

**UNITED STATES OF AMERICA  
BEFORE THE  
SECURITIES AND EXCHANGE COMMISSION**

Administrative Proceeding  
File No. 3-11771

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In the Matter of

Knight Securities L.P.

Respondent.

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**INDEPENDENT DISTRIBUTION  
CONSULTANT'S PROPOSED FAIR  
FUND DISTRIBUTION PLAN**

**I.  
INTRODUCTION**

By Order dated December 16, 2004, the U. S. Securities and Exchange Commission (“Commission”) brought a settled administrative proceeding (the “Knight Matter”) that charged Knight Securities L.P. (“Knight”) with, among other things, failing to meet its duty to provide “best execution” to the Institutional Customers that placed “not held” orders with Knight.<sup>1</sup> Knight, without admitting or denying the allegations contained therein, consented to the entry of the December 16, 2004 Order (defined below). Pursuant to the December 16, 2004 Order, the following is the Independent Distribution Consultant’s Proposed Fair Fund Distribution Plan (the “Plan”) for the distribution of the disgorgement and penalty funds pursuant to Rule 1101 of the Commission’s Rules on Fair Fund and Disgorgement Plans (“Rules”).

**II.  
FACTS**

On December 16, 2004, the Commission issued an Order Instituting Administrative and Cease-and-Desist Proceedings, Making Findings, and Imposing Remedial Sanctions Pursuant to Sections 15(b)(4) and 21C of the Securities Exchange Act of 1934 (“December 16 Order”)

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<sup>1</sup> *In the Matter of Knight Securities, L.P.*, Admin. Proc. File No. 3-11771 (December 16, 2004).

against Knight and ordered, among other things, Knight to pay disgorgement of \$41,146,663.50, prejudgment interest of \$13,195,068.00, and a civil money penalty of \$12,500,000.00 to the Commission and acknowledged that Knight shall also pay a fine of \$12,500,000.00 to the NASD in a related proceeding.

On December 20, 2004, pursuant to the December 16 Order, an interest bearing escrow account was opened at JP Morgan Chase Bank, N.A. (“JP Morgan”) pursuant to an escrow agreement. On December 29, 2004, Knight deposited into the JP Morgan escrow account the disgorgement amount, pre-judgment interest and civil money penalty (“Distribution Funds”) totaling \$66,841,731.50.<sup>2</sup> On October 27, 2005, pursuant to a Commission Order dated September 29, 2005<sup>3</sup>, the Distribution Funds were transferred from the JP Morgan escrow account to the Commission’s Deposit Fund account at the Treasury’s Bureau of Public Debt (“BPD”) pending the distribution of the funds. The Distribution Funds were deposited at the BPD for investment in government obligations.

Pursuant to Section VI.C.6.a. of the December 16 Order, Knight agreed to retain an Independent Distribution Consultant to develop a Plan for the distribution of the Distribution Funds. Knight retained, and the Commission did not object to the retention of, Heffler, Radetich & Saitta, L.L.P. (“Heffler”) as the Independent Distribution Consultant. Pursuant to Rule 1105(a) of the Rules, the Commission staff proposes that Heffler administer the Plan once the Plan has been approved by the Commission. The Commission staff proposes that the bond requirement of Rule 1105(c) of the Rules be waived by the Commission for good cause shown – specifically, that the Distribution Funds will be held at the BPD pending distribution. The fees and costs incurred by Heffler in developing and administering the Plan for distribution in this matter will be the responsibility of Knight and will not be paid from the Distribution Funds.

On June 14, 2005, pursuant to Rule 1105(a) of the Rules, the Commission issued an Order (“Tax Order”) appointing Heffler as the Tax Administrator in the Knight Matter.<sup>4</sup> The Tax Order grants Heffler limited authority and power to (1) act as administrator for tax purposes for the qualified settlement fund (“QSF”); (2) prepare, sign, and file the necessary tax returns and tax-related documents for the QSF; (3) obtain the necessary tax-related documents and identifiers, such as a federal tax identification number, on behalf of the QSF; (4) perform other tax-related

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<sup>2</sup> The \$12,500,000.00 fine was paid directly to the NASD and is not part of the Fair Fund established pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002 for the funds described in the December 16 Order.

