UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-14848

In the Matter of

optionsXpress, Inc.,
Thomas E. Stern, and
Jonathan I. Feldman,

Respondents.

DIVISION OF ENFORCEMENT'S POST-HEARING REPLY BRIEF IN SUPPORT OF ITS CASE AGAINST RESPONDENT JONATHAN I. FELDMAN

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The Division of Enforcement ("Division") respectfully submits this Reply Brief in Support of Its Case Against Respondent Jonathan I. Feldman ("Feldman").

INTRODUCTION

Feldman committed fraud. Despite all of the seeming complexities, this is a simple case of someone who sold something without ever intending to deliver what he had sold. This is a classic form of fraud and Feldman should be held accountable.

Indeed, Feldman's own words both at trial and in the documentary evidence show that he knew what he was doing and that what he was doing was deceptive. Feldman sold options knowing that they would be immediately exercised – "JUL or SEP, ***as u get assigned that night anyway, so what's the diff***?" He traded buy-writes knowing they would not result in delivery – "So I could do a buy-write ***and then I wouldn't settle***." Feldman even explicitly told a friend that he was not delivering – "***I don't settle the stock@all.***" Feldman knew that his conduct was deceptive – he admitted that message board posters were confused by the volume of trading they were seeing in Sears (which was attributable to Feldman's buy-writes) and that they placed "***some significance to it.*** . . ." Feldman knew that the regulators were looking into his activity and that others had been held accountable for nearly identical trading schemes. Feldman even joked and bragged about his deceptive activity – "I read the latest thread on the SHLD 'volume spikes'. Very entertaining. ***(Until someone notifies the SEC and they shut down the strategy!!)***." In sum, Feldman executed his trading strategy knowing that it would – and did – deceive the market.

Now that he has been caught, Feldman is trying to blame his broker, saying that he cannot be held accountable because he found a broker who would let him commit his fraud. This excuse holds no water. Feldman went out and found the one weak link – optionsXpress – that would allow him to commit his fraud and then exploited it. Indeed, Feldman himself recognized this: "Millions of $$ inc [sic] comissions[sic],,,,yet treat me/us like criminals...But, in the big

picture...***it's still quite the gig...where can you get such mkt-b[e]ating retu[r]ns consistently***? So, as disgusting as [optionsXpress] are [sic], have to bend over and get raped, and take the punishment[.]" This is not good faith reliance and should not excuse Feldman's fraud. Feldman is simply not the typical retail investor that he is now trying to paint himself as. He is a sophisticated trader who traded billions of dollars of options knowing that he was deceiving others in order to personally profit at their expense. This is securities fraud.

ARGUMENT

Feldman claims that he did not commit fraud because (1) no one was deceived (Br.[1] at 4-26); (2) he did not act with scienter or negligence (Br. at 26-37); and (3) that the Division did not prove a Rule 10b-21 violation (Br. at 37-39). Feldman also argues that there was no basis for disgorgement, penalty, or a cease-and-desist order (Br. at 41-48) and that these proceedings violate the Dodd-Frank Act (Br. at 49). Each of these arguments is without merit.

I. FELDMAN COMMITTED FRAUD IN VIOLATION OF THE FEDERAL SECURITIES LAWS

A. Feldman Engaged in Deceptive Conduct.

Despite Feldman's many attempts to confuse the issue, he was not charged with violating Regulation SHO ("Reg. SHO").[2] He was charged with fraud, specifically with violations of

[1] "Br." refers to Jonathan I. Feldman's Post-Hearing Brief filed January 11, 2013. "DFOF" refers to the Division's Proposed Findings of Fact filed December 7, 2012. "Tr." refers to the amended transcript of the hearing in this matter dated January 16, 2013. "Reply FOF" refers to the Consolidated Reply Findings of Fact filed by the Division with its Post-Hearing Reply Briefs against each of the Respondents on February 1, 2013. The "Customers" refer to Feldman and the other five customer accounts that engaged in the trading at issue in this lawsuit. DFOF ¶ 47.

[2] Feldman spends pages arguing that optionsXpress did not violate Reg. SHO, including that the buy-writes were not sham transactions and there was no collusion with counterparties. Br. at 5-13, 24-26. In doing so, he completely misses the mark because his violations are based on the fraudulent nature of ***his*** conduct. Nonetheless, Feldman's arguments are unavailing for the same reasons that optionsXpress' arguments regarding Reg. SHO are without merit. *See* Division's Post-Hearing Brief and the Division's Post-Hearing Reply Brief in Support of Its Case Against Respondent optionsXpress, Inc., both incorporated herein by reference. In addition, although Feldman claims sham transactions ***must*** involve collusion between two parties, Br. at 24, the three cases he cites do not support his narrow and exclusive definition. At most they are merely examples of sham transactions. Indeed, one of the cases cited by Feldman, never even uses the word "sham." *Regents of Univ. of California v. Credit Suisse First Boston,*

Section 10(b) of the Exchange Act, Rules 10b-5 and 10b-21 thereunder, and Section 17(a) of the Exchange Act. Under Rule 10b-5(a), Feldman engaged in unlawful conduct if he "employ[ed] any device, scheme, or artifice to defraud." 17 C.F.R. § 240.10b-5(a). Under subsection (c) of Rule 10b-5, Feldman engaged in fraudulent activity if he "engage[d] in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person." 17 C.F.R. § 240.10b-5(c). Similarly under subsections (1) and (3) of Section 17(a) it is unlawful "to employ any device, scheme, or artifice to defraud" or "to engage in any transaction, practice or course of business which operates or would operate as a fraud or deceit upon the purchaser." 15 U.S.C. § 77q(a). The Division has met its burden of showing that Feldman violated these provisions – the evidence clearly shows that Feldman employed a "device, scheme or artifice to defraud" and engaged in an "act, practice or course of business" that operated as a fraud or deceit on other market participants.

1. Feldman Engaged in Deceptive Conduct by Selling Options Without Intending to Fulfill His Obligations.

Feldman engaged in conduct that was deceptive to the market and to market participants. In the simplest terms, Feldman's buy-writes were merely matched orders that were designed to avoid his delivery obligations.[3] Such matched orders have long been prohibited by the anti-fraud provisions of the securities laws. *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 205-06 (1976). In addition, the courts have also long-held that selling options with the intention of not fulfilling

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482 F.3d 372, 377 (5th Cir. 2007). And another, *Yoshikawa v. SEC*, 192 F.3d 1209, 1214 (9th Cir. 1999), has a broader definition of sham than the one Feldman is urging: "a sham transaction in which nominal title is transferred to the purported buyer while the economic incidents of ownership are left with the purported seller."

[3] Feldman's claim that his buy-writes had a legitimate purpose, Br. at 10, is without basis, as is his claim that the Commission has not given a definition of "legitimate," Br. at 11. The definition of "legitimate" is well known. Webster's Dictionary defines it as "accordant with law" or "neither spurious nor false." Merriam-Webster Dictionary, http://www.merriam-webster.com/dictionary/legitimate. Feldman's purpose was not in accordance with law and was deceptive. *See* the Division's Post-Hearing Brief and the Division's Post-Hearing Reply Brief in Support of Its Case Against Respondent optionsXpress, Inc., both incorporated herein by reference.

one's obligations under those contracts – which is precisely what Feldman did – is also fraud. *The Wharf (Holdings) Ltd. v. United Int'l Holdings, Inc.*, 532 U.S. 588, 596-97 (2001). "To sell an option while secretly intending not to permit the option's exercise is misleading, because a buyer normally presumes good faith." *Id.; see also Walling v. Beverly Enter.*, 476 F.2d 393 (9th Cir. 1973) (entering "into a contract of sale with the secret reservation not to fully perform it is fraud cognizable under § 10(b)"). Feldman never even attempted to distinguish these on-point cases although they were cited in the Division's opening brief.[4]

