

EXHIBIT 23

(Part 1 of 2)

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

In re:

**BERNARD L. MADOFF
INVESTMENT SECURITIES
LLC,**

Debtor,

**IRVING H. PICARD, Trustee for
the Liquidation of Bernard L.
Madoff Investment Securities LLC,**

Plaintiff,

v.

SAUL B. KATZ, et al.,

Defendants.

Adv. Pro. No. 08-01789 (BRL)

SIPA LIQUIDATION

**(Substantively Consolidated)
Adv. Pro. No. 10-5287 (BRL)**

11-CV-03605 (JSR) (HBP)

Bruce Dubinsky Deposition Binder

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Part II of III

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This training manual is designed to start with the very basics. While many new employees may already have extensive knowledge of many of the topics to be discussed the program will continue as designed. It can't hurt to review and it will serve to clarify any discrepancies that may occur between what employees may have learned elsewhere. The program is not so long as to waste valuable time if a candidate is already well versed in some or even all areas. Whether or not a candidate has experience, by starting with this basic training plan, it will ensure that everyone has been given the basic knowledge to tackle the task of working on the trading desk.

1. Statement of our firm's values, goals, and business objectives

Bernard L. Madoff Investment Securities was founded in 1960 by Bernie. Originally founded as a proprietary (risking the firm's own capital) trading firm, our current activities now also include customer execution services, market making activities, and several other in-house investment services off the trading desk (we will not go any further than to mention that firm does have other functions besides the trading desk, but they don't affect the trading desk's activities and will not be expanded on here - beyond the scope of training).

Mission statement: "Constantly seek ways to enhance the firm's trading profitability while focusing on always ensuring the customer receives the "best" execution the industry can provide."

The term "best" is defined as: ensuring a fast turnaround time for each order (usually under 5 seconds), exposing each order to stringent criteria to actively search out the best available price (comprehensive price discovery), and employing automated procedures to virtually eliminate errors.

"quality executions and service through innovative technology"

Values:

- A. The firm's integrity comes above all else and influences how employees treat customers, competitors, and coworkers. The firm prides itself on acting professionally at all times, any deviation from this is unacceptable. A reputation takes years to develop and potentially moments to destroy. Never put yourself in a situation that jeopardizes this. Keep your wits!!!
- B. The firm has always made every reasonable attempt to create an environment that enables each trader to perform to the best of his abilities. This includes the provision of a comfortable, state of the art trading floor that offers carefully selected support systems and the staff to maintain them. (The trading floor at Madoff is held in the highest regard by the street and a steady stream of insiders make the trip to see it for themselves.) The firm is always evaluating current and available products to update when warranted.
- C. The firm promotes communication among employees. In this industry, there is no substitute for experience, so relaying past experiences is a crucial teaching tool. It further serves as the best way to create and expand strategies and solve problems. Finally, it forces you to verbalize your thoughts, which

leads to a more complete development of ideas.

- D. The firm encourages the exploration of multiple trading strategies and will always listen to a new strategy. Traders and assistants are encouraged to research new ideas, compile information, and present ideas to management or senior traders for guidance. The firm's goal is to stimulate, not stifle, new ideas. (Good place for a few examples: 1) David Carlson's program for momentum plays incorporates his concepts of applicable market variables to identify positive momentum in stocks, 2) Tom and Larry's spread trading -using technical analysis to identify variations in pairs of stocks' trading ranges and attempting to capitalize on this spread returning towards "normal".)

Business objectives

- A. Expand market share in listed securities (as a % of the NYSE total volume) and expand foray into NMS market making, actively soliciting new customer order flow in these issues.
- B. Continually explore alternative trading strategies, in addition to market making activities, to expand profitability.
- C. Provide the best execution for our customers and expand our customer base by actively soliciting new customers.

