

NEW YORK STOCK EXCHANGE LLC

**NYSE HEARING BOARD DECISION 06-61**

May 4, 2006

GOLDMAN SACHS EXECUTION & CLEARING, L.P.  
(f/k/a SPEAR, LEEDS & KELLOGG, L.P.)  
MEMBER ORGANIZATION

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**Violated NYSE Rule 451 by failing to transmit to beneficial owners, via its service provider, accurate information in connection with proxy solicitations; violated NYSE Rule 452 by voting more shares than it was entitled to in proxy matters and failing to assure that its customers' proxy-voting instructions were accurately transmitted; violated Section 17(a) of Securities Exchange Act of 1934 and Rule 17a-4 thereunder and NYSE Rules 440 and 452.20 by failing to retain all required proxy-solicitation records for three years; failed to implement adequate policies and procedures to ensure that it adjusted its record of stock ownership so that votes of beneficial owners were accurately tallied for proxy-voting purposes; voted more shares than it was entitled to vote in proxy matters; failed to assure that its customers casting proxy votes received accurate recognition of their votes; violated NYSE Rule 401 by failing, on numerous occasions, to reconcile its record of stock ownership to ensure that votes of beneficial owners were accurately tallied for proxy-voting purposes; violated NYSE Rule 342 by failing to reasonably supervise proxy-processing operations to prevent over-voting and assure that its customers casting proxy votes received accurate recognition of their votes and failing to provide for and implement written procedures for proxy operations and supervision of proxy-processing function and of proxy-service provider – Consent to censure and \$500,000 fine.**

**Appearances:**

For the Division of Enforcement  
Simon Swidler, Esq.  
Michael W. Bautz, Esq.

For Respondent  
Ida Wurzinger Draim, Esq.

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A Hearing Officer, on behalf of the New York Stock Exchange LLC (“NYSE”), considered a Stipulation of Facts and Consent to Penalty entered into between the Division of Enforcement of NYSE Regulation, Inc. (“Enforcement”) and Goldman Sachs Execution & Clearing, L.P. f/k/a Spear, Leeds & Kellogg, L.P. (“Respondent” or “GSEC” or the “Firm”), a member organization. Without admitting or denying guilt, Respondent consented to a finding by the Hearing Officer that it:

- I. Violated NYSE Rule 451, in that, on one or more occasions Respondent failed to transmit to beneficial owners, via its service provider, accurate information in connection with proxy solicitations.
- II. Violated NYSE Rule 452 in that Respondent, on one or more occasions, voted more shares than it was entitled to in proxy matters; and failed to assure that its customers' proxy voting instructions were accurately transmitted.
- III. Violated Section 17(a) of the Securities Exchange Act of 1934, as amended, and Rule 17a-4 thereunder, NYSE Rule 440, and NYSE Rule 452.20, in that Respondent failed to retain all required proxy solicitation records for a period of not less than three years, the first two in an easily accessible location.
- IV. Engaged in conduct inconsistent with just and equitable principles of trade in that Respondent:
  - a. failed, on one or more occasions, to implement adequate policies and procedures to ensure that it adjusted its record of stock ownership so that votes of beneficial owners were accurately tallied for proxy voting purposes.
  - b. on one or more occasions, voted more shares than it was entitled to vote in proxy matters.
  - c. failed to assure that its customers casting proxy votes received accurate recognition of their votes.
- V. Violated NYSE Rule 401 by failing to adhere to the principles of good business practices in that Respondent failed, on numerous occasions, to reconcile its record of stock ownership so as to ensure that votes of beneficial owners were accurately tallied for proxy voting purposes.
- VI. Violated NYSE Rule 342 in that Respondent failed to:
  - a. reasonably supervise proxy processing operations to prevent over-voting;
  - b. reasonably supervise proxy processing operations to assure that its customers casting proxy votes received accurate recognition of their votes;
  - c. provide for and implement written procedures for proxy operations and supervision of the proxy processing function; and
  - d. provide for and implement written procedures for supervision of its proxy service provider.