Feldman sold call options without intending to timely deliver the stock when the options were exercised – in doing so, he violated the express terms of the option contracts. Call options are contracts that allow the holder to buy a security at the strike price on or before the expiration of the contract if the holder "exercises" its rights under the contract. DFOF ¶ 41. Thus, as is recognized in numerous articles and by the experts in this case, a call writer promises to deliver stock if assigned and must deliver stock when assigned. *Id.* ¶ 46. Indeed, the equity option specifications themselves explicitly state that call options will be settled by delivering the underlying stock on the third business day following exercise – "[e]xercise notices tendered on any business day will result in delivery of the underlying stock on the third (T+3) business day following exercise." Equity Option Product Specifications; DFOF ¶ 45. Despite, undertaking this obligation when he sold the call options, Feldman knowingly did not deliver on T+3 and

[4] optionsXpress attempted to distinguish *Wharf Holdings* in its brief by stating its customers "satisfied their contractual obligations to their counterparties." Br. at 35 n. 8. However, this distinction is not factually supported. As described in more detail *infra*, the Customers did not fulfill their obligation under the call contracts ***to deliver*** the underlying stock in a timely manner. Equity Options Product Specifications, DFOF ¶ 45.

thus deceived the market.[5] DFOF ¶ 220 ("So I could do a buy-write and then I wouldn't settle"); *Id.* ¶ 218 ("I don't settle the stock@all").[6]

In an attempt to avoid liability, Feldman claims that his trading did not depend on failing to deliver, Br. at 1, but this misses the point. Market participants have two choices when they sell shares short: (a) buy shares to make delivery; or (b) borrow the shares to make delivery. As made evident by his own statements, Feldman's trading strategy relied on avoiding paying hard-to-borrow fees that would naturally occur with his type of trading and which others did incur:

- "[T]he ***only way I was able to make money*** on any of these trades was profiting off of the business model of the companies to choose ***not to charge their customers hard-to-borrow fees. That is the crux of this entire matter,*** and that is how the profit was made." Tr. at 2396:20-2397:1 (Feldman); Feldman FOF ¶ 54 (emphasis added).

- "So, the market might price puts assuming that everybody pays hard-to-borrow fees, but ***I was able to find situations that I did not have to pay hard-to-borrow fees."*** Tr. at 2382:15-19 (Feldman); Feldman FOF ¶ 54 (emphasis added).

- "Feldman said the 'when issued' shares are also ***a cheaper way to play Citi common shares. . . . if you are able to cost-effectively short the common stock."*** OPX Ex. 866 (emphasis added).

- ***"[T]hese put-call volatility skews (as they are called) are definitely much more rampant these days... and I am convinced it is all about the difficulty and the cost of shorting the hard-to-borrow shares.*** This puts more buying pressure on the puts as a substitute for shorting the shares, (along with the fact that ***if a market maker sells a put they ned [sic] to short the stock to hedge the position), causing the relative cost of the puts to soar."*** Div. Ex. 383 at 5 (emphasis added).

- "The only way to effectively to [sic] replace the short position in the stock was to simultaneously write an in-the-money call." Feldman FOF ¶ 116.

- "If Mr. Feldman did not execute the buy-write, he would be forced to close out the position if optionsXpress did not have stock to borrow." *Id.* ¶ 117.

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[5] As described in more detail in the Division's Post-Hearing Brief and the Division's Post-Hearing Reply Brief in Support of Its Case Against Respondent optionsXpress, Inc., both incorporated herein by reference, Feldman and optionsXpress failed to timely deliver shares. *See also* Reply FOF § IV.G-I.

[6] Feldman's claim that he cannot be liable for fraud because the market did not know his name, Br. at 15 and 19, is ridiculous. Fraud, after all, entails *deceptive* conduct. Just because one does not know the name of the person defrauding them does not mean that there has been no fraud. There are many types of fraud where this occurs – wash sales and market manipulation are but two examples.

Further, when Penson told him that he needed to pay hard-to-borrow fees he returned to optionsXpress. DFOF ¶ 214. Feldman's trading strategy clearly depended on not paying hard to borrow fees and he knew it.

2. Feldman Deceived the Market Regarding the Reported Volume.

Feldman also deceived certain investors about the nature of the trading as it related to the reported volumes. For example, financial message boards discussed irregularities with Sears trading. In late December 2009, Feldman's friend, who was engaged in the same trading, told optionsXpress that the participants on the financial message boards "think Sears is buying back shares. . . . ***they have no idea.***" Div. Ex. 370. Feldman similarly informed the floor broker executing his trades that the Yahoo! message boards were "shaken up" that upwards of 50 to 75 percent of the daily volume in SHLD occurred on "one block print." DFOF ¶ 275. Feldman even admitted that he was aware that people on the message boards were confused about the trading he was engaging in and that they placed "***some significance to it.*** . . ." Tr. at 2273-74 (Feldman); DFOF ¶ 274.[7] That this deception was a side effect of Feldman's scheme is irrelevant. Trades, like Feldman's, intended for one deceptive purpose can also deceive another party in violation of the federal securities laws. *See In the Matter of Ofirfan Mohammed Amanat*, Exchange Act Rel. No. 54708, 2006 WL 3199181 (Nov. 3, 2006), *petition for review denied*, 269 Fed. Appx. 217 (3d Cir. 2008) (finding Amanat violated Section 10(b) when he generated thousands of wash trades and matched orders for the purpose of deceiving Nasdaq in connection with a rebate program, but also finding that he violated Section 10(b) because the trades had the effect of defrauding other participants); *see also Graham v. SEC*, 222 F.3d 994

[7] Feldman claims that there is no evidence that anyone was harmed. However, this is not accurate. *See* Division's Post-Hearing Brief and the Division's Post-Hearing Reply Brief in Support of Its Case Against Respondent optionsXpress, Inc., both incorporated herein by reference. *See also* Div. Ex. 310 (Harris Report) at ¶¶ 15, 83-88, 200 (discussing harm as a result of Feldman's trading and "salami slicing").

(D.C. Cir. 2000) (holding wash trades and matched orders violated Section 10(b) where they were for the purpose of deceiving broker-dealers in a scheme similar to check-kiting).

3. Feldman Was Required to Make Delivery.

Feldman repeatedly argues that he had no obligation to deliver shares. This argument should be rejected based on common sense, the evidence, and the law. Feldman sold something. As such, he had the ultimate responsibility for ensuring that what he sold was in fact delivered. This is basic and longstanding contract law. *Samuel H. Cottrell & Son v. Smokeless Fuel Co,* 148 F. 594, 597 (4th Cir. 1906) (quoting *Dermott v. Jones,* 69 U.S. 1, 8 (1865)) ("The law regards the sanctity of contracts and requires the parties to do what they have agreed to do."). Moreover, Feldman cannot blindly rely on his broker-dealer in the face of numerous red flags showing that the shares were not being delivered.[8] *See Silverman v. Motorola, Inc.,* 798 F. Supp. 2d 954, 968-71 (N.D. Ill. 2011) (rejecting an argument that there was no scienter based on reliance on internal processes, the Audit and Legal Committees, and an outside auditor where defendants knew or were reckless as to whether the disclosure was false and misleading); *see also* Section I.B.3 *infra.* Indeed, the evidence shows that Feldman knew the shares were not

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[8] Feldman attempts to argue that his account opening agreement shows that he was relying completely on optionsXpress. Br. at 13. However, what the account agreement actually states is:

> ***All orders*** for the purchase and sale of securities and other property ***will be authorized by you*** and ***executed with the understanding that an actual purchase or sale is intended and that it is your intention and obligation, in every case, to deliver certificates to cover any and all sales*** or to pay for transactions upon our demand. If we make a sale of any securities and/or other property at your direction, and if you fail to deliver to us any securities and/or other property that we have sold at your direction, we are authorized to borrow or otherwise obtain the securities and other property necessary to enable us to make delivery, and ***you agree to be responsible for any cost or loss we may incur, including the cost of borrowing and obtaining the securities*** and other property. ***You agree that optionsXpress acts as your agent*** to complete all such transactions and is authorized to make advances and expend monies as required.

