

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDINGS RULINGS
Release No. 722/ September 5, 2012

ADMINISTRATIVE PROCEEDING
File No. 3-14853

In the Matter of	:	
	:	ORDER ON MOTION FOR PARTIAL
OX TRADING, LLC,	:	SUMMARY DISPOSITION
OPTIONSXPRESS, INC., and	:	
THOMAS E. STERN	:	

On April 19, 2012, the Securities and Exchange Commission (Commission) issued an Order Instituting Administrative and Cease-and-Desist Proceedings (OIP) pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 (Exchange Act) and Section 9(b) of the Investment Company Act of 1940. The OIP alleges that OX Trading, LLC (OX Trading), willfully violated Sections 15(a) and 15(b)(8) of the Exchange Act and that optionsXpress, Inc. (optionsXpress), and Thomas E. Stern (Stern) caused and willfully aided and abetted OX Trading's violations. The allegations do not involve fraud or harm to customers, but whether a business entity was required to register with the Commission.

The OIP was served by April 25, 2012. Stern filed an individual Answer and OX Trading and optionsXpress filed a joint Answer (OX Trading Answer) on May 29, 2012. The hearing is scheduled to begin on October 22, 2012. An Initial Decision is due by February 19, 2013. OIP at 8; 17 C.F.R. § 201.360(a)(2).

On May 31, 2012, I granted the Division of Enforcement (Division) leave to file a motion for partial summary disposition on the issue of whether OX Trading was required to be registered. Tr. 7; 17 C.F.R. § 201.250(a). On July 20, 2012, the Division filed a Motion for Partial Summary Disposition and Memorandum in Support (Motion) with a Declaration of Jill S. Henderson in Support (Declaration) and four exhibits.¹

¹ Exhibit 1 is the OX Trading Certificate of Formation dated August 20, 2007, and Limited Liability Company Agreement entered on the same date; Exhibit 2 consist of four pages of transcript of statements to the Division by Peter J. Bottini (Bottini), in Trading in Certain Options and Common Stock of Sears, File No. HO-11327-A on April 22, 2010; Exhibit 3 consists of four pages of transcript of statements to the Division by Stern, in Trading in Certain Buy-Writes, File No. HO-11327-A, May 17, 2011; and Exhibit 4 consists of a Decision

On August 10, 2012, Respondents filed a Response to the Motion with thirteen exhibits (Respondents Opposition).² On August 24, 2012, the Division filed a Reply Brief in Support of its Motion (Reply).

The Division's Motion

Is Summary Disposition Appropriate

The Division maintains that summary disposition is appropriate because there are no material facts in dispute and the only dispute is a legal issue. Reply at 1.

Facts

OX Trading, organized in August 2007, with Bottini as President and Stern as CCO, CFO, Secretary, Director, and financial and operations principal, was registered as a broker-dealer with the Commission on February 1, 2008, and applied to become a member of the CBOE in 2007.³ OIP at 2; OX Trading Answer at 3-4; Respondents Opposition at 5, 9. Stern believed these steps were optional from a regulatory perspective, but necessary for OX Trading to participate in a joint back office arrangement with optionsXpress. Respondents Opposition at 9. OX Trading ceased being a CBOE member on March 2, 2009, deregistered as a broker-dealer with the Commission on October 17, 2009, and continued doing business as a proprietary trading firm. OIP at 4; OX Trading Answer at 10-11; Respondents Opposition at 11.

OX Trading was granted conditional approval for re-registration with the Commission on August 26, 2010. OIP at 6; OX Trading Answer at 15. The CBOE approved OX Trading's application to be a CBOE proprietary trading permit holder organization on November 9, 2010.

Accepting Letter of Consent and Letter of Consent in OX Trading, LLC, File No. 12-0040, before the Business Conduct Committee of the Chicago Board Options Exchange, Incorporated (CBOE), dated June 28, 2012, and June 15, 2012, respectively.