<sup>3</sup> *In the Matter of Knight Securities, L.P.*, Admin. Proc. File No. 3-11771 (September 29, 2005).

<sup>4</sup> *In the Matter of Knight Securities, L.P.*, Admin. Proc. File No. 3-11771 (June 14, 2005).

and reporting duties on behalf of the QSF as required by Department of the Treasury regulations relating to QSF administrators; and (5) communicate on behalf of the QSF on matters set forth in items 1 through 4. All taxes will be paid out of the Distribution Funds and Heffler will be responsible for paying the taxes to the U.S. Internal Revenue Service (“IRS”) and relevant state taxing authorities, if applicable.

Pursuant to the December 16 Order and subsequent amended Order dated July 27, 2005<sup>5</sup>, Heffler is required to submit a Plan to the staff of the Commission for the administration and distribution of the Distribution Funds. Accordingly, this Plan has been prepared pursuant to the Rules, 17 CFR 201.1100 *et seq.*, and the proposed distribution shall occur pursuant to Section 308 of the Sarbanes-Oxley Act of 2002.

### **III.**

### **PROPOSED DISTRIBUTION PLAN**

Pursuant to the requirements outlined in the Rules, Heffler has proposed a Plan and it is divided into three separate phases. In compliance with Rule 1101(b)(2) of the Rules, the initial phase of the Plan is to identify each Institutional Customer and confirm the Disgorgement Amounts assigned to each Institutional Customer. The amount of disgorgement and the specific trades that will be eligible for proceeds from the Distribution Funds were determined by the Commission staff by identifying certain “not held” orders that were placed by Institutional Customers of Knight during the relevant time period. In determining which trades would be eligible to be the subject of the distribution, the Commission staff used certain profit per share parameters to identify a class of trades in which the highest profits per share were extracted from customer orders. Accordingly, the eligible claimants are limited to those injured customers. Heffler will examine those trades in order to identify the Institutional Customers who were injured because Knight failed to obtain best execution on those violative trades. The second phase of the Plan is to calculate each Institutional Customers’ Distribution Amount. The final phase of the Plan is to distribute the Distribution Amounts to approved Institutional Customers. The plan for each phase is outlined below.

#### **A. DEFINITIONS**

“Disgorgement Amount(s)” shall mean the per-trade calculation of profits that were improperly realized from “not held” orders in the class of trades identified by the Commission staff.

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<sup>5</sup> *In the Matter of Knight Securities, L.P.*, Admin. Proc. File No. 3-11771 (July 27, 2005).

“Distribution Amount(s)” shall mean the total of the Disgorgement Amount assigned to each trade plus an interest amount calculated on the Disgorgement Amount from the date of the applicable trade to the date the Plan is approved by the Commission.

“Institutional Customers” shall mean those individuals or entities that placed a “not-held” order with the Lead Sales Trader between January 1999 and November 2000 that fell within the class of trades previously identified by the Commission staff.

“Lead Sales Trader” or “LST” shall mean the former Knight institutional sales trader who was primarily responsible for the handling of the Institutional Customers’ “not held” orders that are the subject of the December 16 Order.

**B. PHASE 1: IDENTIFICATION OF INSTITUTIONAL CUSTOMERS AND VERIFICATION OF DISGORGEMENT AMOUNTS**

Pursuant to the December 16 Order, Knight provided Heffler access to its files, books, records, and personnel for review and verification of the Disgorgement Amounts assigned to each Institutional Customer. The initial documentation provided was a database of LST trades (“LST Database”) prepared by Knight, listing 1,450 trades during the period January 1999 through November 2000 that satisfied the profit per share criteria identified by the Commission staff. Each trade identified on the LST Database listed the date of the trade, type of trade, number of shares, purchase or sale amount, the name of the institution placing the trade and the Disgorgement Amount. The following tests will be performed to verify that all LST trades and Institutional Customers were properly identified by Knight and included on the LST database.

Heffler’s initial test of the LST Database will be to confirm that the total Disgorgement Amount for all 1,450 trades equaled the Disgorgement Amount paid by Knight in December 2004. The total Disgorgement Amount per the LST Database should calculate to \$41,146,663.50 to agree to the total disgorgement set forth in the December 16 Order.