For the sole purpose of settling this disciplinary proceeding, Enforcement and Respondent stipulate to certain facts, the substance of which follows: \*

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\* Hearing Officer Note: The facts, allegations, and conclusions contained in paragraphs 1 to 41 are taken from the executed Stipulation of Facts and Consent to Penalty between Enforcement and Respondent. No changes have been made to the stipulated paragraphs by the Hearing Officer, except that a pseudonym has been provided to protect the privacy of a non-party.

### **Background and Jurisdiction**

1. GSEC, formerly known as Spear, Leeds & Kellogg, L.P., is a limited partnership and wholly owned subsidiary of The Goldman Sachs Group, Inc. GSEC's main lines of business include securities clearing and trade execution on a fully disclosed basis.
2. Beginning in October 2003, and extending into 2004, the NYSE Regulation's Division of Member Firm Regulation ("MFR") conducted a special proxy examination ("Proxy Examination") of GSEC. In a report dated June 14, 2004, the MFR examiners noted certain deficiencies related to the operations and supervision of the proxy processing function at the Firm. On or about July 30, 2004, MFR referred the results of the Proxy Examination to Enforcement for investigation.
3. By letter dated August 24, 2004, Enforcement notified the Firm of its investigation.
4. In previous Hearing Panel Decisions ("HPD"), the Firm was sanctioned for various violations. In HPD 03-108, the Firm consented to a censure, a fine of \$450,000 and an undertaking based on the finding that it violated NYSE Rule 342 by failing to establish and maintain reasonable procedures and systems to prevent its employees from aiding and abetting the violation of Section 15(c)(1)(A) of the Securities Exchange Act of 1934 by a non-member firm direct access customer that manipulated the price of a listed security. In HPD 01-199 the Firm consented to a censure and fine of \$175,000 based on findings that it violated NYSE Rules 431(f)(8)(B) and 342 by employing an incorrect formula to determine day trading margin calls and violated Section 220.6(c) of Regulation T and NYSE Rule 342 by failing to require adequate funds in prime brokerage accounts.

### **Overview**

5. Beginning prior to January 2003, and through November 2003, the Firm (a) failed to timely reconcile stock records of beneficial ownership in connection with proxy voting; (b) failed to implement adequate policies and procedures to accurately adjust its record of stock ownership so that votes of its customers were accurately tallied for proxy voting purposes; (c) on one or more occasions submitted more votes than it was entitled to vote in proxy matters ("over-voting");<sup>1</sup> (d) failed to assure that its systems and procedures provided for accurate submission of proxy data to the Tabulator as the issuer's agent; and (e) failed to retain all proxy solicitation records required to be retained by applicable rules. In February 2004 and March 2004, the Firm, on five occasions, transmitted proxy materials to its customers reflecting fewer shares than those customers were entitled to vote. Finally, the Firm failed to reasonably

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<sup>1</sup> As used herein, "over-voting" by a broker-dealer means that the broker-dealer's service provider submitted proxies for more shares than the broker-dealer was entitled to vote on a specific proxy matter and does not mean that the transfer agent tabulating the votes (the "Tabulator") necessarily counted these over-voted shares in determining the outcome of the proxy matter. See NYSE Information Memo 04-58, "Supervision of Proxy Activities and Over-voting" (Nov. 5, 2004)

supervise and control its business activity relating to the proxy processing function, and failed to establish a separate system of follow-up and review, to comply with proxy rules, in that the Firm (a) failed to reasonably supervise proxy operations to prevent over-voting; (b) provide for and implement adequate written procedures for proxy operations and supervision of the proxy processing function; and (c) provide for and implement written procedures for supervision of its proxy process provider.