Div. Ex. 291 at 5 (emphasis added). This agreement makes clear that optionsXpress was Feldman's agent and that Feldman had the ultimate responsibility for delivering shares.

being delivered – "***I don't settle the stock@all.***" DFOF ¶ 218 (emphasis added); *see also id.* ¶¶ 219-20. Thus, by definition Feldman's reliance was not in good faith.

In addition, despite Feldman's arguments to the contrary, the market ***does*** expect that shares will be delivered on T+3.[9] *See id.* ¶ 12; Tr. at 153 (Risley) (settlement date is T+3); Tr. at 52 (Colacino) (settlement date is T+3). The experts in this case – including Feldman's own expert – testified that delivery is due three days after the trade date. Resp. Ex. 915 (Sirri Report) at ¶¶ 60-61, Div. Ex. 310 (Harris Report) at ¶ 83; Tr. at 1450 (Harris); Resp. Ex. 248 (Saha Report) at 29; *see also* Div. Ex. 401 at 5-6 (Sirri saying that delivery is due within the standard three-day settlement period and noting that "the majority of trades settle within the standard three-day settlement period"). Further, an explicit term of the options contracts that Feldman sold spells this out – "Exercise notices tendered on any business day will result in ***delivery of the underlying stock on the third (T+3) business day following exercise."*** Equity Options Product Specifications; DFOF ¶ 45 (emphasis added). The Commission has also made this clear – "[g]enerally, investors complete or settle their security transactions within three settlement days. This settlement cycle is known as T+3." 74 Fed. Reg. 38266, 38267 & n.16. Thus, Feldman' suggestion that delivery was not expected on T+3 is completely without basis.

Feldman also argues that he cannot be held liable because he had an agreement with optionsXpress whereby they would not charge him hard-to-borrow fees. Br. at 3, 22-23. This argument is a red herring. As an initial matter, optionsXpress did not charge its customers

[9] Feldman claims that "[t]he Division asserts that Mr. Feldman was not buying in on T+1 or T+4, but really on 'T+6, T+10, or T+227.' This statement by the Division as it relates to Mr. Feldman is indisputably false. . . ." Br. at 13 (citations omitted). However, it is Feldman who misapprehends. The reference to "T+6, T+10, or T+227" that Feldman quotes was referencing optionsXpress and not Feldman: "Because the failures to deliver were never cleared up, the buy-writes were not done on T+1, they were done on T+6, T+10, or T+227, for example. Hence, by the time ***optionsXpress*** made the decision in August 2009 to purportedly require the Customers to buy-in on what Respondents call 'T+1' – and even then, only some but not all of the hard-to-borrow securities at issue – it was not, in fact, 'T+1.'" Div. Br. at 17 (citations omitted). Nevertheless, Feldman did have buy-writes that were done on T+6 or more. *See* Div. Ex. 310 (Harris Report) at Ex. 6 (p.20) (daily CSKI buy-writes); Div. Dem. Ex. 502 at 20 (CKSI buy-writes resulting in no effect at CNS day after day); Reply FOF ¶ 108.

borrowing fees because ***optionsXpress did not pay to borrow any shares***, and in any event, Feldman knew that his trading was not resulting in delivery.[10] *See* Section I.B., *infra.* Feldman cannot avoid liability just because he found the one broker-dealer who would allow him to do repeated buy-writes. *See SEC v. Simpson Capital Mgmt., Inc.,* 586 F. Supp. 2d 196, 208 (S.D.N.Y. Sep. 3, 2008) (finding that customers' scienter could be shown where "the defendants devised the scheme to defraud and [] they proceeded to deal only with brokers who agreed to continue to join with them in the scheme to defraud mutual funds"). If optionsXpress had complied with its obligations it would likely have resulted in Feldman's trading being shut down – just like what happened at Penson, E*Trade, and TD Ameritrade. The likelihood of optionsXpress eating the nearly $4 million in hard-to-borrow fees attributable to Feldman's trading in return for $807,213 in commissions is extremely small. Div. Ex. 310 (Harris Report) at Ex. 21-22. Indeed, this is exactly what happened in March 2010 – optionsXpress shut down Feldman's strategy rather than pay to borrow the shares from other market participants.

Feldman also attempts to escape liability by claiming others were doing this too. This argument is unavailing. Br. at 19. The evidence shows that this conduct was happening overwhelmingly at optionsXpress. DFOF ¶¶ 103-05; Reply FOF ¶¶ 9-10. Further, even if other firms appeared on CBOE's surveillance does not mean (1) that they were engaged in the same conduct as Feldman, or (2) that that these other brokers did not promptly shut down the activity as did Penson, E*Trade, and TD Ameritrade. Besides, whether someone else may or may not have been committing fraud does not excuse Feldman. Every witness who testified at the hearing who was not either employed by optionsXpress or retained as an expert by Respondents

[10] Feldman's argument also suffers from a logical inconsistency. If optionsXpress was not charging him hard-to-borrow fees regardless of what he did, why was Feldman incurring the costs of the buy-writes, each and every day? In other words, if optionsXpress was borrowing the shares, why would they ask Feldman to buy-in? Buy-ins take place when a clearing broker does not have shares to deliver, does not want to lend in-house shares to its customers, or is not borrowing or cannot borrow the shares. It defies logic that Feldman, a sophisticated investor, would not have known that the daily buy-in notices meant that optionsXpress was not borrowing the shares.

testified that the Customers' use of buy-writes with deep-in-the-money calls is highly unusual and not normal market activity. DFOF ¶ 77.

4. *Finnerty* Does Not Apply Because Options Purchasers Did Not Receive the Benefit of Their Bargain.

Feldman also attempts to escape liability by citing *United States v. Finnerty*, 533 F.3d 143 (2d Cir. 2008) for the proposition that "[b]road as the concept of 'deception' may be, it irreducibly entails some act that gives the victim a false impression." Br. at 19. However, Feldman's reliance on *Finnerty* is misplaced.

In *Finnerty*, the Second Circuit found that the purchasers and sellers of the stock received the benefit of their bargain. *Finnerty,* 533 F.3d at 145; *see also Simpson Capital Mgmt.,* 586 F. Supp. 2d at 204 (distinguishing *Finnerty:* "[A]ll that Finnerty did was to execute trades at disclosed terms…[he] did not deceive either the buyer or the seller with respect to the terms of their trades. Each side of the trade knew what it got—the shares purchased or sold and at what price."). Here, unlike in *Finnerty*, the purchasers of Feldman's sales did not receive the benefit of their bargain – they were deceived as to the terms of their trades. Feldman sold options for which one of the express terms was "[e]xercise notices tendered on any business day will result in delivery of the underlying stock on the third (T+3) business day following exercise." Equity Options Product Specifications, DFOF ¶ 45. However, Feldman did not intend to – and indeed, did not – deliver stock by T+3 in violation of the terms of the call option contracts. Thus, Feldman did in fact deceive the buyers with respect to the terms of their trades.

In any event, *Finnerty* may not be good law. As discussed in the Division's opening brief, the Second Circuit has given *Chevron* deference to the Commission's post-*Finnerty* adjudicatory ~~decision~~ finding Finnerty's conduct to be deceptive, which the Second Circuit has held "'trumps' [the Second Circuit's] prior interpretation in *Finnerty*." *See Van Cook v. SEC,* 653 F.3d 130, 141 (2d Cir. 2011) (citing *David A. Finnerty,* Exchange Act Rel. No. 59998, 95

SEC Docket No. 2534, 2009 WL 1490212, at *3 (May 28, 2009)). Feldman claims that this ruling by the Second Circuit is not applicable here because the Commission found an additional misrepresentation – that Finnerty had represented to the NYSE that he would comply with its rules.[11] This is not a meaningful distinction – Feldman was similarly deceptive by not complying with the options specifications which specifically state that the seller will deliver shares three days after assignment. DFOF ¶ 45. In addition, there is clear and unequivocal evidence that other market participants were deceived about the nature and purpose of Feldman's trading and that Feldman knew it. *See In re Amanat,* Exchange Act Rel. No. 54708 (finding wash trades and matched orders entered for one deceptive purpose also deceived others). Indeed, Feldman admitted that he knew the message board posters were confused by the volume of trading in Sears resulting from his buy-writes and that they placed some significance on it. DFOF ¶ 274; Tr. at 2273-74 (Feldman).