2. New employees' role.

There is an infinite list of potential trading strategies. This has led to the firm's policy of continually hiring new traders and assistants as qualified candidates become available. We have not set a limit on the number of traders hired. As long as it can be justified, we'll hire talent. Your role is to start as an assistant and learn the business. You are expected to contribute to your team's ability to produce results. The goal is to prepare you to accept more and more decision making responsibilities with the purpose of attaining enough knowledge, experience, and ingenuity to explore current and new viable strategies. There are no guarantees when or if you will become traders, but we hire with the belief that you have the talent and drive to excel and be a positive contributor to the success of the firm. As the environment, both internal and external, becomes more and more competitive, it becomes more necessary to display creativity, hard work, and drive to continually generate profits. The traders that can adapt to the changes in the environment are the ones who will succeed in the long run.

We will provide the tools for you to tackle this challenge. These include the fundamental training you receive here, the experience your coworkers and being on the desk provide, and the necessary physical materials (systems, research, support staff, etc.). It is up to you to put these to work and constantly challenge yourself and coworkers to explore the endless list of possibilities. The ultimate responsibility for your success lies with you.

3. Goals of training program.

This program is designed to provide the first step in the developmental process. We will create the backdrop for your learning by giving an overview of the industry and Madoff 5 place within it. You will learn the ins

and out of the industry, then we will focus on more specifics, such as what traders at Madoff do, how to use the systems we employ, and what your individual responsibilities are. As we said, this is just the first step. There is an overwhelming amount of information. The goal here is to provide a starting point by making sense of the basics. The next step after this program will be direct interaction with your coworkers. Your traders will have the primary responsibility of expanding the topics discussed here, but the ultimate responsibility for your development, again, lies with you. Press your trader and any other source of information to learn as much as possible!!

4. Assistant's responsibilities.

At the end of this program, before you are turned back over to the desk, we will go over your individual responsibilities in detail. For now, try to concentrate on seeing the big picture as we go over the basics.

1. Overview of the securities industry.

The securities industry offers a wide array of participants. Their roles are varied, covering a wide range of functions and often overlapping in several areas. It is useful to be familiar with these distinctions to gain a better understanding of how their interaction affects the marketplace and our firm. It will also help define our niche in the industry. The discussion here will be as detailed or succinct as necessary, depending on the knowledge of the trainees.

A. Brokers vs. Traders / Agent vs. Principal

- Stock brokers act as a conduit between the party wishing to buy or sell a security and the party willing to take the other side of the transaction. They **do not** risk their own capital and are unaffected by market movements after the transaction occurs. They work for the commissions they can generate from each transaction. Brokers' roles may be more involved depending on the level of service they offer. For example, discount brokers only offer execution services. Full service brokers will support the investors by providing research information and suggest **trading** strategies and identify opportunities. Brokers act as a **customer's** "agent". Thus, brokers trade as agency, executing orders on behalf of a **customer**, utilizing the **customer's** capital and for the **customer's** account.

Traders, on the other hand, take a position risking capital (either their own or their firm's). They are affected by market movements and make **trading** decisions. They earn money by generating **trading** profits, not through commissions. Since traders utilize a firm's capital and trade for the firm's account, their trades are deemed "principal" transactions.

B. Exchanges vs. OTC market

- Historically, securities only traded on the NYSE. However, over time several other exchanges came into existence (AMEX, Philadelphia, Cincinnati, Boston, Pacific - S.F. and L.A., Midwest). These exchanges all compete with each other, but in reality, the NYSE is by far the largest and when the public thinks of a stock exchange, they envision the NYSE.

The OTC market refers to all trades that are not done on a particular exchange. This may include dealer to dealer trades, after hour trades, 19c3 trades (to be discussed later), etc.

C. Participating firms and their roles

- **Trading** firms are firms that risk their own capital to buy and sell securities and hope to capitalize on market movements.