The next test to perform is to determine if all trades by the LST that meet the applicable profit per share criteria were included on the LST database. Heffler will conduct this test by reviewing the LST’s compensation records. The LST’s compensation package was partially based on profits by trade. Heffler will obtain a database of all trades made by the LST (“Total Database”) during the period of January 1999 through November 2000. The schedules received should reflect the commissions earned on those trades. Heffler will compare the sum of the commissions paid to the LST in the Total Database to payroll records and Form W-2s.

Heffler will perform additional tests to determine if all appropriate LST trades were identified by Knight and included on the LST Database. Through discussions with Knight and the staff of the Commission, Heffler will document the methodology used to calculate the Disgorgement Amount for each applicable LST trade. Heffler will obtain all trades for randomly selected dates to test the accuracy of the LST Database, in terms of trades recognized for disgorgement from the Total Database. Based upon random sample dates and trades tested, Heffler will confirm that all trades on the Total Database that reflect improperly realized profits within the criteria determined by the Commission staff are listed on the LST Database and that all trades not reflecting such profits are excluded from the LST Database.

The final phase of Heffler's testing is to verify that all Institutional Customers are identified and listed on the LST Database. Heffler will confirm that each trade listed on the LST Database includes the name of the institution placing the order by indexing the LST Database by institution.

It was determined by Heffler, in consultation with Knight and the staff of the Commission, that a claim form is not required to be sent or filed by the Institutional Customer, as set forth in Rule 1101(b)(4) of the Rules, because the Institutional Customers who were affected by the violations committed by Knight<sup>6</sup> will be readily identifiable from documentation that is provided by Knight. Heffler will contact each one to confirm the payee information, tax identification number and the mailing address. Accordingly, there was no need for Institutional Customers to file a claim form and submit supporting documentation for their transaction(s) and document eligibility pursuant to Rule 1101(b)(4) of the Rules. No Distribution Amounts will be sent to an Institutional Customer until all contact information is obtained and confirmed, including, if requested, any information to support the named payee's legal entitlement to participate in the distribution.

C. PHASE II: CALCULATION OF DISTRIBUTION AMOUNT TO INSTITUTIONAL CUSTOMERS

The Distribution Amounts will first be calculated on a per-trade basis and then aggregated for each Institutional Customer for distribution. Each Distribution Amount consists of the Disgorgement Amount plus an interest amount that will be calculated from the date of the trade to the date the Plan is approved by the Commission. A Distribution Report ("Report") will

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<sup>6</sup> Knight consented to the entry of the Commission's December 16 Order without admitting or denying the Commission's findings.

be provided to the Commission listing the name of each Institutional Customer and its assigned Distribution Amount.

The Distribution Amount assigned to each Institutional Customer is a set number as described above. The interest amount is a calculation based on the Disgorgement Amount using the applicable rates in effect during the applicable periods. Any questions concerning the calculations of the Distribution Amount must be sent to Heffler, in writing. The correspondence must state the reason for the inquiry and include any supporting documentation. Heffler will send a confirmation, via first-class mail, indicating receipt of the letter and that a response will be made within 30 days of receipt of the correspondence, unless input from the Commission is required before a complete response can be issued. Heffler will send a formal response once comments or resolutions are received from the Commission.

#### D. PHASE III: DISTRIBUTION TO INSTITUTIONAL CUSTOMERS

The final phase of the Plan is the distribution of the funds to the Institutional Customers. Before a distribution is made Heffler will submit a report to the Commission seeking approval in accordance with Rule 1101(b)(6) of the Rules. This report will include the name of each Institutional Customer along with their Distribution Amount.

Once the Plan has been approved by the Commission, Heffler will send each approved Institutional Customer a Distribution Plan Letter (attached hereto as Exhibit A) which will provide a brief description of the Knight Matter and an explanation of the Distribution Amount, including an order-by-order breakdown. In order to receive the Distribution Amount, each approved Institutional Customer must provide Heffler, within 120 days of receipt of the Distribution Plan Letter, a certification stating that the Institutional Customer, in accordance with the Institutional Customer's fiduciary or other legal obligations, will direct the Distribution Amount to the specific investor(s) or the related fund(s) on whose behalf the relevant "not held" orders were placed. The certification must include, at a minimum, a list of the specific investor(s) or, if not economically feasible, the related fund(s) on whose behalf the relevant "not held" orders were placed based on the order-by-order breakdown provided by Heffler. Additionally, the Institutional Customer must certify that it will undertake to pay each specific investor or related fund the appropriate portion of the Distribution Amount as provided by Heffler.