5. *Janus* Is Not Applicable to Rule 10b-5(a) and (c) or Section 17(a).

Feldman argues that he did not have the requisite control to be a primary violator of Rule 10b-5, citing *Janus Capital Group, Inc. v. First Derivative Traders*, 131 S. Ct. 2296 (2011). Br. at 40-41. This argument has no merit and should be rejected for the following reasons.

First, *Janus* on its face does not apply to this case. The *Janus* decision was based on the word "make" in Section 10b-5(b). *Id.* However, neither subsection (a) nor (c) – the two provisions of Section 10b-5 at issue in this case – contains the word "make." Indeed, other Courts that have considered the application of *Janus* to subsections (a) and (c) have found that it

[11] Moreover, under Feldman's reasoning, an open market trade can only be unlawful if there is a specific misstatement to a particular person. This is not the law. Acceptance of Feldman's theory would eliminate liability for many long-standing forms of securities fraud. As stated in the Division's Post-Hearing Brief, it is a well-known principal that the securities laws and rules must be read broadly and flexibly and not "technically and restrictively," *SEC v. Zandford*, 535 U.S. 813, 819 (2002), because the securities laws were enacted for the purpose of protecting against fraud and were designed to prevent "all the ingenious variations of security fraud that arise." *United States v. Jensen*, 608 F.2d 1349, 1354 (10th Cir. 1979).

does not apply. *See, e.g., SEC v. Sells*, 2012 U.S. Dist. LEXIS 112450 at **18-21 (N.D. Cal. Aug. 10, 2012) (finding that *Janus* does not apply to subsections (a) and (c)); *SEC v. Pentagon Capital Mgmt. PLC*, 844 F.Supp.2d 377, 421-22 (S.D.N.Y. Feb. 14, 2012) (same). Further, *Janus* does not apply to Section 17(a) cases. *See, e.g., SEC v. Stoker*, 865 F. Supp. 2d 457, 464-66 (S.D.N.Y. 2012) (holding that *Janus* does not apply to Section 17(a) and citing other cases with the same finding).

Second, Feldman controlled the deceptive conduct. Specifically, it was ***Feldman*** – not optionsXpress – who sold the options knowing he would delay delivery by doing buy-write after buy-write.[12] It was ***Feldman*** who traded the buy-writes. It was ***Feldman*** whose trading affected the market volume. It was ***Feldman*** who bragged about his effect on the markets – "Do u realize that w ***my daily buy writes*** this year . . . that's $51mm/day of 1099! Proceeds. My annual 1099! Will be over $2bb!. . . See how it happens? Same trade every day. Get assigned stock + sell options." DFOF ¶ 244 (emphasis added). Indeed, Feldman "had a good laugh" about the fact that ***his*** buy-writes were "panicking other people on the message boards." *Id.* ¶ 275. Feldman should not be allowed to now disclaim responsibility for ***his*** trading.

Indeed, the Court in *Simpson Capital Mgmt.*, 586 F. Supp. 2d at 208, rejected a similar argument. There, the court found that Rule 10b-5(a) and (c) only require that the defendant "directly or indirectly use[] or employ[] a deceptive device or engage[] in an act or practice that operated or would act as a fraud." *Id.* at 208. The Court went on to find that the defendants could be directly liable where they devised the scheme to defraud and dealt only with brokers who agreed to join them in the scheme. *Id.* This is exactly what occurred in this case. Feldman devised the scheme to defraud and dealt only with brokers that would allow him to use the buy-writes to cover his buy-ins. Feldman had sufficient control to be found primarily liable.

[12] optionsXpress, however, did aid and abet Feldman's violation of Section 17(a) and Rules 10b-5 and 10b-21 as outlined in the Division's Post-Hearing Brief and the Division's Post-Hearing Reply Brief in Support of Its Case Against Respondent optionsXpress, Inc., both incorporated herein by reference.

6. Dr. Sirri Did Not Opine that Feldman's Trading Was in Compliance With the Law.

Despite Feldman's assertions to the contrary, Br. at 5 and 12, Dr. Erik Sirri ***did not opine*** that (1) Feldman's trading did not cause a Reg. SHO violation or (2) that Feldman did not violate the anti-fraud rules. Dr. Sirri testified that he was not offering any opinions on whether Feldman violated Rule 10b-21, Section 10(b), or Section 17(a), Tr. at 3265:19-24, and stated quite clearly that ***"I'm not offering any opinions about whether optionsXpress complied with SHO."*** Tr. at 3260:3-4 (Sirri) (emphasis added). Furthermore, even if Dr. Sirri had offered such opinions, they should be disregarded because experts should not offer legal conclusions.[13] *Densberger v. United Techs. Corp.*, 297 F.3d 66, 74 (2d Cir. 2002) ("It is well-established rule in this Circuit that experts are not permitted to present testimony in the form of legal conclusions."); *Pfizer, Inc. v. Teva Pharm. USA, Inc.*, 2006 WL 3041097, at *2 (D.N.J. Oct. 26, 2006) (excluding expert testimony that either explains the law in general or offers legal conclusions "that follow from the facts presented at trial"); *In re Methyl Tertiary Butyl Ether Products Liability Litig.*, 643 F. Supp. 2d 482, 498-501 (S.D.N.Y. 2002) (opinion testimony about ultimate legal conclusion not permissible).

Similarly, Feldman's claims that Dr. Sirri was an expert on Reg. SHO and that "the Division did not object to his report or expert testimony" should be disregarded. Feldman FOF ¶ 20. It is ***simply not true.*** *First,* Sirri is not a Reg. SHO expert. *See* Division's Post-Hearing Reply Brief in Support of Its Case Against Respondent optionsXpress, Inc., incorporated herein by reference. *Second,* the Division did object. During trial the Division stated: "Had I been informed that Dr. Sirri was being put up as an expert in Reg SHO compliance, I certainly would have had an issue with that because he has the exact same background that Dr. Harris does in

[13] John Ruth's opinion regarding the clarity of Reg. SHO, Br. at 29, should be disregarded for the same reason.

those respects and Dr. Sirri clearly testified that he was giving no legal opinions here and he was solely testifying as an economist." Tr. at 4903:13-20 (Block) (emphasis added).

B. Feldman Acted With Scienter.

Feldman argues that the Division cannot show he acted with scienter because no one specifically told him that what he was doing was illegal and that in any event, he cannot be held liable because he relied on his broker-dealer. Br. 26-36. Neither of these arguments holds up to scrutiny. Both are merely attempts to avoid the consequences of his conduct by blaming others. There is ample evidence that Feldman knew what he was doing and he knew it was deceptive – that is all the law requires. However, the evidence shows even more than that. The record is replete with red flags alerting Feldman to the fact that his conduct was illegal. In the face of this evidence, any reliance Feldman may have placed on optionsXpress was clearly not in good faith and was not reasonable. *See Silverman,* 798 F. Supp. 2d at 968-71.

1. Feldman Knew What He Was Doing and He Knew the Consequences.

The law does not require that the Division show that someone specifically told Feldman that his conduct was illegal. "[K]nowledge of one's actions and their consequences is all the law requires; a demonstration of a subjective belief that those actions are illegal is unnecessary" for purposes of scienter. *SEC v. Falstaff Brewing Corp.*, 629 F.2d 62, 79 n.32 (D.C. Cir. 1980). The evidence amply shows that Feldman had knowledge of his actions and the consequences thereof.