² Exhibit A is Bottini testimony on May 25, 2011; Exhibit B is a New Trading Permit Holder Orientation Checklist; Exhibit C is Stern testimony on May 17, 2011; Exhibit D is an OX Trading Board Presentation; Exhibit E is an Affidavit of Bottini on August 10, 2012; Exhibit F is Bottini testimony on May 26, 2011; Exhibit G is Stern testimony on May 18, 2011; Exhibit H is an Alan Samuelson (Samuelson) e-mail on December 31, 2008; Exhibit I is a Samuelson e-mail on January 7, 2009; Exhibit J is a Notice of Termination; Exhibit K is a February 25, 2009, Leimer e-mail; Exhibit L is James Adams testimony on April 7, 2011; and Exhibit M is the Concept Release on Equity Market Structure, Exchange Act Release No. 34-61358 (Jan. 14, 2010).

³ Stern was also CFO of optionsXpress. OIP at 2; Stern Answer at 2; OX Trading Answer at 3. According to Stern, he was also Chief Administrative Officer of optionsXpress Holdings, Inc. (Holdings); the President and CEO, CCO, and Director of optionsXpress International, Inc.; and CFO and Director of brokersXpress, LLC. OIP at 2; Stern Answer at 2.

OIP at 6; OX Trading Answer at 16. OX Trading is not a member of FINRA. OIP at 3; OX Trading Answer at 6.

OX Trading and optionsXpress were subsidiaries of Holdings, until September 1, 2011, when it became a wholly owned subsidiary of The Charles Corporation. OIP at 1-2; OX Trading Answer at 2. optionsXpress is a self-clearing, retail, on-line broker, specializing in options and futures. OIP at 1-2; OX Trading Answer at 2. OX Trading was created, in part, to provide price improvement, i.e., generally the execution of an order at a price better than the public quote at the time the market center received the order, for customers of optionsXpress and to generate revenue for Holdings. OIP at 2; OX Trading Answer at 3-4. Respondents Opposition at 5. Stern described OX Trading as a liquidity provider. OIP at 2; OX Trading Answer at 7; Motion, Exhibit 3.

An OX Trading employee testified that:

The entity's desire is to make money, so after we price improve a customer order we end up having a position. And we manage those positions in such a way to . . . capture profit within those trades. . . . OX Trading makes money if it sells an option at one price and buys it at a lower price and sells it at a higher price.

OIP at 3; OX Trading Answer at 6.

Holdings's former CEO testified that:

[OX Trading] generates revenue by trading, by entering into primarily options positions and hedging those positions and either letting them expire or trading out of them and generating profit by buying low and selling high or selling high and buying low.

OIP at 3; OX Trading Answer at 6.

OX Trading requested that optionsXpress provide it with opportunities in certain securities, and, in response, it would receive notice of customer orders in these securities. Respondents Opposition at 6. optionsXpress sent OX Trading electronic requests for quotes (RFQ) and OX Trading developed source code which determined how to respond to RFQ. OIP at 2; OX Trading Answer at 4. To determine the extent to which it could profitably price improve a customer's order, OX Trading used its proprietary source code or algorithm to analyze the bid/ask spread, the option's theoretical value, and its positions. Respondents Opposition at 6. If an exchange market maker or market participant did not beat OX Trading's limit order and it was equal or better than the National Best Bid or Offer (NBBO), then the exchange mechanism allowed OX Trading to take some or all "of the other side of the customer fill." *Id.* at 7. Based on its algorithm, OX Trading responded to only a fraction of the notices it received from optionsXpress. *Id.* at 6-7.

[If] OX Trading's source code determined to act as the counterparty to an optionsXpress customer's order, OX Trading's source code would respond with a

bid/ask spread and an exchange where the quote was available. OX Trading and optionsXpress admit that optionsXpress' smart router would then send the customer order to an exchange identified by OX Trading's source code. OX Trading and optionsXpress admit that CBOE's Automated Improvement Mechanism ("AIM") was one such destination. OX Trading and optionsXpress admit that if OX Trading's source code determined not to act as the counterparty to an optionsXpress customer's order, the order was routed to an exchange of third party broker.⁴

OX Trading Answer 5.

OX Trading never purchased or sold contracts directly from or to an optionsXpress customer. Respondents Opposition at 8. Neither OX Trading nor optionsXpress advertised to customers or publicized the securities OX Trading was willing to price improve. Id. at 5.