Brokerage firms offer customers brokerage services (this can include discount service and full-service) and earn money through commissions. (Olde Discount Brokerage, Shearson Lehman)

- Investment firms pool customers' money and invest it to generate returns for the customers. This is the world of fund managers. They pass the loss or profits to the customers. They earn money by charging management fees and often times they charge commissions. (Dreyfus or Fidelity)
- M&A boutiques search for both private and public firms that are undervalued and capitalize by purchasing them and then quickly selling off the assets or divesting certain divisions in the hopes of rapidly realizing a profit. (Blackstone, KKR)
- Banks are becoming more and more involved in the markets every day as regulations ease. They hope to offer customers a host of services that include brokerage, investment advice, fund management, and underwriting services. (Chemical Bank, Citibank)
- Trusts are similar to banks but are subject to slightly different laws regarding their participation in the markets. The important point is that banks and trusts are aggressively seeking more access to the securities industry and are making inroads. This increases the level of competition in the industry. (Northern Trust)
- Market maker/specialists firms coordinate trading in securities. They are charged with maintaining a continuous, two-sided market and for maintaining an orderly marketplace in the security. They are considered the buyer or seller of last resort and must stand ready to make a trade. In exchange for this risk, they earn money by making trading decisions, earning the "spread" between the bid and ask, and may collect fees for executing transactions. Often times, firms will be the specialists in many stocks. (Robb Peck and Merrill Lynch)
- Investment banks provide a broad range of services: research for clients and sale, brokerage business, funds, consultation (m&a and divestitures), capital market activities (IPOs, secondaries, etc.), trading, market making. (Goldman Sachs, Morgan Stanley)
- Hedge funds are limited partnerships in which the limited partners put up the capital and the general partner manages it. The general partner usually collects a management fee (usually 1% of the annual average principal amount) and 20% of the profits, while the remainder gets passed on to the limited partners. In theory, these funds are supposed to be "hedged" investments, meaning they are market neutral. However, over time, the definitions have broadened and today's hedge funds very often resemble the same type of investments used by mutual funds.

There is tremendous overlap between these various functions and many firms compete in several of these categories. For example, the large investment banks will participate in virtually every segment mentioned above. Madoff's niche is in the trading and market maker categories.

2. How securities trade.

- What is a security? A security is evidence of debt or ownership. Today, there are many types of securities. The most typical are:
 - common stocks - representing ownership in a company
 - bonds - representing debt of a company
 - preferred stocks - representing ownership higher in priority than common stock
 - warrants - representing the right, but not the obligation, to buy stock (longer term, usually several years between issue date and expiration date)
 - rights - representing the right, but not the obligation, to buy stock (usually very short term, only a few weeks between issue date and expiration date)
 - options - representing the right, but not the obligation, to buy (calls) or sell (puts) stock (vary in length from one month to several years -LEAPS, but

most fall in the range of one month to three months)(options always expire on the Saturday following the third Friday of each calendar month)

derivative hybrids - representing many varying twists on the traditional types of securities

- Stocks **do not** trade at a single given price, they trade by bid and ask - the price someone is willing to pay and the price someone is willing to offer. Trades then occur on the bid, the offer, or in between as parties have their orders matched up with others. (It is a result of supply and demand, when they match, a trade occurs.)
- An investor's (and trader's) position in a security can be one of three choices: 1) long - buying the security, paying cash to receive certificates of ownership for the security. (In reality, rarely do companies actually print and distribute stock certificates. Instead, a central depository to be discussed in detail later simply maintains accounts for the various players in the industry. All changes in ownership by these players results in the appropriate accounting adjustment to reflect the new number of shares owned by each firm. Ownership of these securities is maintained at the depository in the name of the brokerage firm. The brokerage firm itself is then responsible for maintaining the records of the individual holders of the securities. This tradition of leaving the securities at the depository in the name of the brokerage firm is referred to as leaving the security in "street name".), 2) flat - having no position in a security (neither long nor **short**, zero shares), and 3) **short** - borrowing a security from someone who is long, then selling these borrowed certificates for cash. In this transaction, the investor hopes to profit by a fall in the price of the security. In which case, he will repurchase the securities for less cash than he initially received and **return** them to the lender of the certificates. This often presents a difficult concept, but thinking of positions in purely accounting terms, you can have credits and debits (either long or **short**). The mechanics of actually shorting a stock will be discussed in detail when we talk about the P&L run analysis later. Just be aware that people can buy and sell securities regardless of their current position. However, the rules governing **trading** place stricter requirements on effecting **short** sales **compared to** other types of transactions (namely, the securities must be sold on upticks, when the price of the security is improving in order to prevent **short** sellers from further contributing to a security prices decline).