First, Feldman knew the deep-in-the-money call options he sold would be promptly exercised, resulting in a rolling pattern of failures.[14]

- "[W]hen[e]ver I get a buy-in (I'm talking hunderds [sic] of thousands of shares sometimes), ***I recreate the position by selling in-the-money calls,***

[14] Feldman now claims that the rate of assignment was highly variable, Br. at 31. However, this claim is misleading and not in accord with the evidence. Even Feldman's own expert notes that written calls for the 13 stocks in the OIP were regularly assigned on the same day they were written – AIG (97%), AMED (98%), APWR (78%), CSKI (91%), C (98%), LPHI (91%), MJN (100%), OSIR (100%), SEED (100%), SHLD (97%), TLB (100%), TXI (95%), and UA (83%). Resp. Ex. 915 (Sirri Report) at Ex. 13 (noting the percentage of written calls assigned at least in part on the day they were sold).

which of course [sic] then get assigned, leaving me short again. It's a viscious [sic] cycle. . . ." Div. Ex. 383 at 4 (emphasis added).

- Feldman was told that "***market-makers are always going to assign what you're short.***" DFOF ¶ 221 (emphasis added).

- An optionsXpress trader told Feldman that "***the market maker is usually always going to assign*** whatever call [it purchases] . . . ***normally you'll always going to get assigned.***" *Id.* ¶ 242 (emphasis added).

- Feldman wrote a friend: "it [a]lmost doesn't matter, JUL or SEP, ***as u get assigned that night anyway, so what's the diff?***" *Id.* ¶ 244 (emphasis added).

- Feldman wrote the floor broker that: "Do u realize that w my daily buy writes this year . . . that's $51mm/day of 1099! Proceeds. My annual 1099! Will be over $2bb!. . . ***See how it happens? Same trade every day. Get assigned stock + sell options.***" *Id.* ¶ 244 (emphasis added).

- Feldman emailed optionsXpress: "a buy-write of 2500 SHLD, incurs a commission of $1,250 ***each and every day.***" *Id.* (emphasis added).

- Feldman testified that ***it would be "stupid to say"*** that none of his deep-in-the-money calls (that were part of the buy-writes) were going to get assigned. *Id.* ¶ 245 (emphasis added).

- Feldman emailed optionsXpress' Risk Department: "***it's part of my daily routine***. Brush teeth, get coffee, rest [sic] C [Citigroup, Inc.], cover buyin on C [Citigroup, Inc.]." *Id.* ¶ 244 (emphasis added).

Second, Feldman knew that the buy-writes resulted in a failure to deliver shares.

- Feldman told a broker: "***I don't settle the stock@all.***" *Id.* ¶ 218 (emphasis added).

- Feldman told a broker: "So I could do a buy-write ***and then I wouldn't settle.***" *Id.* ¶ 220 (emphasis added).

- Feldman asked a broker: "So how many SHLD do I have to buy-in today (***to avoid settlement***)?" *Id.* ¶ 219 (emphasis added).

- An optionsXpress compliance officer told Feldman that "[w]ith the SHLD and the additional MJN shorts, however, ***we are experiencing persistent fails.*** Because of that, we must take action everyday." The compliance officer then added: "***With the initial short position (resulting a fail to deliver) of MJN,*** Rule 204 was triggered. . . ." *Id.* ¶ 225 (emphasis added).

- A broker told Feldman that the issue was an ***"unsettled trade of 100mm constantly rolling."*** Div. Ex. 25 at 22.

- ***A broker told Feldman that Penson had to borrow the stock*** to avoid Rule 204 buy-ins. OPX Ex. 801.

- optionsXpress told Feldman: "***You have not cleared your settled position*** in MJN, where we have been buying you in on roughly 220,000 shares for the last four days." DFOF ¶ 224 (emphasis added).

Third, Feldman knew that his actions were deceiving the market.

- Feldman himself admitted that he knew the message board posters were confused by the volume of trading they were seeing in Sears (which was attributable to Feldman's buy-writes): "it would obviously appear as a volume spike or whatever, and I think that they saw this, and ***someone attached some significance to it.*** . . ." *Id.* ¶ 274; Tr. at 2273 (Feldman) (emphasis added).

- Feldman informed the floor broker for his trades that the Yahoo! message boards were "shaken up" that upwards of 50 to 75 percent of the daily volume in SHLD occurred on "one block print."[15] DFOF ¶ 275.

Fourth, Feldman knew that the regulators were concerned about his trading.[16]

- ***optionsXpress informed Feldman that the SEC was investigating his trading*** and that regulators were continuing to ask questions. *Id.* ¶¶ 141, 223.

- Another broker-dealer told Feldman that regulators were concerned about this type of activity: "I don't think [optionsXpress is] going to take [you] because the ***CBOE regulators are starting to get heavy on them with this activity***, because that's why [the clearing broker] is . . . getting skittish." *Id.* ¶ 222 (emphasis added).

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[15] When Feldman was asked by a poster on another site how he got around his delivery obligations, Feldman did not answer. Instead, he stopped posting. Div. Ex. 383 at 5-8.

[16] Feldman argues that Penson did not tell him that there were regulatory problems and that the other brokers did not stop his activity because it violated Reg. SHO. Br. at 35-36. This argument distorts the record. Terra Nova told Feldman that regulators were concerned about this type of activity: "I don't think [optionsXpress is] going to take [you] because the ***CBOE regulators are starting to get heavy on them with this activity***, because that's why [Penson] is . . . getting skittish." DFOF ¶ 222 (emphasis added). Moreover, the broker who Feldman was dealing with at Terra Nova told him that Penson wanted him out immediately. The clear inference from the tone of the phone conversation was that the clearing firm had grave concerns with the trading. Tr. at 2305-06 (Feldman). TD Ameritrade told Feldman that his "strategy that continues to be executed creates operational risk, market risk and potential ***regulatory risk for the clearing firm***. The nature of frequent assignment of the short calls creates an obligation for delivery of shares that lags the closing transaction of the short position by one day. In several instances over the last two months, ***these fails have continued to age as new calls are written simultaneously with the closing transactions***. As a result of these frequent sizable and aged fails to deliver, the firm has absorbed significant market, economic, ***and regulatory risk to allow this activity to continue***." Div. Ex. 416 (emphasis added). optionsXpress informed Feldman that the SEC was investigating his trading. DFOF ¶ 141. Indeed, optionsXpress raised Feldman's rate for buy-ins by $.005 per share in part because it was having to interact with the regulators about the trading. *Id.* ¶ 223. The witness from E*Trade testified that it shut down Feldman's trading over concerns that allowing it to continue would result in Reg. SHO problems. *Id.* ¶¶ 288-90.

- While optionsXpress allowed Feldman to return, ***it raised his rate for buy-ins by $.005 per share. optionsXpress said one of the reasons for the increase in rates was the fact that it was still having to interact with the regulators*** about the trading which raised the firm's overhead. *Id.* ¶ 223 (emphasis added).

Fifth, Feldman knew the regulatory framework for delivery.

- Feldman read Rule 204. *Id.* ¶ 278.

- An optionsXpress compliance officer explained to Feldman that "when an assignment results in a short sale in a security we are already failing to deliver, we have to take action to clean up the entire fail immediately." *Id.* ¶ 225. Feldman responded by asking if there were other ways he could "***restart the clock.***" *Id.* ¶ 226. (emphasis added).

Sixth, Feldman knew others had been held liable for similar conduct.

- Feldman read *Hazan*. *Id.* ¶ 278.

Seventh, Feldman knew optionsXpress was the only broker who would allow the activity.

- Feldman told his friend: "Millions of $$ inc [sic] comissions[sic],,,,yet treat me/us like criminals...But, in the big picture...***it's still quite the gig...where can you get such mkt-bating [sic] retu[r]ns consistently***? So, as disgusting as [optionsXpress] are [sic], have to bend over and get raped, and take the punishment[.]" *Id.* ¶ 235. (emphasis added).

- Within two weeks of transferring part of his positions to another broker-dealer, Feldman was told that he had to pay hard-to-borrow fees if he wanted to continue the trading. Instead of paying the hard to borrow fees, Feldman fled back to optionsXpress, the only broker that would take him. *Id.* ¶¶ 211-14.

Eighth, Feldman thought that his deception was entertaining and a joke.

- Feldman bragged about the effect of his trading on the market to a floor broker. *Id.* ¶ 275. Feldman knew and "had a good laugh" about the fact that his buy-writes were "panicking other people on the message boards." *Id.*

- Feldman told a friend: "I read the latest thread on the SHLD 'volume spikes'. Very entertaining. ***(Until someone notifies the SEC and they shut down the strategy!!)***." *Id.* ¶ 277 (emphasis added).