If some or all of OX Trading's price improvement orders filled, OX Trading might engage in hedging transactions in order to manage risk and to make a profit. Id. at 8. It would send hedging orders to optionsXpress, its clearing firm, "to ensure its positions would stay within certain equivalent share values and Greek values (theta, gamma, vega)." Id. OX Trading made a profit "by selling 'an option at one price and buy[ing] it at a lower price and sell[ing] it at a higher price' to the market, not by marking up a security that it had in inventory and selling at a higher price to an optionsXpress customer." Id. at 9.

The Division's Allegations

The Division maintains that in the period March 2, 2009, to November 16, 2010, OX Trading acted as a securities dealer when it was not registered with the Commission, not a member/permit holder of an exchange, and not a member of the Financial Industry Regulatory Authority (FINRA). According to the Division, OX Trading's conduct violated Exchange Act Sections 15(a) and 15(b)(8). Motion at 1-3; Exchange Act Section 3(a)(5).

I. The Division charges that OX Trading violated Section 15(a)(1) of the Exchange Act by operating as an unregistered dealer from at least October 17, 2009, to November 16, 2010.

It is undisputed that from at least October 17, 2009, to November 16, 2010, OX Trading traded in its own account, and its participation in the purchase and sale of securities involved more than a few isolated transactions. Id. at 7. The Division argues that OX Trading was a dealer because it engaged in the business of buying and selling securities for its own account and it did not qualify for any dealer exception. Reply at 3. The Division notes that the statutory definition of a dealer excludes persons who buy for their own account, but not if they do so, as OX Trading did, as part of a regular business. Motion at 6. The Division argues that OX Trading fits the definition of a dealer because it participated in a high volume of trading on a

⁴ An OX Trading employee testified that on one occasion, optionsXpress's head trader directed OX Trading to take the trade of an optionsXpress customer. OIP at 2; OX Trading Answer at 4-5.

regular basis, with customers of optionsXpress, before customer orders were placed in the market, and at least partially for the benefit of someone else. Reply at 4.

According to the Division, the statutory scheme requires registration because unregistered dealers, like OX Trading, that interact with customer orders before those orders go to the market are uniquely able to harm investors by interfering with their orders in a nontransparent way. Motion at 5-6. The Division notes that OX Trading claims that its “trades price improved optionsXpress’ customer orders to the tune of \$13 million.” Reply at 4.

The Division maintains that OX Trading does not meet either exception to the statutory definition of dealer. See 15 U.S.C. § 78o(a)(5)(B), (C). First, OX Trading is not a bank. Second, OX Trading does not qualify for the trader exception because OX Trading bought and sold securities in its own account as part of its regular course of business; in fact, it was its only business. Motion at 7-8; Reply at 4. The Division cites SEC v. Big Apple Consulting U.S.A., Inc., 2011 WL 3753581 at *9 (M.D. Fla. Aug. 25, 2011) (quoting Gordon Wesley Sodorff, Jr., 50 SEC 1249 at *4 (1992)), for the proposition that an entity can be a dealer even when the entity’s principal business is not a dealer activity. The Division contends further that it makes no difference whether or not the person uses a broker-dealer to place the trades. Motion at 8 n.5.

The trader exception in Section 3(a)(5)(B) of the Exchange Act is referred to as the dealer/trader distinction. Definition of Terms, 67 Fed. Reg. 67499 (Nov. 5, 2002). The Division argues that the definition of a dealer is best understood by considering that Congress’s statutory scheme to protect investors consists of a broad definition of the term “dealers,” those who are required to be registered, and a narrow exception from that definition for persons who buy or sell securities, but not as part of a regular business, i.e., traders. Reply at 5-6. The Division contends that “OX Trading . . . does not qualify for the trader exception because it bought and sold large volumes of securities for its own account, as part of its regular business (indeed its only business), and (critically) did so before orders went to the market.” Id. at 6.

The Division would reject a claim that OX Trading is a trader because it engages in proprietary trading. The Division argues that most proprietary trading firms make investment decisions after orders are placed in the market, but OX Trading interacted with optionsXpress customer order flow before orders were sent to the market. Also, OX Trading’s profits came from its ability to trade on optionsXpress customer order flow. It is irrelevant whether it held itself out separately to customers. Motion at 12.