An investor or trader can buy a security at any price as long as someone else is willing to sell it and it doesn't violate the rules to protect other participants (i.e. you can't trade through other bids or offers - the trade must be in line with the current market in the security, or address all of those who display a willingness to participate at better prices than the negotiated price. It is the specialist's responsibility to ensure that these rules are followed). An investor can sell a security from a long position at any price as long as a buyer can be found (and, again, no rules are violated). However, a sale that will create a **short** position must be sold on an uptick.

Once a trade takes place, it is reported to the "tape", one of the transacting parties has the obligation to report details of the trade to the appropriate governing body, this in turn leads to the compilation of all **trading** activity which can be witnessed as the ticker tape or called up on a host of pricing services. (We will explain in detail the rules governing trade reporting later). This trade reporting must be done within 90 seconds of the trade taking place.

There are two basic types of marketplaces : the dealer to dealer market and the auction market.

dealer to dealer market - defined as a market where dealers who specialize in the particular security stand ready to make bids and offers. They buy and sell for their own account, hoping to realize profits by selling higher than they buy. Transactions are usually negotiated via telephone between participants (although as technology develops, there are emerging means to approach an electronic market between dealers, i.e. the advent of SOBS, Instinet, and SelectNet). The

NASDAQ over the counter market is an example of a dealer to dealer market.

auction market - defined as a market where all transactors in a security converge at one place to bid or offer. The New York Stock Exchange is an example of an auction market. On the exchange, electronic orders interact with traders, brokers, and specialists to execute transactions at the best prevailing prices.

- There are four different levels of a marketplace: primary, secondary, third, and fourth.
 - primary market - the issuance of new securities in an offering to the public (if first time a company is going public, it is an IPO, if issuing more shares of existing company, it is a seasoned offering)
 - secondary market - transactions in already existing securities that take place on an exchange or in the OTC market (the third market)
 - third market - trading of an exchange listed security on the over the counter market
 - fourth market - direct interaction between investors without the service of brokers (i.e. institution to institution transactions)

SEGMENTS OF THE MARKETPLACE

The stock market can be divided into two broad areas; the over the counter market and the exchange market. The distinction between these two markets is becoming complicated, (note the highly publicized battle between the NYSE and NASDAQ) and there is some overlap which we will discuss. We will also discuss the possible confusion of some seemingly ambiguous terms, such as what is an OTC stock now that listed stocks trade in the over the counter market. (We will discuss the differences between NMS stocks vs. listed stocks and the OTC market vs. an exchange market. NMS stands for National Market Securities.).

Two types of securities: listed vs. NMS

When a company decides to go public and issue securities representing ownership in the company, the firm must decide where to register their securities. Their options are limited by stringent requirements set forth by the exchanges and the NASD National Association of Security Dealers - the OTC governing body). Assuming the company is large enough to meet the criteria, they alone must decide whether to register on an exchange (known as a "listed" stock) or register with NASDAQ as an NMS stock. This determines where the secondary market for the security will develop. The competition between the exchanges and NASDAQ is fierce, and both generate a lot of publicity around major firm's selection of a marketplace. (For example, NASDAQ regularly touts MCIC as a shining example of a major company that chooses to remain NMS. The NYSE makes a major announcement every time a company switches its registration from Nasdaq to the exchange - for example, when Nike went to the "big board").