This evidence clearly shows that Feldman knew what he was doing and that his conduct was deceptive. The Division has more than adequately demonstrated that Feldman acted with scienter.

2. At a Minimum, Feldman Was Negligent.

The evidence described above clearly demonstrates that Feldman acted with sufficient scienter to violate Section 10(b) and Section 17(a)(1). This same evidence more than amply provides proof of negligence which is all that the Division must show for a violation of Section 17(a)(3) of the Securities Act. *SEC v. Monarch Funding Corp.*, 192 F.3d 295, 308 (2d Cir. 1999). Furthermore, Feldman made clear during the hearing that he is someone who pushes to get what he wants and is not the type of person who trusts what others – including his brokers – are telling him. Tr. at 2626-34 (Feldman) (testifying that he "didn't trust people" he deals with and "questions them"). Yet, despite this skepticism, Feldman did not do any due diligence – in the face of numerous red flags – to find out about the legality of his trading. The evidence overwhelmingly shows that Feldman acted, at a minimum, with negligence.

3. Feldman Did Not Rely on optionsXpress in Good Faith.

Feldman claims that he cannot have scienter because he relied on optionsXpress. Br. at 26-31. This is without merit – any reliance Feldman may have placed on optionsXpress was not in good faith. *See Silverman,* 798 F. Supp. 2d at 968-71 (rejecting a good faith reliance argument where the defendants knew or were reckless in not knowing about the securities law violation). The record is replete with evidence of Feldman's knowledge. *First*, optionsXpress told Feldman that it was having failures to deliver related to his activity: "With the SHLD and the additional MJN shorts, however, *we are experiencing persistent fails.*"[17] DFOF ¶ 225 (emphasis added); *see also id.* ¶ 224 ("*You have not cleared your settled position in MJN*") (emphasis added)). *Second*, Feldman knew that regulators were looking at his activity and that,

[17] Feldman's claim that the buy-in notices and Daily Position Recap reports provided him with confirmation that he had covered his short position is not credible. Feldman FOF ¶ 82. Feldman testified that although his Position Recap report showed that he had no short position as of the night before, he did not question optionsXpress when he was informed early the following morning that he in fact had a short position that needed to be bought in. Tr. at 2624-25 (Feldman). Feldman also admitted that this occurred frequently. *Id.*

due to the increased compliance costs, optionsXpress was charging him additional fees. *Id.* ¶¶ 141, 222-23. *Third,* Terra Nova told Feldman that "CBOE *regulators are starting to get heavy on them with this activity,* because that's why [the clearing broker] is . . . getting skittish." *Id.* ¶ 222 (emphasis added). *Fourth*, Feldman was asked to leave Terra Nova in a very short period of time. *Id.* ¶¶ 211-13. *Fifth*, Feldman read Rule 204. *Id.* ¶ 278. *Sixth*, Feldman even read *Hazan.*[18] *Id.* ¶ 278. *Seventh*, Penson charged Feldman hard-to-borrow fees even though he claims he thought his buy-writes were satisfying his delivery obligations. *Id.* ¶ 214. *Eighth,* Feldman knew that no other broker would allow the activity. *Id.* ¶ 235.

Further, Feldman's claim that he was merely taking advantage of his broker, Feldman FOF ¶ 54, is not a valid excuse. As discussed above, Feldman was well aware that his shares were not being delivered and he had ultimate responsibility for delivery. In addition, courts have long held that it is not "unfair to require that one who deliberately goes perilously close to an area of proscribed conduct shall take the risk that he may cross the line." *United States v. Kay*, 513 F.3d 432, 442 (5th Cir. 2007) (citing *Boyce Motor Lines, Inc. v. United States*, 342 U.S. 337, 340 (1952)). Feldman knew what he was doing, knew that he was taking advantage, and in doing so he crossed the line into fraud. He should be held accountable.

Given the numerous red flags that he encountered throughout his trading at optionsXpress and his experience with another broker, any "reliance" Feldman placed on optionsXpress was clearly not in good faith. While Feldman attempts to portray himself as a simple retail investor, he was not. He was a sophisticated trader who knew what he was doing and knew that his trades were not settling. His reliance on his broker argument should not be countenanced. Indeed,

[18] Feldman argues that *Hazan* was distinguishable from his trading, Br. at 25, however, this is meritless for the same reasons discussed in the Division's Post-Hearing Brief and the Division's Post-Hearing Reply Brief in Support of Its Case Against Respondent optionsXpress, Inc., both incorporated herein by reference. Indeed, Feldman had exactly the same economic motivation as Hazan did – to remain short without paying for it.

similar, "my broker let me do it" defenses have been rejected by the courts.[19] *See Simpson Capital Mgmt., Inc.*, 586 F. Supp. 2d at 208 (defendant may be liable for deceptive conduct even though his broker is the one who did the late trading when defendant "identified individuals at five-broker dealers who agreed to participate in the late trading scheme").

4. Feldman Cannot Claim He Relied on the Regulators.

Feldman cannot excuse his conduct by claiming reliance on the regulators. As a preliminary matter, Feldman never spoke with the regulators. Whatever they may or may not have said is completely speculative and irrelevant because the simple fact of the matter is Feldman never asked any regulator if his conduct was legal nor did he do any other due diligence despite facing numerous red flags.[20]

Shockingly, Feldman even goes so far as to claim that "FINRA concluded that the trading did not violate Reg SHO." Br. at 29, 35. This is supported by nothing in the record and is a complete falsehood. ***Indeed, all three of the FINRA witnesses testified to the exact opposite.*** *See* Tr. at 2923 (DeMaio) ("The trades ultimately accomplish sort of setting a check mark that the shares were nominally purchased then they were immediately sold again. We viewed that as continuation of the fail. And that the closeout had not been accomplished."); Tr. at 2892 (Huber) ("we continued to have concerns about the activity and wanted to move our investigation forward"); Tr. at 2792 (Aylward) (explaining that FINRA continued to investigate the activity until it deferred the matter to the SEC); DFOF ¶¶ 208, 210, 228. The Court should disregard Feldman's blatantly false assertion.

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[19] Feldman goes so far as to claim that he "had no alternative" but to rely on optionsXpress. Br. at 36. However, he did have an alternative – he did not have to place the buy-write trades. Yet, he did so knowing the calls would be assigned, that he would enter into another buy-write, and that as a result no shares would be delivered. *See supra* Section I.B.1; *see also* Tr. at 3878-79 (Overmyer) (testifying that he would have "need[ed] to get out of this position" if faced with the same situation).

[20] In addition, far from saying that FINRA would not have given any guidance about the trading, Gene DeMaio of FINRA testified that "[i]f a customer called and asked, are there any, is there any guidance regarding Reg. SHO, for instance, we certainly would point them to circulars if that was the question." Tr. at 2932:19-23 (DeMaio).

Feldman also claims that CBOE did not believe Feldman's trading violated Reg. SHO. Br. at 29, 35. This claim too is misleading. As discussed above, Feldman is not alleged to have violated Reg. SHO because non-brokers cannot violate the Rule. Instead, Feldman is charged with fraud. Furthermore, CBOE's investigation focused on whether Zelezny (a retail customer), not optionsXpress, violated Reg. SHO. Reply FOF ¶¶ 126, 133, 140, 149, 150, 158. CBOE determined that Zelezny did not violate Reg. SHO (once again, Reg. SHO does not apply to non-brokers) but nonetheless, CBOE hoped to refer the matter to the SEC because CBOE did not have jurisdiction over retail customers. *Id.* ¶¶ 131-32. Indeed, the CBOE investigator on the matter wrote to the SEC stating "CBOE will be submitting an advisory to the SEC on this matter in the near future." *Id.* ¶ 155. Consistent with its focus on the retail customer, CBOE did not consider the optionsXpress letter of caution to have provided optionsXpress with any guidance on whether the firm violated Rule 204T in connection with Zelezny's trading nor did it think that the letter cleared optionsXpress of any wrongdoing under Rules 204 or 204T. *Id.* ¶ 161.