### **Summary of the Proxy Process**

6. Pursuant to NYSE Rule 451, a member organization is required to transmit proxy materials to the beneficial owners of stocks that it holds in street name, when a person soliciting proxies supplies such material and provides assurance for reimbursement of expenses.
7. Pursuant to NYSE Rule 452, a member organization is required to “give or authorize the giving of a proxy for stock registered in its name, or in the name of its nominee, at the direction of the beneficial owner.”
8. To accomplish the obligations set forth in NYSE Rule 452, member organizations must collect and transmit to the issuer any voting instructions furnished by Shareholders of the security for which proxies are solicited who hold their shares beneficially through such member organizations. Member organizations may contract with a proxy service provider to distribute the proxy materials, collect the voting instructions from Shareholders and transmit those instructions to the transfer agent engaged by the issuer to tabulate the votes (the “Tabulator”).
9. Matters in which a member organization may vote without customer instructions and matters which it may not are set forth in NYSE Rules 452.10 and 452.11. For certain routine matters included on corporate ballots, proxies attributable to customer positions may be voted by a member organization, on a discretionary basis, absent the receipt of votes cast by Shareholders.
10. For each proxy solicitation, the Tabulator compares the proxy votes submitted on behalf of the member organization and/or its customers with the number of shares reflected on the records of the Depository Trust Clearing Corporation (“DTCC”) for the member organization on the applicable record date. The number of shares showing on the records of DTCC for the member organization, with certain adjustments, is the maximum number of shares (votes) that will be tallied by the Tabulator in determining the outcome of the proxy vote. If a member organization submits to the Tabulator more shares than are shown for the member organization on the records of DTCC, and they are not held at another depository or in physical form at the Firm, then it may have over-voted.
11. There are no standard industry procedures that govern the Tabulators’ approach to dealing with over-voting. For non-contested proxy votes, Tabulators have traditionally addressed over-voting by reducing the default “For Management” vote

- submitted by the broker-dealer. However, Tabulators may respond to over-votes with a variety of other vote-counting procedures, including counting votes on a “first in-first voted” or “last in-first voted” basis, or disregarding altogether a vote submitted by a broker-dealer. Depending upon the procedure implemented by the Tabulator, certain customers’ voting instructions may not be represented as originally given.
12. Failure to timely reconcile stock records on beneficial ownership may result in inaccurate instructions being given to the proxy service provider. If there is no reconciliation of stock records of beneficial ownership, customer votes may be allocated inaccurately, because customers with long and short positions in the same stock may receive requests for proxy voting instructions for too many shares. Similarly, if stock in margin accounts has been used for stock loans, and both the margin account holder or holders and the recipient of the stock loan submit voting instructions for the same stock, then the margin account holder may submit a proxy for shares of which he is at that time not the beneficial owner, and for which he is not entitled to submit a proxy. Failure to perform proper reconciliations may allocate more votes, and in some instances fewer votes, to customers than is proper.

#### **Proxy Processing at GSEC**

13. At all relevant times, and continuing through the present, the Firm has used a proxy service provider (the “Agent”). When the Agent receives notice of a pending proxy action it transmits an electronic notification to the Firm’s automated system which electronically screens the Firm’s records to determine client positions, client names and client addresses eligible to participate in the proxy action and transmits the information to the Agent. Upon receipt, the Agent arranges with the issuer, or its agent, the Tabulator, to obtain the appropriate number of copies of proxy-related materials, which it then forwards to the beneficial owners of the issuer’s security. Proxy instructions are generally returned directly to the Agent, which in turn reports the votes to the Tabulator involved in the proxy action.
14. At all relevant times, the Agent has offered a service relating to the monitoring of potential over-votes. This service compares a broker-dealer’s DTCC position with the voting instructions submitted by that broker-dealer through the Agent and notifies the broker-dealer if instructions to vote shares exceed that position. This notification permits broker-dealers to examine their records and to adjust (when appropriate) their records with the position reflected on DTCC’s records. Utilization of this service is an important tool in a broker-dealer performing reconciliations of its proxy records with positions at DTCC.

15. The outsourcing of its proxy function to the Agent, as set forth above, did not relieve the Firm of the regulatory responsibility for compliance with the NYSE Rules relating to operation and supervision of the proxy processing function.<sup>2</sup>

