. See *Markowski* v. *SEC*, 34 F.3d 99 (2d Cir. 1994).

transactions, and real money," are made to affect the price of the stock rather than for a legitimate purpose. *Id.* at C4-C6 (citing *Chevron U.S.A. Inc.* v. *Natural Resources Defense Council, Inc.*, 467 U.S. 837, 843-844 (1984)).

The court reasoned that another provision of the Exchange Act—Section 9(a)(2)—demonstrates "Congress's determination that 'manipulation' can be illegal solely because of the actor's purpose." Pet. App. C5 (citing 15 U.S.C. 78i(a)(2)). That provision makes illegal "actual or apparent" transactions in any security registered on a securities exchange if the transactions are made "for the purpose of inducing the purchase or sale of such security by others." *Ibid.* (quoting 15 U.S.C. 78i(a)(2)). The court concluded that, given "Congress's clear endorsement for sanctions against this sort of manipulation [under Section 9 for exchange-traded securities], the Commission's inclusion of it within the phrase 'manipulative . . . device' in § 10(b)"—which unlike Section 9 applies to all securities—"cannot have been unreasonable." *Id.* at C6.

The court also rejected petitioners' arguments that the fact that Global's trading in Mountaintop resulted in a net loss precluded a finding of manipulation and established that petitioners could not have acted with the scienter necessary to violate Section 10(b). Pet. App. C6-C7. The court observed that Global had an incentive to support the price of Mountaintop securities even if that action meant its trading in the securities would be unprofitable in the short run: "to maintain customer interest in Global generally and to sustain confidence in its other securities." *Id.* at C6. Moreover, "[j]ust because a manipulator loses money doesn't mean he wasn't trying." *Ibid.* "Indeed," the court observed, attempts to support the price of a security over time

are likely to "exhaust the manipulator's resources." *Id.* at C6-C7.[2]

ARGUMENT

The court of appeals correctly held that petitioners' conduct was a "manipulative * * * device" within the meaning of Section 10(b). That decision does not conflict with any decision of this Court or of any court of appeals. This Court's review is therefore not warranted.[3]

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[2] The court further held that the Commission's finding that petitioners published non-bona fide quotations in violation of an NASD rule followed "handily" from the finding of manipulation, because a non-bona fide quotation is defined in the NASD rule as a quotation published "without having reasonable cause to believe that such quotation . . . is not published for any fraudulent, deceptive or manipulative purpose." Pet. App. C3-C4. The court also affirmed the Commission's findings that petitioner Markowski violated the agreement restricting Global's inventory to no more than 200% of the firm's net capital and that petitioner Markowski failed to appear as required by NASD rules for an investigatory interview. *Id.* at C8.

[3] We do not separately address the second question that petitioners purport to present for review: whether the court of appeals' interpretation of Section 10(b) improperly "transfers the burden of proof for manipulation * * * to Petitioners who must disprove any wrongdoing." Pet. i. Petitioners do not address that question elsewhere in the petition. Nor did they raise that issue either before the Commission or in the court of appeals, and that court's decision did not address the question. The issue is thus not properly before the Court. See *EEOC* v. *FLRA*, 476 U.S. 19, 24 (1986) (the "normal practice" of this Court "is to refrain from addressing issues not raised in the Court of Appeals"); 15 U.S.C. 78y(c)(1) ("No objection to an order or rule of the Commission, for which review is sought under this section, may be considered by the court unless it was urged before the Commission or there was reasonable ground for failure to do so."). In any event, petitioners'

1. Section 10(b) makes it "unlawful for any person, directly or indirectly, * * * [t]o use or employ, in connection with the purchase or sale of any security * * *, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [SEC] may prescribe." 15 U.S.C. 78j(b). Rule 10b-5, which implements that provision, forbids the use, "in connection with the purchase or sale of any security," of "any device, scheme, or artifice to defraud" or any other "act, practice, or course of business" that "operates * * * as a fraud or deceit." 17 C.F.R. 240.10b-5.

This Court has described Section 10(b) as "a 'catchall' clause to enable the Commission to 'deal with new manipulative (or cunning) devices.'" *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 203 (1976); accord *Herman & MacLean* v. *Huddleston*, 459 U.S. 375, 386-387 (1983); *Central Bank of Denver, N.A.* v. *First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 174 (1994). Section 10(b) and Rule 10b-5 "prohibit *all* fraudulent schemes in connection with the purchase or sale of securities, whether the artifices employed involve a garden type variety of fraud, or present a unique form of deception." *Superintendent of Insurance* v. *Bankers Life & Cas. Co.*, 404 U.S. 6, 11 n.7 (1971) (quoting *A.T. Brod & Co.* v. *Perlow*, 375 F.2d 393, 397 (2d Cir. 1967)).