The Division cites the following factors, which, taken together, show that OX Trading is a dealer because it bought and sold securities for its own account and did so as part of its regular business. OX Trading:

1. Purchased or sold securities as principal from or to customers;
2. Bought and sold securities for its own account with a certain regularity;
3. Traded securities for the benefit of others, including an affiliate, rather than solely for its own benefit;
4. Placed itself in the middle of securities transactions as principal;
5. Profited from markups or spreads rather than from appreciation in the value of securities;

6. Had a regular clientele;
7. Held itself out as buying or selling securities at a regular place of business; and
8. Provided liquidity to optionsXpress and its customers. Id. at 9-11.

II. The Division charges that OX Trading violated Section 15(b)(8) of the Exchange Act from March 2, 2009, to November 16, 2010, by operating as a dealer when it was not a member/permit holder of an exchange or a member of FINRA.

Section 15(b)(8) of the Exchange Act, 15 U.S.C. § 78o(b)(8), makes it unlawful for a registered broker or dealer to effect any purchase or sale of any security unless it is a member of FINRA, or it “effects transactions in securities solely on a national securities exchange of which it is a member.” Id. at 13. Section 3(a)(48) of the Exchange Act, 15 U.S.C. § 78c(a)(48), includes in the definition “registered broker or dealer,” a broker or dealer that is required to be registered. Id.

The Division claims that two of the three elements it must show to establish a violation of Section 15(b)(8) of the Exchange Act are undisputed: (1) OX Trading was not a member or permit holder of any exchange or a member of FINRA from March 2, 2009, to November 16, 2010; and (2) OX Trading effected transactions in securities during this period. Id. at 13. The Division claims further that it has satisfied the third element by showing that OX Trading was a dealer and required to register. Id.

Respondents Opposition

Is Summary Disposition Appropriate

Respondents see the issue presented here, i.e., whether to grant the Motion, to be a determination whether the evidence shows a disagreement sufficient to require submission to fact finding, and not a determination on the merits of the case presented. Respondents Opposition at 4. Respondents argue that summary disposition is inappropriate because: (1) the issue of whether OX Trading was a dealer is intensely factual; (2) trading volume alone is not dispositive; and (3) the primary indicator is whether the party is engaged in the public securities business.⁵ Id. at 2, 12, 16-17. They contend that there is a dispute about what they claim are twelve factors the Commission has established to indicate a dealer. Id. at 22. Respondents intend to present expert testimony on the issue, and contend that the nature of a party’s participation in the purchase or sale of securities or the public securities business are subjects best resolved at a hearing. Id. at 3 n.5.

Arguments

Respondents contend that the totality of its activities show OX Trading to be a trader seeking profits. Id. at 2. They argue that “providing price improvement and having orders submitted as a cross with customer orders does not turn a trader into a dealer.” Id. at 3.

⁵ At the prehearing conference on May 31, 2012, concerns were expressed, but not strong opposition to the filing of the Motion. Tr. 7-9.

Respondents contend that it is well accepted in the securities industry that proprietary trading firms that trade on a regular and frequent basis are not required to register as dealers. Id. at 14. They cite a 2009 Commission approval of rules from the International Securities Exchange (ISE) and the CBOE that created a class of non-broker-dealer customers that would receive the same priority as broker-dealer and market maker quotes. Id. They also cite similar rules by the BOX Options Exchange regarding so called “professional” customers, and ISE’s new “Professional Order” category for certain non-broker-dealer accounts. Id.

Respondents insist that the Division’s assertion, that persons that trade with frequency and provide liquidity to the marketplace need to register as dealers, is contradicted by certain exchange rules and Commission comments surrounding them. Id. at 16. According to Respondents, the Commission has valued the liquidity provided by trading firms - hedge funds, private investment partnerships, and proprietary trading firms - over the cost of requiring them to register as broker-dealers. Id.

Respondents view the issue of whether a party that buys and sells securities must register as turning on whether the party is “carry[ing] on a public securities business,” and that the focus of the “dealer” inquiry is on whether an entity interacts directly with the public. Id. at 16-17. They claim there is a dispute of material fact as to whether OX Trading sufficiently interacted with the public to be a trader or a dealer. Id.

Respondents contend that OX Trading looks more like a trader than a dealer. Id. at 17. They claim that the Commission has established by no-action letters that the following factors indicate that a party is a dealer, and the Division has cherry-picked among them in making its case that OX Trading is a dealer.