C. Feldman Violated Rule 10b-21.

The Commission adopted Rule 10b-21 to emphasize that naked short selling schemes perpetrated by sellers are always illegal under the federal securities laws. 73 Fed. Reg. 61666, 61667 (Oct. 17, 2008); *see also The Wharf (Holdings)*, 532 U.S. at 596-97; *Walling v. Beverly Enter.*, 476 F.2d 393. It was concerned that sellers who deceived others about their intention or ability to timely deliver securities were having a detrimental effect on the markets. 73 Fed. Reg. at 61667. These concerns were not, as Feldman argues, Br. at 39 and Feldman FOF ¶ 122, limited to explicit misrepresentations by customers to their own brokers. 73 Fed. Reg. at 61667 ("***Among other things,*** Rule 10b-21 will target short sellers who deceive their broker-dealers about their source of borrowable shares for purposes of complying with Regulation SHO's 'locate' requirement."). This broader purpose was reflected both in the rule – which specifically relates to deception of any broker-dealer, a participant of a registered clearing agency, or a

purchaser – and in the adopting release which discusses the aiding and abetting liability of brokers. *Id.* at 61673.

To prove a violation of Rule 10b-21, the Division must show (1) that an order was submitted to sell an equity security; (2) the seller deceived a broker or dealer, a participant of a registered clearing agency, or a purchaser about its intention or ability to deliver the security; (3) the seller failed to deliver the security; and (4) scienter. The Division has proven all of these elements.

First, Feldman concedes that he submitted orders to sell equity securities. Br. at 37 ("the Division has shown that Mr. Feldman submitted orders to sell equity securities").

Second, as discussed above in Sections I.A and B above, Feldman deceived participants of a registered clearing agency and purchasers about his intention or ability to deliver the security and did so with scienter. Feldman sold options knowing that they would be exercised and assigned – "JUL or SEP, ***as u get assigned that night anyway, so what's the diff***?," DFOF ¶ 244 (emphasis added). He also knew that he did not plan to deliver those shares ("***I don't settle the stock@all,***" *id.* ¶ 218 (emphasis added)) because he would just do another buy-write – ***See how it happens? Same trade every day. Get assigned stock + sell options,***" *id.* ¶ 244 (emphasis added). Feldman also was aware that his actions were deceptive. *Id.* ¶ 274. Indeed, Feldman thought it was funny – "I read the latest thread on the SHLD 'volume spikes'. Very entertaining." *Id.* ¶ 277.

Third, Feldman failed to deliver shares.[21] Feldman was the seller of the shares. As such, he had the ultimate responsibility to ensure that what he sold was in fact given to those to whom he sold it. This is a longstanding facet of the law and is no different than someone selling a car, coal or some other commodity with no intention of delivering it. *See, e.g., Sade v. Staley*, 212 F.Supp. 631, 632-33 (D.D.C. 1963) (finding that where a customer directs a broker to sell stock

[21] For a full discussion of the failures to deliver at CNS, see the Division's Post-Hearing Brief and the Division's Post-Hearing Reply Brief in Support of Its Case Against Respondent optionsXpress, Inc., both incorporated herein by reference. *See also* Reply FOF § I.B.ii-iii.

and refuses to deliver that stock to the buyers, the broker can recover from the customer damages the broker suffered in covering the delivery); *see also The Wharf (Holdings)*, 532 U.S. at 596-97 ("To sell an option while secretly intending not to permit the option's exercise is misleading, because a buyer normally presumes good faith."). As discussed above, Feldman cannot point to optionsXpress as an excuse for his failure to deliver stock. optionsXpress told Feldman his sales were not resulting in timely delivery – ***"we are experiencing persistent fails."*** DFOF ¶ 225 (emphasis added). Indeed, Feldman himself recognized that there was no delivery – ***"I don't settle the stock@all."*** DFOF ¶ 218 (emphasis added).

Fourth, while Feldman argues that he cannot be held liable under Section 10b-21 because optionsXpress knew what he was doing, Br. at 38-39, this argument has no merit. The text of Rule 10b-21 prohibits deception not only of one's own broker, but any broker or dealer, a participant of a registered clearing agency, or a purchaser. As discussed above, other participants of a registered clearing agency and purchasers were deceived. To read this explicit language out of the rule goes against long-standing tenets of statutory interpretation. *See Miccosukee Tribe of Indians of Florida v. United States*, 2008 WL 2967654, at *18 (S.D. Fla. July 29, 2008). Under Feldman's interpretation of Rule 10b-21, a customer who sells something with no intention of ever delivering what he sold could not be liable if that customer's broker knew the customer's fraudulent plan. This is simply wrong.

In short, Feldman violated Section 10b-21 when he sold equity securities while deceiving participants of a registered clearing agency and purchasers about his intention or ability to deliver those securities and then failed to deliver the securities. He should be held accountable for his deception.

II. THE COURT SHOULD ORDER DISGORGEMENT, PENALTIES, AND OTHER EQUITABLE RELIEF

A. Feldman Should Be Ordered to Pay Disgorgement of $4,000,000 Plus Pre-Judgment Interest.

The Division is "entitled to disgorgement upon producing a reasonable approximation of a defendant's ill-gotten gains." *SEC v. Calvo*, 378 F.3d 1211, 1217 (11th Cir. 2004); *SEC v. Patel*, 61 F.3d 137, 139 (2d Cir. 1995). As described in its opening brief, the Division has produced such a reasonable approximation – over $4 million. Div. Br. at 43. Thus, the burden has shifted to Feldman to show that the Division's disgorgement figure is not a reasonable approximation. *SEC v. First City Fin. Corp.*, 890 F.2d 1215, 1232 (D.C. Cir. 1989); *SEC v. Benson*, 657 F. Supp. 1122, 1133 (S.D.N.Y. 1987). He has not done so.

1. The Division's Disgorgement Amount Is a Reasonable Approximation of Feldman's Ill-Gotten Gain.

Feldman argues that the Division's calculation is not a reasonable approximation of his ill-gotten gain because it is based on his failure to pay hard-to-borrow fees. Br. at 44. However, this argument is unavailing for several reasons. *First*, losses avoided – in this case, the hard-to-borrow fees Feldman avoided paying – is a long-recognized basis for disgorgement. *Patel*, 61 F.3d at 139-40 (imposing disgorgement based on losses avoided); *Pentagon Capital Mgmt.*, 844 F. Supp. 2d at 425. *Second,* the Division did not calculate Feldman's ill-gotten gains solely by determining the amount of losses avoided – instead, the Division did more than was required and calculated Feldman's ill-gotten gains using three separate methods: (1) by evaluating the trades that Feldman ordered; (2) by calculating stock loan fees avoided; and (3) by analyzing the increase in the net asset value of Feldman's account due to his realized and unrealized profits on the securities named in the Order Instituting Proceedings ("OIP").[22] Div. Ex. 310 (Harris

[22] Feldman's argument that the Division's disgorgement number was unreasonable because the expected profit calculation was based on an assumption of 100% assignment makes little sense. Br. at 46-47. The testimony he cites appears to refer to the expected profit calculation. Tr. at 4978-82 (Harris).

Report) at ¶¶ 146-64. Each of these methods produced a similar number – further indicating the reasonableness of the Division's request for disgorgement.

Feldman also argues that the Division's use of commercially available, historical hard-to-borrow rates is not reasonable. Br. at 45. This argument has no merit. Far from being unreasonable, the borrow rate used by the Division is in fact conservative because it is the inter-dealer rate not the retail rate. Tr. at 5021 (Harris) (testifying that the rebate data reflected the wholesale rate not the retail rate). In any event, when determining the amount of disgorgement, courts should resolve all doubts against the defrauding party. *First City Fin. Corp.*, 890 F.2d at 1232.