The Commission has long viewed securities trades made with the intent to affect the price of the securities as a manipulative and deceptive device that is proscribed by Section 10(b) and Rule 10b-5. See, *e.g.*, *Halsey, Stuart & Co.*, 30 S.E.C. 106, 112 (1949). The courts of appeals that have addressed such manipula-

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contention that the court of appeals has somehow shifted the burden of proof is without merit.

tive schemes have likewise uniformly concluded that they violate those provisions. See *Pagel, Inc.* v. *SEC*, 803 F.2d 942, 945-946 (8th Cir. 1986); *Alabama Farm Bureau Mut. Cas. Co.* v. *American Fidelity Life Ins. Co.*, 606 F.2d 602, 611-613 (5th Cir. 1979), cert. denied, 449 U.S. 820 (1980); *United States* v. *Charnay*, 537 F.2d 341, 347-351 (9th Cir.), cert. denied, 429 U.S. 1000 (1976); *Schlick* v. *Penn-Dixie Cement Corp.*, 507 F.2d 374, 379 (2d Cir. 1974), cert. denied, 421 U.S. 976 (1975).

As this Court recently reiterated in *SEC* v. *Zandford*, 122 S. Ct. 1899 (2002), among Congress's objectives in adopting the Exchange Act were "to insure honest securities markets and thereby promote investor confidence," and "to substitute a philosophy of full disclosure for the philosophy of *caveat emptor* and thus achieve a high standard of business ethics in the securities industry." *Id.* at 1903 (internal quotation marks omitted). Trades made for the purpose of manipulating stock prices subvert the integrity of the markets because their effect "is to distort the character of the market as a reflection of the combined judgments of buyers and sellers, and to make of it a stage-managed performance." *Halsey, Stuart & Co.*, 30 S.E.C. at 112. They deceive investors by creating a false impression that the prices for the manipulated securities have been "established by the free and honest balancing of investment demand with investment supply." H.R. Rep. No. 1383, 73d Cong., 2d Sess. 10 (1934).

Section 10(b) proscribes intentional conduct designed to deceive investors, including any scheme to affect stock prices "beyond the operation of normal market factors." *Alabama Farm Bureau Mut. Cas. Co.*, 606 F.2d at 611. Such "[d]eceitful manipulation of the market price of publicly-owned stock is precisely one of the

types of injury to investors at which the [Exchange] Act and the Rule [10b-5] were aimed." *Mutual Shares Corp.* v. *Genesco, Inc.*, 384 F.2d 540, 547 (2d Cir. 1967). The Commission's longstanding and consistent interpretation of Section 10(b) and Rule 10b-5 to encompass the kind of conduct engaged in by petitioners is thus reasonable and entitled to deference in the courts. See *Zandford*, 122 S. Ct. at 1903.

2. Petitioners contend that a "manipulative * * * device" under Section 10(b) encompasses only fictitious trades—in which ownership of the securities remains in the hands of the manipulators ("wash sales" and "matched sales"). There is, however, no support in the language of Section 10(b) or in this Court's decisions for such a limitation on the statutory language. Indeed, in *Santa Fe Industries, Inc.* v. *Green*, 430 U.S. 462 (1977), cited by petitioners (Pet. 12-13), the Court described the kinds of deceptive practices encompassed by the term "manipulation" to include not only "wash sales" and "matched orders" but also "rigged prices, that are intended to mislead investors by artificially affecting market activity." 430 U.S. at 476. Trades made solely to prop up the price of a security operate to "rig" prices just as effectively as do fictitious trades because they give the false appearance of real market demand for the securities. See A.A. Berle, Jr., *Stock Market Manipulation*, 38 Colum. L. Rev. 393, 401-402 (1938) (even when fictitious trades are not involved, it violates the antifraud provisions of the federal securities laws to create the appearance of an active market without disclosing to the public "that the market activity was created strictly by the persons who were selling") (citing *Coplin* v. *United States*, 88 F.2d 652 (9th Cir.), cert. denied, 301 U.S. 703 (1937)).

Moreover, as the court of appeals explained, the express language of the Exchange Act demonstrates that Congress intended to prohibit actual trading designed to rig market prices. Section 9(a)(2) makes it unlawful to engage in "actual or apparent active trading" in exchange-registered securities "for the purpose of inducing the purchase or sale of such securit[ies] by others." 15 U.S.C. 78i(a)(2). Given that express congressional prohibition on "actual" trading with the intent of affecting the market for exchange-traded securities, the court of appeals correctly concluded that the SEC reasonably interpreted Section 10(b) to proscribe such conduct with respect to non-exchange-registered securities. Pet. App. C6. The ban of manipulative devices in Section 10(b) was intended to include the practices listed in Section 9, see *SEC* v. *Resch-Cassin & Co.*, 362 F. Supp. 964, 975 (S.D.N.Y. 1973), although it is not limited to them, see *Charnay*, 537 F.2d at 350-351 (Rule 10b-5 bans manipulative trades whether or not Section 9(a)(2)'s requirement of a purpose to induce others to trade is present).[4]