1. Issuing or originating securities;
2. Participating in a selling group or underwriting securities;
3. Purchasing or selling securities as principal from or to customers rather than from or to only brokers or dealers;
4. Carrying a dealer inventory;
5. Quoting a market in securities or publishing any quotations on or through any quotation system used by dealers, brokers, or institution investors, or otherwise quoting prices other than on a limited basis through a retail screen broker;
6. Holding oneself out as a dealer or market-maker or as otherwise willing to buy or sell particular securities on a continuous basis;
7. Rendering incidental investment advice;
8. Handling other people’s money or securities or executing securities transactions on other people’s behalf;
9. Extending or arranging for the extension of credit to others in connection with securities;
10. Conducting processing or clearing activities;
11. Obtaining a regular clientele;
12. Engaging in trading transactions for the benefit of others, rather than consistently with one’s own judgment, investment and liquidity objectives;
13. Running a matched book of repurchase agreements; and

14. Advertising or otherwise informing people. Id. at 17-18.

According to Respondents, the Division's suggestion that OX Trading interacted with the public is not supported by the evidence. OX Trading did not:

1. Advertise to the public;
2. Take orders from the public;
3. Hold itself out as willing to buy or sell on a continuous basis;
4. Render investment advice;
5. Handle customer funds;
6. Extend credit;
7. Conduct processing or clearing activities;
8. Run a matched book of purchases or sales; or
9. Carry a dealer inventory. Id. at 18-19.

Respondents insist that OX Trading bought and sold options contracts through a registered broker-dealer on a public exchange and did not buy or sell securities from or to optionsXpress customers. Id. at 19. Respondents argue that OX Trading was not a counterparty because it submitted orders to optionsXpress for a single side of any given transaction and optionsXpress placed the order with an exchange; OX Trading was unknown to the market and did not know the market participants on the other side of its trades.⁶ Id. OX Trading was able to make money if it was able to buy at one price and sell at a higher price in the market; it did not make money from marking up inventory. Id. at 20.

Respondents claim that the Division's argument that OX Trading acted essentially as a market maker is false. Id. at 20-21. OX Trading never had an obligation to buy and sell any security on a continuous basis, it did not quote prices to the public, and did not stand ready to trade at prevailing market prices or better. Id. at 21.

Respondents argue that OX Trading is not a dealer because it had no public customers. It never purchased or sold securities or option contracts directly from or to any party; all its purchases and sales were sent by optionsXpress on an agency basis to an exchange. Id. They argue that OX Trading is a trader because it does not handle other people's money or securities, does not trade continuously, and otherwise does not provide the type of services provided by dealers. Id. at 22.

Respondents reject the Division's argument that OX Trading is not a trader because it interacts with "customer overflow" and provides "liquidity." Respondents contend that the document that the Division cites in support of its argument, Concept Release on Equity Market Structure (Concept Release), Exchange Act Release No. 34-61358, 2010 WL 148783 (Jan. 14, 2010), actually demonstrates that proprietary trading firms, like OX Trading, commonly provide

⁶ Respondents want to establish through expert testimony that OX Trading did not trade every time optionsXpress requested a quote or have its orders completely filled every time its price was better than the NBBO, but the Division does not dispute these positions. Respondents Opposition at 6-8, 20; Reply at 2.

liquidity and price improve the market without registering as dealers. Respondents Opposition at 23. According to Respondents, using the Division's logic all proprietary trading firms are required to register as broker-dealers. Id. at 23-24.

Respondents reject the argument that because OX Trading orders were paired with customer orders, it was trading with customer order flow and is a dealer not a trader. Id. at 24. They maintain that Sodorff, a case cited by the Division, involved interaction with the public at multiple points in buying and selling securities, which caused the finding that he was a dealer, and that OX Trading's activity of pairing orders with customers and taking them to a public exchange is not the kind of public interaction that Sodorff was regulating. Id. at 25.

Finally, Respondents maintain that crossing customer trades before they reach the market is not a dealer activity. As one example, they describe a CBOE system approved by the Commission, AIM, and argue that "CBOE contemplated and encouraged its Members to send customer orders (including from non-broker-dealers) as the 'contra' orders through their price improvement auctions in the exact manner as optionsXpress handled OX Trading's orders." Id. at 28.