If an Institutional Customer cannot identify all of the relevant investors or related funds on whose behalf a particular "not held" order was placed, the Institutional Customer should -- in

the certification provided to Heffler -- provide an explanation as to why it is unable to identify all relevant investors or related funds.

Additionally, if an Institutional Customer cannot identify any relevant investors or related funds for a particular “not held” order, they should so specify in their certification to Heffler. In that case, the Institutional Customer will not receive the Distribution Amount for that particular “not held” order and the Distribution Amount for that “not held” order will be aggregated with any excess funds and delivered to the United States Treasury.

Once Heffler receives the certification from the Institutional Customer, Heffler will issue the distribution check to the Institutional Customer with an enclosure (attached hereto as Exhibit B). On the date of a distribution to an Institutional Customer, the distribution check will be prepared and the total Distribution Amount will be transferred from the BPD to the distribution checking account, from where all distribution checks will be written. No check will be issued until the funds are wired from the Commission’s Deposit Fund account into the distribution checking account. A distribution check will be shipped overnight for next day delivery, to each approved Institutional Customer. Each distribution check will clearly indicate that it must be negotiated within 180 days of issuance. However, for any check not negotiated within 60 days of issuance, Heffler will contact the appropriate Institutional Customer via telephone or first-class mail. Any checks not negotiated within the 180 day period will be deemed abandoned and the funds will remain in the Distribution Account until such time the Commission dissolves the Deposit Fund Account and Distribution Account.

Institutional Customers must submit a final certification that all moneys received have been paid out to the relevant investors or related funds, within 90 days of receipt of the Distribution Amount. The staff of the Commission will be informed of non-compliance with this procedure.

#### E. OTHER MATTERS

Heffler will submit an accounting of all moneys received, earned and paid out of the distribution fund within 10 days of the end of every calendar quarter to the staff of the Commission.<sup>7</sup> The quarterly reports will be issued until a final accounting is made to the staff of the Commission (and approved by the Commission).

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<sup>7</sup> Some filings may occur more than 10 days after the close of the calendar quarter due to the timing of the receipt of the statement from the BPD.

The Plan shall terminate on September 30, 2007. Heffler will continue to reconcile the Deposit Fund Account and Distribution Account until the plan terminates. On or before 30 days following the termination of the Plan, pursuant to Rule 1101(b)(5) of the Rules, Heffler shall prepare a written report on the Plan and its execution, and submit that report to the staff of the Commission.

Following the completion of the distribution or termination of the Plan, any funds that have not been distributed shall be delivered to the United States Treasury.

Heffler has and will continue to file on a timely basis all required federal, state and local tax returns and estimated payments with respect to the Distribution Funds. Copies of all filings will be submitted to the Commission's staff member in this matter.

Heffler will inform the Commission staff of any material changes in the Plan, and will obtain approval from the Commission prior to their implementation. If material changes are required, this Plan may be amended upon the motion of Knight, Heffler or upon the Commission's own motion.



**EXHIBIT A**

DISTRIBUTION PLAN LETTER TO INSTITUTIONAL CUSTOMERS

[Date]

Dear Institutional Customer:

Pursuant to the settlement reached between the Securities and Exchange Commission (“Commission”) and Knight Securities, L.P. (“Knight Securities”) on December 16, 2004 you are receiving this distribution because you were identified as one of the Institutional Customers affected by the findings of violations by Knight Securities that the Commission made in its December 16, 2004 Order. The affected trades occurred during the period between January 1999 and November 2000. Not all trades during the period were affected by the findings of violations by Knight Securities that the Commission made in its December 16, 2004 Order. The distribution will be made to reimburse you for the profits that were improperly realized by Knight from certain “not held” orders that were placed by you during the relevant time period. Interest will be included for the period from the date of the applicable trade to the date that the Commission approved the distribution plan. Please find enclosed an order-by-order breakdown of the distribution amount.