### **Over-Voting by the Firm**

16. For 2003, the Proxy Examination and subsequent Enforcement investigation identified four instances of five sampled in which the Firm over-voted, that is, the Firm submitted more proxy votes than it was entitled to cast, in connection with proxy matters. In March 2003, for example, the Firm submitted voting instructions for a total of 379,801 shares in a proxy matter involving XYZ (record date March 4, 2003). As of the record date, according to the information maintained at DTCC, the Firm was only eligible to submit voting instructions for 212,469 shares. Thus, the Firm submitted voting instructions for 167,332 shares more than it was entitled to vote. The over-vote instructions submitted by the Firm in the other three instances ranged from 97,567 to 402,821 shares.
17. Prior to December 2003, the Firm's record keeping system was fully automated. Its system was coded to remove stock shares loaned from its tally of eligible voting shares and, thereafter, subtract the voting shares from margin account customers who agreed to allow their shares to be loaned out and forfeit certain rights, including voting rights ("Non-Segregated Accounts"). The Firm's system did not affect non-margin customers with fully paid positions ("Segregated Accounts").
18. The above-mentioned over-voting was caused by the Firm's failure to properly account for Firm and customer short positions when calculating its long position. The Firm should have removed short positions in a particular security and decreased the voting shares in its margin accounts prior to the Agent's submission to the Tabulator.
19. Prior to December 2003, the Firm did not subscribe to the over-vote service provided by the Agent.
20. Each of the instances of over-voting detected occurred during, or very shortly after, the two-week period, in March 2003. All of the over-votes were caused by the Firm submitting excess "For Management" votes in non-contested matters.

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<sup>2</sup> NYSE Information Memo 04-58, "Supervision of Proxy Activities and Over-voting" (Nov. 5, 2004), issued after the matters addressed in this Stipulation, provides that, with regard to member organizations' use of service providers in the proxy process, although member organizations may outsource the gathering and voting of proxies, this "does not relieve the member organization of the regulatory responsibility for complying with the relevant regulations, supervising this process, maintaining adequate and accurate books and records, and ensuring that the rights of beneficial shareholders are protected. This responsibility would entail initial and continuing due diligence to assure that the service provider is capable of collecting and reporting the customer votes, and that the source of share information is accurate." *Id.*, pp. 1-2.

21. Enforcement's investigation did not disclose any instance in which an over-vote affected the outcome of a proxy vote or any instance in which a shareholder, who attempted to vote his or her shares, was disenfranchised.
22. However, by submitting an over-vote, the Firm subjected its customers to the risk that their proxy votes would not be accepted by the Tabulator.

### **Under-Voting by the Firm**

23. In December 2003, the Firm implemented a number of changes to prevent over-voting. The Firm (a) immediately subscribed to the over-vote service provided by the Agent; (b) enhanced its written supervisory procedures; and (c) initiated the reprogramming of its internal systems to reconcile the number of shares eligible to be voted for each customer account with the aggregate number of shares held at DTCC as of the record date, which was completed in late February 2004.
24. The newly reprogrammed system accesses DTCC's records to determine its maximum number of eligible voting shares. The system then reviews the Firm's stock record to identify all customer accounts for which it holds shares in a particular stock. The system identifies the number of eligible shares to which each account is entitled and assigns the appropriate number of shares to each beginning with Segregated Accounts and, if any shares remain, to Non-Segregated Accounts on a pro rata basis.
25. For 2004, the Proxy Examination and subsequent Enforcement investigation identified an instance in which the Firm submitted fewer proxy votes than its customers were entitled to vote. More specifically, in March 2004, the Firm instructed the Agent to transmit proxy materials to its customers relative to only 52,703 voting shares in a proxy matter related to XYZ (record date March 9, 2004). As of the record date, according to DTCC, the Firm's customers were entitled to vote 111,703 shares. Thus, the Firm provided proxy materials to its customers for 59,000 shares fewer than its customers were entitled to vote.
26. As a result, three Non-Segregated Account customers (seven account numbers), who were entitled to 93 votes, were disenfranchised, while 33 Segregated Accounts had their eligible voting shares reduced from 111,610 to 52,703 – a reduction of approximately 41%.
27. The failure to submit all customer votes in the 2004 XYZ proxy matter was the result of a programming error that caused the Firm to double-subtract 59,000 shares that were being held in "safekeeping".<sup>3</sup>

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<sup>3</sup> Safekeeping shares are shares that are in the client's name, but in the Firm's physical possession. These shares should not be included in determining the eligible voting shares held by the Firm since the individual customer will receive proxy materials directly from the issuer.