Ruling

Summary Disposition Is Appropriate

Summary disposition is a procedural device allowing the speedy disposition of a controversy without the need for trial in certain circumstances. Black's Law Dictionary 1449 (7th ed. 1999), citing Rule 56 of the Federal Rules of Civil Procedure. The Commission's Rules of Practice at Rule 250 allow a motion for summary disposition to be granted where there is no genuine issue with regard to any material fact and the party making the motion is entitled to summary disposition as a matter of law. 17 C.F.R. § 201.250(b). In deciding such a motion, the facts of the pleadings of the party against whom the motion is made should be taken to be true, except as modified by stipulations or admissions by that party, by uncontested affidavits, or by facts officially noticed. Id. at (a).

In 1995, when the Commission began to allow motions for summary disposition, it noted the potential efficiency gained by allowing hearing officers to eliminate unnecessary hearings in some cases, and that it expected that summary disposition would be "sought or granted . . . comparatively rare[ly]." SEC Rules of Practice, Exchange Act Release No. 34-35833, 60 Fed. Reg. 32738, 32767-68 (June 23, 1995). However, much has changed in the last almost twenty years, and successful motions for summary disposition are no longer rare.⁷ In 1995, the Commission also commented that in granting partial summary disposition in some cases, a

⁷ Most Commission summary dispositions involve follow-on proceedings where there has been a prior civil or criminal determination. However, follow-on proceedings require a public interest finding that is not required in this situation. Blinder, Robinson & Co. v. SEC, 837 F.2d. 1099, 1109 (1988). The record shows two court cases resolved by summary judgment where the issue was whether a party was a dealer: Big Apple Consulting U.S.A., Couldock & Bohan, Inc. v. Societe Generale Sec. Corp., 93 F. Supp. 2d 220, 229 (D. Conn. 2000).

hearing would still be necessary in order to determine a respondent's state of mind and the need for remedial sanctions, but neither of those issues is present here. Id. at 32767.

Courts have held that the standard for deciding a motion for summary disposition is the same as considering a motion for a directed verdict: "whether the evidence presents a sufficient disagreement to require submission to a jury or whether it is so one-sided that one party must prevail as a matter of law." Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 251-52 (1986). See also Matsushita Elec. Indus. Co., Ltd. v. Zenith Radio Corp., 475 U.S. 574, 587 (1986).

The Motion is appropriate because no material fact disputes exist. The Division accepts as true what Respondents represent to be "Disputed Facts and Additional Facts Necessitating Trial," and the Division does not challenge that OX Trading's trades were placed on a public exchange, that OX Trading was not a market maker, and that it had no public customers of its own. Respondents Opposition at 4-11; Reply at 2-3. The only issue here is whether OX Trading should have been registered with the Commission as a dealer from at least October 17, 2009, to November 16, 2010, and a member/permit holder of an exchange or a member of FINRA from at least March 2, 2009, to November 16, 2010. The record, consisting of the OIP; Respondents' Answers; the Motion with an Affidavit and four exhibits; Respondents Opposition with thirteen exhibits; and a Reply contain an ample description of the factual situation. The issue is a question of law and the parties agree on the facts that are salient to deciding it. There is no need for, and it would not be efficient to hold, a hearing at which Respondents intend to present testimony from two experts.

OX Trading willfully violated Section 15(a)(1) of the Exchange Act by operating as an unregistered dealer from at least October 17, 2009, to November 16, 2010.⁸

Section 15(a)'s present format was adopted in 1975 as part of the Securities Acts Amendments of 1975. See Robert L.D. Colby and Lanny A. Schwartz, What is a Broker-Dealer?, § 1A:1.1, <http://www.davispolk.com/files/Publication>, citing H.R. Rep. No. 94-123, 94th Cong., 1st Sess.; H.R. 4111 (1975).

The underlying policy for the broker-dealer registration requirement and associated regulated framework is to provide important safeguards to investors. The Exchange Act's regulatory framework is designed to ensure that all Registered Broker-Dealers and their associated persons satisfy professional standards, have adequate capital, treat their customers fairly, and provide adequate disclosure to investors. (footnotes omitted) Id.