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[4] Some commentators have argued that trades made with the intent to affect the price of the security but that are not fictitious should not be proscribed because, it is argued: there is no evidence that they actually affect securities prices; such schemes are self-deterring in that they cannot succeed; and enforcement efforts are too costly. See D.R. Fischel & D.J. Ross, *Should the Law Prohibit "Manipulation" in Financial Markets?*, 105 Harv. L. Rev. 503 (1991). As the title of Fischel & Ross's article indicates, however, their argument addresses what they believe the law *should be*, not what it is. As demonstrated above in the text, Congress expressly recognized in Section 9(a)(2) of the Exchange Act the need to proscribe actual trades intended to affect the prices of securities, not just fictitious trades. Moreover, other commentators have disagreed with the premises underlying Fischel & Ross's arguments. See S. Thel, *$850,000 in Six Minutes—The Mechanics of Securities*

Petitioners incorrectly contend (Pet. 13-14) that a defendant's conduct cannot properly be deemed fraudulent for purposes of Section 10(b) based solely on his subjective intent when carrying out his actions. Just last Term, in *Zandford*, this Court held that a stockbroker's sale of his customers' securities was fraudulent in violation of Section 10(b) because he made the sale with the secret intent to keep the proceeds. 122 S. Ct. at 1905. And, in another recent decision construing Section 10(b), the Court held that the sale of an option with a secret intent not to honor it violates Section 10(b). *Wharf (Holdings) Ltd.* v. *United Int'l Holdings, Inc.*, 532 U.S. 588 (2001). More broadly, the principle is well-established that fraud may be based on the undisclosed intent not to perform a promise. See *Durland* v. *United States*, 161 U.S. 306, 312-314 (1896) (mail fraud); Restatement (Second) of Torts § 530 cmt. c (1977). Indeed, it is commonplace in many areas of the law, including criminal law, that legality turns on intent, motive or purpose. See *Morissette* v. *United States*, 342 U.S. 246, 250-252 (1952).

Petitioners are also mistaken in contending (Pet. 13-14) that their conduct was "fully disclosed" and therefore not deceptive. On the contrary, petitioners did not reveal to investors that they were buying up Mountaintop at high prices even though there was no retail demand for the securities and that they purchased the securities solely in order to prop up the price. Their non-disclosure left investors with the false impression that Mountaintop's prices reflected "the free and honest balancing of investment demand with investment sup-

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Manipulation, 79 Cornell L. Rev. 219 (1994) (suggesting that manipulators may profit from very small, short-lived price changes they have artificially induced).

ply," H.R. Rep. No. 1383, *supra*, at 10, created by "the combined judgments of buyers and sellers," when the prices actually reflected "a stage-managed performance." *Halsey, Stuart & Co.*, 30 S.E.C. at 112. Their conduct thus falls squarely within Section 10(b)'s prohibition on fraud in connection with the purchase or sale of securities. *Charnay*, 537 F.2d at 351 ("Failure to disclose that market prices are being artificially depressed [or increased or supported] operates as a deceit on the market place and is an omission of a material fact" actionable under Section 10(b).).

3. Also without merit is petitioners' contention (Pet. 16) that a finding of manipulation is precluded by the fact that Global ultimately lost money on its Mountaintop transactions. The decision in *United States* v. *Mulheren*, 938 F.2d 364 (2d Cir. 1991), on which petitioners rely (Pet. 16), does not support their argument. Although the court in *Mulheren* did observe that "[o]ne of the hallmarks of manipulation is some profit or personal gain inuring to the alleged manipulator," 938 F.2d at 370, it did not hold that there can be no manipulation in violation of Section 10(b) if the fraudulent scheme fails to make a profit. The court relied on the absence of profit as only one factor in many in determining that the evidence was insufficient to establish beyond a reasonable doubt that the transactions in that criminal case—which consisted of two purchase orders made within a few minutes on a single day—were made solely to raise the price of the securities involved. See *id.* at 369-372.

Even if there were a requirement that a manipulator obtain some "personal gain" from his scheme, that requirement would be met here. As the court of appeals recognized, Global supported the price of Mountaintop "not to profit from later sales of Mountaintop, but to

maintain customer interest in Global generally and to sustain confidence in its other securities." Pet. App. C6. Maintaining customer confidence in Global was the "personal gain" that petitioners sought to—and for a time did—achieve through their manipulation.

As the court of appeals understood, the fact that petitioners *ultimately* lost money on the Mountaintop scheme does not preclude a finding either of manipulation or of scienter. Manipulations that continue for an extended period often will be unsuccessful because a "protracted struggle against market fundamentals will exhaust the manipulator's resources." Pet. App. C7. That does not prevent the conduct from being manipulative and unlawful under Section 10(b). See *L.C. Wegard & Co.*, 53 S.E.C. 607, 613 (1998) (manipulation found even though the trading at issue lost money for the firm), aff'd, 189 F.3d 461 (2d Cir. 1999) (Table); *R.B. Webster Investments, Inc.*, 51 S.E.C. 1269, 1274 (1994) (it is not inconsistent with a finding of intent to manipulate that the manipulator failed to profit, or even lost money).

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

THEODORE B. OLSON
Solicitor General

GIOVANNI P. PREZIOSO
General Counsel
MEYER EISENBERG
Deputy General Counsel
JACOB H. STILLMAN
Solicitor
SUSAN S. MCDONALD
Senior Litigation Counsel
SUSAN K. STRAUS
Attorney
Securities and Exchange Commission

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