28. The error did not alter the voting results in the two routine matters on the XYZ ballot. In the five non-routine matters on the ballot, the Firm's error caused three customers to submit fewer votes than they were entitled to.
29. A further review by the Firm requested by Enforcement identified four additional instances in which the Firm submitted to the Tabulator fewer proxy votes than its customers were entitled to vote.<sup>4</sup> However, in three instances there was no impact on Segregated Accounts. In the one instance involving Segregated Accounts, customers received approximately half of their respective votes. Enforcement's investigation did not disclose any instance in which an under-vote affected the outcome of a proxy vote
30. The Firm responded to the Proxy Examination finding by correcting the programming error that led to the subtractions of the "safekeeping" shares from the Firm's inventory. In addition, the Firm implemented an internal control report to reconcile the eligible voting shares with the available inventory.

#### **Failure to Maintain Proxy Records**

31. Section 17(a) of the Securities Exchange Act of 1934 ("Exchange Act"), Rule 17a-4 thereunder and NYSE Rule 440 require member organizations to retain originals of all communications received and copies of all communications sent by the Firm relating to [its] business for not less than three years, the first two in an accessible place.
32. NYSE Rule 452.20 requires member organizations to retain "all proxy solicitation records, originals of all communications received and copies of all communications sent relating to such solicitation" for not less than three years, the first two in an easily accessible place.
33. NYSE Rule 452.17 states in relevant part that "[r]ecords covering the solicitation of proxies shall show the following: (1) the date of receipt of the proxy material from the issuer or other person soliciting the proxies; (2) names of customers to whom the material is sent together with the date of mailing; (3) all voting instructions showing whether verbal or written; and (4) a summary of all proxies voted by the member organization clearly setting forth total shares voted for or against or not voted for each proposal to be acted upon at the meeting."
34. From in or about March 2002 to in or about July 2004, the Firm did not have the following proxy related documents on its premises: The Final Vote Summary, Affidavits of Compliance and the Independent Audit Report.
35. The Firm's failure to retain these records was the result of the Agent having sent them addressed to a person no longer employed by the Firm. The Agent retained a copy of

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<sup>4</sup> The number of shares that did not receive a vote in these four instances ranged from two to 11,780 shares.

these records for the Firm, but was unable to provide them when requested by MFR during the Proxy Examination.

36. In or about July 2004, the Firm implemented procedures whereby these records were to be delivered to and retained by the Head of its Proxy Department.

### **Failure to Supervise**

37. NYSE Rule 342(a) provides that each “business activity of a member or member organization . . . shall be under the supervision and control of the member or member organization establishing it and of the personnel delegated such authority and responsibility.” NYSE Rule 342(b) states that:

The general partners or directors of each member organization shall provide for appropriate supervisory control and shall designate a general partner or principal executive officer to assume overall authority and responsibility for internal supervision and control of the organization and compliance with securities’ laws and regulations. This person shall: (1) delegate to qualified principals or employees responsibility and authority for supervision and control of each . . . business activity, and provide for appropriate procedures of supervision and control[;] (2) establish a separate system of follow-up and review . . . .”

38. Beginning prior to January 2003, and through December 2003, the Firm did not provide for or implement adequate written operational or supervisory procedures relating to its Proxy activities, in that the Firm lacked adequate written operational and supervisory procedures.
39. Beginning prior to January 2003, and through December 2003, the Firm failed to perform reconciliations of its records of beneficial ownership, or to subscribe to a service that would provide sufficient information to do the reconciliation at the Firm.
40. Beginning prior to January 2003, and through December 2003, the Firm did not provide for and did not implement written procedures for the supervision of the Agent responsible for handling certain proxy functions.
41. Beginning prior to January 2003, and through February 2004, the Firm did not reasonably supervise its proxy operations to prevent over-voting. Specifically, the Firm (a) failed to implement adequate procedures to reconcile and adjust its records of beneficial ownership; (b) did not transmit to the Agent accurate information in connection with proxy matters; (c) did not assure that its systems and procedures provided for the accurate submission of proxy data to proxy tabulators; (d) voted more shares than it was entitled to vote in certain proxy matters; and (e) failed to submit all customer votes in certain proxy matters.

**DECISION**

The Hearing Officer, in accepting the Stipulation of Facts and Consent to Penalty, found Respondent guilty as set forth above.

**PENALTY**

In view of the above findings, the Hearing Officer imposed the penalty consented to by Respondent of a censure and a \$500,000 fine.

For the Hearing Panel

Peggy Kuo - Chief Hearing Officer