⁸ It does not appear that violations of Exchange Act Sections 15(a) or 15(b)(8) require a showing that a person acted willfully or with scienter. The OIP, however, uses the term willful. OIP at 7. To commit a willful violation, a Respondent need only have intentionally committed the act which constitutes the violation. See Arthur Lipper Corp. v. SEC, 547 F.2d 171, 180 (2d Cir. 1976); Tager v. SEC, 344 F.2d 5, 8 (2d Cir. 1965); James E. Ryan, 47 S.E.C. 759, 761 n.9 (1982).

Section 15(a)(1) of the Exchange Act, 15 U.S.C. § 78o(a)(1), makes it unlawful for any dealer to make use of the mails or any means or instrumentality of interstate commerce to effect any transactions in any security unless such dealer is registered with the Commission.

Section 3(a)(5)(A) of the Exchange Act, 15 U.S.C. § 78c(a)(5)(A), defines a dealer as “any person engaged in the business of buying and selling securities . . . for such person’s own account through a broker or otherwise.”

A determination of whether a person is a dealer involves a two-part analysis: whether (1) the entity is buying and selling securities for its own account; and (2) engaging in that activity is part of its regular business. The unequivocal evidence is that OX Trading was doing both of these things. OX Trading engaged in the business of buying and selling securities for its own account through a broker-dealer, optionsXpress, and it engaged in these activities as part of its regular business; in fact, it was its only business. There is an oft quoted expression that “If something looks like a duck, swims like a duck, and quacks like a duck, then it probably is a duck.” In this situation, OX Trading is a dealer because it exhibited the significant characteristics of a dealer.

The conclusion that OX Trading is a dealer is supported by Bottini’s testimony that his role in OX Trading’s creation was to formulate the concept “of a broker-dealer that could provide price improvement for customer orders at optionsXpress.” Respondents Opposition, Exhibit A at 422. Additional support is Stern’s initial decision to register OX Trading as a broker-dealer with the Commission effective in 2008, and OX Trading’s re-registration as a dealer with the Commission on November 16, 2010.⁹

OX Trading appears to take the position that it is not a dealer and that it is a proprietary trading firm within the meaning of Exchange Act Section 3(a)(5)(B), which states “[t]he term ‘dealer’ does not include a person that buys or sells securities . . . for such person’s own account, either individually or in a fiduciary capacity, but not as a part of a regular business.” Respondents Opposition at 17-22, 29. This so-called trader exception is inapplicable because OX Trading’s regular business was trading securities to improve prices, in addition to making profits. According to Respondents, since 2007, “OX Trading generated substantial trading profits while also providing thousands of optionsXpress customers with substantial price improvement – to the tune of \$13 million.” *Id.* at 5. Respondents’ considerable efforts to establish its status as a trader are unpersuasive. *Id.* at 17-29.

For all these reasons, OX Trading operated as an unregistered dealer from at least October 17, 2009, to November 16, 2010, in willful violation of Section 15(a)(1) of the Exchange Act.

⁹ In 2011, Stern claimed he registered OX Trading to achieve economies in its business operations. Respondents Opposition, Exhibit C at 401.

OX Trading willfully violated Section 15(b)(8) of the Exchange Act from March 2, 2009, to November 16, 2010, by operating as a dealer when it was not a member/permit holder of an exchange or a member of a registered securities association.

Section 15(b)(8) specifies that:

It shall be unlawful for any registered broker or dealer to effect any transaction in, or induce or attempt to induce the purchase or sale of, any security . . . unless such broker or dealer is a member of a securities association registered pursuant to Section 15A of this title or effects transactions in securities solely on a national securities exchange of which it is a member.

OX Trading engaged in securities transactions as a dealer after it ceased being a member of the CBOE on March 2, 2009, until November 16, 2010, when the CBOE issued OX Trading an electronic access permit. OX Trading Answer at 16. OX Trading is not a member of FINRA. Id. These essential elements for a violation of Section 15(b)(8) of the Exchange Act are present here. Accordingly, on these facts, OX Trading willfully violated Section 15(b)(8) of the Exchange Act from March 2, 2009, to November 16, 2010, by operating as a dealer when it was not a member/permit holder of an exchange or a member of a registered securities association.

Order

The Division's Motion for Partial Summary Disposition is GRANTED. The hearing on the remaining issues set out in the OIP will begin on October 22, 2012.

Brenda P. Murray
Chief Administrative Law Judge