In order to participate in the distribution you must identify the specific investor(s) or the fund(s) on whose behalf the relevant “not held” orders were placed. If a transaction relates to multiple investors then identify each specific investor or related fund. Once you have identified the specific investor(s) or the funds related to the “not held” orders, you must provide us a certification stating that you, in accordance with your fiduciary or other legal obligations, will direct the distribution amount to the specific investor(s) or the related fund(s) on whose behalf the relevant “not held” orders were placed. Additionally, you must certify that you will undertake to pay each specific investor or related fund the appropriate portion of the distribution amount that is provided to you.

The certification must include, at a minimum, a list of the specific investor(s) or, if not economically feasible, the related fund(s) on whose behalf the relevant “not held” orders were placed based on the order-by-order breakdown. If you can not identify all of the relevant investors or related funds on whose behalf a particular “not held” order was placed, then you should provide an explanation as to why you are unable to identify all relevant investors or related funds. If you can not identify any relevant investors or related funds for a particular not-held order, then you should so specify in the certification.

You will have 120 days from the date you received this letter to provide the certification. Please forward the requested information to:

Heffler, Radetich & Saitta, LLP  
1515 Market Street, Suite 1700  
Philadelphia, PA 19102  
Attention: Ronald A. Bertino

This distribution does not affect any legal claim that you may possess, nor does it affect any defense to such a claim, although Knight Securities may have certain rights of offset or reduction with respect to any such claim as described in Paragraph VI.C.5 of the December 16, 2004 Order of the Commission in In the Matter of Knight Securities, L.P., Admin. Proc. File No. 3-11771.

If you have any questions regarding this distribution, please do not hesitate to contact the office of the Independent Distribution Consultant at 215-665-1124 or Thomas M. Merritt, Chief Legal Officer, Knight Capital Group, Inc. at 201-557-6949.

Sincerely,

HEFFLER, RADETICH & SAITTA, LLP  
Independent Distribution Consultant

**EXHIBIT B**

LETTER TO INSTITUTIONAL CUSTOMERS ENCLOSING DISTRIBUTION CHECK

[Date]

Dear Institutional Customer:

You previously received correspondence indicating you were identified as one of the Institutional Customers affected by the findings of violations by Knight Securities L.P. ("Knight Securities") that the Securities and Exchange Commission ("Commission") made in its December 16, 2004 Order. You submitted documentation that identifies the specific investor(s) and/or related funds on whose behalf the relevant "not held" orders were placed. Enclosed is the distribution check for the transactions for which you were able to identify the investor or related funds.

You are required to supply an additional certification stating that distributions were made to all investors/funds identified. This must be submitted within 90 days of the date you received the distribution amount. Please forward the requested information to:

Heffler, Radetich & Saitta, LLP  
1515 Market Street, Suite 1700  
Philadelphia, PA 19102  
Attention: Ronald A. Bertino

The staff of the Commission will be informed of non-compliance with this procedure.

Because the tax treatment of this distribution varies based on the recipient's tax status and treatment of their investments, the Independent Distribution Consultant cannot determine the appropriate tax reporting for any recipient. You should consult your tax advisor to determine the tax consequences, if any, of this distribution to you. Please note that the Internal Revenue Service has issued regulations under Internal Revenue Code §468B which provides in part: "Whether a distribution to a claimant is included in the claimant's gross income is generally determined by reference to the claim in respect of which the distribution is made and as if the distribution were made directly by the transferor."

This distribution does not affect any legal claim that you may possess, nor does it affect any defense to such a claim, although Knight Securities may have certain rights of offset or reduction with respect to any such claim as described in Paragraph VI.C.5 of the December 16, 2004 Order of the Commission in In the Matter of Knight Securities, L.P., Admin. Proc. File No. 3-11771.

If you have any questions regarding this distribution, please do not hesitate to contact the office of the Independent Distribution Consultant at 215-665-1124 or Thomas M. Merritt, Chief Legal Officer, Knight Capital Group, Inc. at 201-557-6949.

Sincerely,

HEFFLER, RADETICH & SAITTA, LLP  
Independent Distribution Consultant