A. Exchange Trading

When a company decides to register as a listed stock, it selects which exchange it will register on. Most large companies choose the NYSE, however, they may select the AMEX or one of the regional exchanges. In most cases, larger companies select the prestige of the NYSE while smaller firms which do not meet the strict capital requirements of the NYSE select the AMEX. In addition, many smaller companies that act regionally often choose to register with the regional stock exchange located in their territory instead of the AMEX (i.e. many Midwest firms choose to register on the Midwest stock exchange). Once a company has registered with a

particular exchange, the other exchanges often choose to cross list the securities - a practice where the other exchanges will also make markets and trade in the securities of that company. For example, while IBM is registered and listed on the NYSE, all of the regional exchanges also make a market in it. The exception to cross listing is the refusal of the Amex and the NYSE to cross list each others securities.

Each exchange has its own criteria for registration, mostly dealing with the company's size (income, assets, etc.), the number of shares issued, the number of shareholders, and the market value of the shares. Once registered, the company must periodically provide its financial records in a timely fashion and satisfy other criteria to remain listed. The NYSE has the most stringent requirements of the exchanges, and is also the most prestigious.

NYSE listings account for approximately 87% of market value of all listed securities, AMEX accounts for only 2% (usually smaller, younger firms). NYSE daily volume is around 350 million shares.

Only members of an exchange may trade on the exchange. Membership to the exchange is represented by ownership of a "seat" on the exchange. Any nonmembers who wish to trade must pay a member a fee to execute orders on their behalf, thus the emergence of brokers on the floor of the exchange.

Here we will describe how the exchange functions, but it should be noted that one regional stock exchange, the Cincinnati Stock Exchange, is an electronic exchange - no trading floor exists, instead, a computer that represents the exchange routes all exchange orders to the firms that are members of the exchange and they perform the functions of exchange members from their own offices, thus, it is a decentralized exchange. On the floor of a non-electronic exchange, there are a host of components and functions that make up the activities of the exchange:

1. Key players:

- specialists-Each stock is controlled by a specialist (firms pay for the right to act as the specialist - referred to as owning the book in a stock since the specialists maintains all the orders comprising the order book in the stock), most specialists firms own the book in more than one stock (often times hundreds of stocks). The specialist oversees all transactions that occur on the exchange in his stock. He must maintain a continuous, two-sided market and maintain an "orderly" market in each stock. He acts as the buyer or seller of last resort. As other participants wish to execute orders, they interact with the specialist, buying from his inventory. Often, participants around the specialist will execute a transaction amongst themselves, with the specialists permission, and they report the trade to him. He still oversees all trading. He can execute orders from his order book or he can take positions himself and risk his capital. We will get into a greater discussion of the rules he must follow after you have witnessed transactions in the market place (to be discussed later - such as trade throughs, trading ahead of book, reflecting size, etc.). Other responsibilities of the specialists include the obligation to report all transactions of 100 shares or greater that occur in his stock on his exchange to the "tape". The "tape" refers to the traditional ticker tape that used to prevail to show a continuous record of all transactions (greater than 100 shares) that took place. It is mandated that all transactions greater than 100 shares must be reported to the consolidated tape (includes the transactions in all listed securities in all marketplaces - exchanges and third market). His clerks at the post do this for him as he calls out trades. He also opens his stock every morning by comparing his buy orders to his sell orders to determine where his initial quote will be. If he has an imbalance in orders that will lead him to open a stock more than 1/4 of a point from the previous close, he must communicate this imbalance to other exchanges in hopes of attracting orders to offset the imbalance. He also is responsible for trading halts and

re-openings based on intraday news or a sudden influx of order imbalances, but these must be accompanied by the approval of exchange governors.

- retail brokers - Employees of member firms that handle customer orders, they do not risk the firm's capital, they simply receive and execute customer transactions for a commission.
- two dollar brokers - Independent members of the exchange that will execute orders for anyone, they usually take up the excess business that brokerage firms can't handle and they receive a fee for their services. They are free-lance brokers. Their name arose out of the simple fact that they used to earn a two-dollar commission for transactions, but today's commissions are much different. Since each member firm can only have one floor broker per exchange seat that they own, it becomes inevitable at times (especially busy periods like the opening) that the demands on the firm's brokers will exceed their capacity. This is why the two dollar brokers stay in existence - they handle the overflow.
- traders - Independent members of the exchange who risk their own capital and take positions hoping to earn trading profits.
- floor governors - Members of the NYSE that are appointed by the exchange and are responsible for overseeing the activities of the exchange members to ensure all rules of the exchange are enforced. They are responsible for maintaining the integrity of the exchange. Whenever a dispute arises over a possible rule infraction, a floor governor will be notified and hand down a ruling to settle it.
- clerks - Employees of various member firms, they handle the various clerical duties that arise.

2. Description of the floor:

- large open room, often divided into several "rooms" where different stocks are traded
- area surrounding the floor is composed of booths where members rent a phone to conduct their business (i.e. brokerage firms rent a booth and have a clerk man the telephones that connect them to the outside world)
- the center area of the floor houses posts - a large donut shaped desk
- stocks are traded at the posts, each stock is assigned to a specific post and trades at the same location always
- more than one stock trades at each post
- the specialist stands in front of the post, his clerks stand inside the desk and record the specialist's transactions as he reports them

3. Types of orders.

- Market order to buy or sell - these are orders to buy a specified number of shares at the best available offer or to sell at the best available bid.
- Limit order to buy or sell - these are orders to buy or sell a specified number of shares at a specified price.
- Buy stop - this is an order with a limit above the current market price, as the stock rises and hits the customer's limit price, the order is triggered. At this point, the order becomes either a market order or a limit order (depending on how the customer had designated it at the time the order was initially entered) to buy a specified number of shares. If it was designated as a market stop order, it will be executed as part of the very next print in the stock after the triggering print has occurred (note that this price may differ significantly from the limit price that triggered the

ordered). If it was designated as a limit stop order, the order is now handled like any other limit order, awaiting a chance to execute the order at the limit price. A buy stop order can be used to cover a **short** position that is going against the investor or to get long as a momentum play (buying when a stock hits a technical buy level, etc.)

Sell stop - this is an order with a limit below the current market price, as the stock drops and hits the **customer's** limit price, the order is triggered. At this point, the order becomes either a market order or a limit order (depending on how the **customer** had designated it at the time the order was initially entered) to sell a specified number of shares. If it was designated as a market stop order, it will be executed as part of the very next print in the stock after the triggering print has occurred (note that this price may differ significantly from the limit price that triggered the order). If it was designated as a limit stop order, the order is now handled like any other limit order, awaiting a chance to execute the order at the limit price. Sell stop orders can be used to sell out a losing bet when it reaches a predetermined bailout point, to attempt to "lock" in a profit by hanging on to a long position until the momentum of the stock turns to the down side, or to establish a **short** position.

- Day orders are orders that exist until the end of that **trading** day or until they are executed, whichever comes first.
- GTC - orders that are "good-til-canceled", they stay in effect until the **customer** cancels it or it is executed, whichever comes first.
- DNR - orders that "do not reduce" the buy limit price on the day a stock goes ex-dividend
- Sell **short** limit or market - orders to sell "**short**" must be executed on an "uptick" - that is, a price equal to the previous price as long as the preceding print at a different price was a lower price or if the price is higher than the previous price.

- All limit orders are treated as limit "or better", which means the **customer** gets his price or the best available price, whichever benefits the **customer**.
- Limit orders take precedent first by price, then, if at the same price, time order takes precedent (first in takes priority).
- All limit orders to **buy** stock are automatically reduced by the ex-dividend amount on the day a stock goes ex-dividend, unless they are designated as DNR. All orders on the sell side of the book are left unchanged.

4. Methods for **trading** on the floor.

- DOT is an automated system that electronically delivers orders and executions from member firms directly to the specialists and back again without the use of a floor broker. This results in a speedy delivery of orders and executions. These orders are entered directly into the specialists electronic order book. DOT can be used for orders up to 30,099 shares.
SuperDOT is an extension of the DOT system. Once again, it is the same electronic system that delivers orders and executions from member firms directly to the specialists and back again. However, the distinction is that SuperDOT is for orders exceeding 30,099 shares. These orders are not automatically integrated into the electronic order book of the specialist, instead they are handled manually by the specialist upon their arrival to the floor.
- At this point, it is very important to note that Madoff's normal DOT order is a size less than ten thousand shares. Thus, it is crucial for traders at Madoff, when wishing to send an order exceeding 10,000 shares, verify that the order is actually received by the specialist. This can be done by contacting the brokerage firm that the DOT order is routed through. While DOT and SuperDOT are designed to handle orders in

excess of 10,000 shares, very often the individual brokerage firms that use DOT and SuperDOT have established filters to prevent orders being sent in error. The result can be failure of your oversized order reaching the floor in a timely fashion. Therefore, it is in a trader's best interest to verify all orders of significant size in order to minimize the likelihood of an error occurring.

- Brokers can deliver orders to the specialists, who then adds it to his limit order book or executes it immediately. This is referred to as "dropping the order on the book". It now is the specialist's responsibility to handle the order properly. The specialist informs the broker when his order is executed.

- Brokers can also stand "in the crowd" at the specialist's post and wait for a stock to trade at the price of their customers' orders, then interact with either the specialist or other players in the crowd to execute a transaction and report it to the specialist.

- Other exchanges have direct electronic lines to the specialists. There are two types of lines: ITS lines and CAES lines.

ITS (inter market trading system) lines are an exchange to exchange electronic link. Specialists on one exchange can send orders to other exchanges via these lines. These orders must be designated with the current market price (i.e. to buy at the offered price and to sell at the limit price) when they are sent. The orders can be either principal or agency and can be any size. Upon their arrival at another exchange's specialist booth, that specialist will immediately execute as much of the order as possible (if any at all) based upon the availability of bids or offers in his market place. The specialist can then cancel the balance of the order. If he does not cancel the order, it will be automatically canceled after three minutes. The specialist will not add the order to his limit book. ITS lines are maintained by the exchanges themselves. NASDAQ has access to the ITS system, but only in 19c3 stocks (this will be described in more detail in the section titled "third market trading").

CAES (computer automated execution service) lines are electronic links established and maintained by Nasdaq. They link market makers and order entry firms to each other. CAES can be used by these participants for trading in any listed securities. Again, any orders sent via these lines to a market maker must be designated with the current market price (i.e. to buy at the offered price and to sell at the limit price) when they are sent. The size of the order that can be sent depends on whether it is principal or agency. Principal orders can only be sent up to the size the market maker is displaying. Agency orders can be sent up to 1,000 shares. Upon their arrival at the market maker's NASDAQ terminal, that market maker will immediately execute as much of the order as possible (if any at all) based upon the availability of bids or offers in his market place. note, a market maker is obligated to make a print on his quote for at least the size he is displaying, unless he has already made a print with someone else during the relevant time period - usually measured in seconds). The market maker can then cancel the balance of the order. If he doesn't cancel the order, it will be automatically canceled after three minutes. The market maker will not add the order to his limit book.

One additional link worth noting due to its relevance to Madoff is the NSTS National Security Trading System). This is the system of electronic linkages established and maintained by the Cincinnati Stock Exchange to link competing dealers to the exchange itself. This is important to Madoff since we are a competing dealer on the Cincinnati exchange. These lines are the method we use to send our commitments to the Cincinnati, who in turn will either use an NSTS line to send the order to another competing dealer on the Cincinnati or use an ITS line to send the commitment on to another exchange.

- Most specialists allow a type of order execution called "matching". In this case, a broker approaches the specialist with his limit order to buy on the bid or sell on the offer and informs the specialists of his order. As counter orders come to the specialists, the specialists will allocate some of it to his own customer limit book and some to the broker who is matching. The rough rule of thumb is that 25% to 50% goes to the book and the balance gets distributed among all the brokers matching at that price. Specialists have some discretion in how to handle it, some execute in rotation, some divide each trade, etc. In the recent past, "walking matches" were

allowed, where a broker with a good relation with a specialist could inform the specialist of his order and count on the specialist to call him to the post when he had stock to trade. This freed the broker to travel the floor executing other orders. This practice of calling a broker to the post when a trade was going to occur has since been prohibited. Today, a walking match refers to the fact that the broker who has the order may be walking around to different posts working orders in other stocks. The risk is that he may miss a trade in one stock while he is at another stock's post. Thus, walking matches are less likely to get executed than a regular matching order. Customers never ask for a walking match. They simply exist because some brokers are understaffed to afford to leave a broker waiting at a particular post waiting for a trade to occur.

5. Regulation and process for problem resolution

- All security trading falls under the realm of the SEC, but each marketplace has its own self-governing body that enforces its rules in an effort to stave off further regulation by the SEC.

In the case of the NYSE, the exchange has exchange members who serve as floor governors in addition to their other duties. These governors oversee the floor activities, ensure rule compliance, and rule on disputes. If the execution is being handled by a broker or through DOT, the member firm must request a floor governor's ruling. If the execution is being generated by a competing exchange, that exchange's officers must request the ruling. If the trade is being generated from the third market, NASDAQ must request the ruling.

Usually, whoever would be responsible for requesting a ruling can resolve the issue directly by dealing with the post and asking for an explanation of what transpired and why without requesting a floor governor.

B. Third market trading

The third market is the trading of exchange listed securities away from the floor of the exchange. This is the same definition as saying trading listed stocks in the over the counter marketplace.

Several significant events and rule changes led to the development of the third market. In the 1960s, third market firms offered reduced commissions to institutions, drawing business away from the exchanges (who operated with fixed commissions until 1975, hampering their efforts to compete based on price). As business began to leave the exchanges, the SEC stepped in to offer some protection. They amended rule 394 50 that exchange members were only allowed to execute trades off the exchange if the transaction was a customer order and the trade meant an equal or better execution for the customer. Then, in 1976, the SEC went a step further with the introduction of Rule 390. This rule prohibits exchange members from: trading listed stocks OTC (in the third market), crossing customer orders OTC, and trading for their own accounts OTC (except in foreign markets and 19c3 stocks - 19c3 stocks are explained below). In essence, this rule prevents member firms from trading in the third market except for 19c3 stocks, which provided a significant opportunity for nonmember firms to compete with the exchange. This rule prohibiting member firms from trading non 19c3 listed securities on the OTC market place gave Madoff the opportunity to fill a niche in the marketplace. We can trade for the firm's own account in the third market in non 19c3 issues. Thus, third market firms were free to develop without competition from the much larger member firms. Customers are able to receive cheaper executions in the third market since operating costs for third market firms is drastically lower than for member firms (exchange members pay huge costs associated with maintaining membership in addition to expensive fees for executing transactions, which are passed on to the customer in the form of fees and commissions).

On July 1, 1981, the 19c3 rule went into effect. This rule allowed member firms to begin trading listed securities in the third market. This means that member firms and nonmember firms (like ourselves) are able to make a market in a 19c3 security and interact directly with the exchange specialist. However, the rule only