Feldman next argues that because there are other means by which disgorgement could possibly be calculated, the Division's approximation is not reasonable. Br. at 44. However, the court in *First City Fin. Corp.* rejected a similar argument noting that "the risk of uncertainty should fall on the wrongdoer whose illegal conduct created that uncertainty." *First City Fin. Corp.*, 890 F.2d at 1232.

Feldman also argues that the Division's disgorgement number is not a reasonable approximation because a failure to deliver cannot be mapped to a particular customer. However, the record indicates that four separate brokers – optionsXpress, Penson, TD Ameritrade, and E*Trade – were all able to do what Feldman claims is impossible – map a failure to deliver to Feldman. DFOF ¶¶ 279-92. Indeed, optionsXpress' failures at CNS track directly to its Customers engaging in the buy-write activity. *See* Reply FOF § I.B.ii, and to Feldman

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The disgorgement amount from expected profit method was calculated by taking the expected revenue generated from Feldman's Purpose Trades (*e.g.*, reverse conversions and three-way trades) and subtracting the cost associated with buying or selling the underlying stock upon expiration. Div. Ex. 310 (Harris Report) at ¶¶ 147-48. This method does not rely on the assignment rate. Harris then subtracted commissions, SEC fees, and the costs of the buy-writes to arrive at a net total. *Id.* at ¶¶ 151-53. To the extent that Feldman is arguing about any shares that optionsXpress may have lent him free of charge, Harris addresses this issue in paragraph 154 of his report. *Id.* at ¶ 154; *see also* Tr. at 4982-83 (Harris) (stating that he did not think it was necessary to adjust the 100% assignment rate).

specifically, *see id.* ¶¶ 13-14, 22-23, 28-29. Further, to the extent a broker allocated its failure to deliver to Feldman, it became his failure to deliver. If it were otherwise, it would be nearly impossible for a customer to have a failure to deliver. This is a result that is at odds with common sense and the Commission's promulgation of Rule 10b-21 which was specifically designed to reach customers' failures to deliver. 73 Fed. Reg. at 61672 ("The rule targets the misconduct of sellers. . . . Thus, Rule 10b-21's focus is on whether or not there is a fail to deliver by the seller.").

Lastly, Feldman argues that the Division's calculation is not reasonable because it includes trading done before a pattern emerged. Br. at 44. The scienter evidence described above disputes this. For instance in June 2009, Feldman stated that he was in a "viscious [sic] cycle" of writing buy-writes and getting assigned all over again. Div. Ex. 383 at 4. Nonetheless, to the extent the Court views this as a valid criticism, the Division also calculated Feldman's profits after December 1, 2009. In this short period of time, Feldman still made $1,389,442 from his trading.[23] DFOF ¶ 309.

Feldman argues that the Division's calculation of his profits after December 1, 2009 is unreliable because it includes conduct that occurred before December 1, 2009. Br. at 47. This is simply not what the record reflects for two main reasons.

First, Feldman claims that the calculation includes profits Feldman made for AIG, APWR, C, OSIR, SHLD, TXI and UA before December 1, 2009, citing Div. Ex. 497 at Ex. 20-R to 23-R. This is a ***gross mischaracterization*** of the evidence. To begin with C, OSIR, TXI and UA ***do not appear*** on Exhibit 20-R, 21-R, 22-R, or 23-R at all. Div. Ex. 497 at Ex. 20-R to 23-R. Further, the only periods for APWR and SHLD that appear on these exhibits are for periods

[23] As explained in the Division's Finding of Facts, this number is based on Feldman's total net expected profits, DFOF ¶ 309, and was calculated by taking Feldman's $2,570,038 gross profit based on that calculation, Div. Ex. 497 (Harris Rebuttal) at Ex. 20-R, and then, being extremely conservative, subtracting Feldman's costs, $1,180,596, *id.* at Ex. 21-R.

after December 1, 2009 – APWR 3 which covers the period ***March 4, 2010 to March 10, 2010*** and SHLD 2 which covers the period ***December 2, 2009 to March 9, 2010***.[24] *Id.*, Div. Ex. 310 (Harris Report) at ¶ 108; OIP at ¶ 44. Thus, Feldman's claims are not supported by the record.

Second, the Division is basing its disgorgement amount after December 1, 2009 on the ***total expected profits methodology,*** Div. Ex. 497 at Ex. 20-R, whereas the citation in Feldman's brief relates to the net asset value profits methodology, *id.* at Ex. 23-R. Br. at 46. Because of the concern about the inclusion of AIG in the ***estimated account net asset value profits*** calculation in Exhibit 23-R, the Division is not relying on that calculation. Instead, the Division based its approximation on ***the total expected profits calculation*** which does not include AIG. *See* Div. Ex. 497 at Ex. 20-R. Therefore, the concerns raised by Feldman about the calculation are unfounded.

2. The Division's Disgorgement Amount Is Casually Related to Feldman's Fraud.

Feldman also argues that the Division's disgorgement numbers are not casually related to the fraud. In doing so, Feldman simply reiterates his arguments that he has not committed fraud. Br. at 41-47. These repetitive arguments are not persuasive. As discussed above, whether optionsXpress charged Feldman hard-to-borrow fees is irrelevant, delivery is expected by T+3, and Feldman did have failures to deliver. Feldman's arguments to the contrary should be rejected.

3. Commissions Should Not Be Deducted.

Lastly, Feldman argues that the commissions he paid to optionsXpress should be deducted from the disgorgement amount. Br. at 42. Courts have rejected these types of

[24] There is no excuse for Feldman presenting this mischaracterization to the Court – this is the ***second*** time he has made the same error. *See* Feldman's Opposition to the Division of Enforcement's Motion to Offer Supplemental Evidence (Nov. 13, 2012) at 4. In its reply brief to that motion, the Division explained that Feldman was confusing the OIP security periods for optionsXpress and Feldman. *See* Division's Reply Brief in Support of Its Motion to Offer Supplemental Evidence (Nov. 20, 2012) at 5.

arguments by defendants.[25] *See SEC v. Hedgelender LLC*, 786 F. Supp. 2d 1365, 1371-72 (S.D. Ohio 2011) (refusing to decrease disgorgement amount to include "offsets"); *SEC v. Solow*, 554 F. Supp. 2d 1356, 1365 (S.D. Fla. 2008) (ordering disgorgement of gross profits and refusing to offset the amount of disgorgement by commissions the wrongdoer paid to others); *SEC v. Great Lakes Equities Co.*, 775 F. Supp. 211, 214 (E.D. Mich. 1991) (finding deductions for overhead, commissions, and other expenses not warranted). Moreover, commissions are irrelevant to the losses avoided method of calculating disgorgement. The Court should not deduct the Commissions paid by Feldman from the disgorgement amount and should therefore order Feldman to pay $4,000,000 in disgorgement plus pre-judgment interest.

Feldman profited by over $4 million from his fraud and he should be ordered to disgorge this amount plus pre-judgment interest because, as Courts have long recognized, wrongdoers should not be allowed to profit from their misconduct. *SEC v. First Jersey Sec., Inc.*, 101 F.3d 1450, 1474 (2d Cir. 1996).

B. Feldman Should Be Ordered to Pay a Penalty.

The Court should order Feldman to pay a penalty for his fraud. Exchange Act Section 21B(a) authorizes the Commission to assess a civil money penalty where a respondent has willfully violated the Exchange Act, the Securities Act, or rules and regulations thereunder. To determine whether to issue a penalty, courts consider the following six statutory factors: (1) fraud; (2) harm to others; (3) unjust enrichment; (4) prior violations; (5) need for deterrence; and (6) such other matters as justice requires. *See* Exchange Act Section 21B(c) ("Determination of Public Interest"). In this case, all of these factors are present. As discussed herein, Feldman committed fraud and as a result of his fraud market participants were harmed and market

[25] Moreover, Feldman has not produced any evidence regarding the amount of commissions he paid. *Calvo,* 378 F.3d at 1217 ("The SEC is entitled to disgorgement upon producing a reasonable approximation of a defendant's ill-gotten gains. The burden then shifts to the defendant to demonstrate that the SEC's estimate is not a reasonable approximation."). However, if the Court determines that commissions should be deducted, the commissions for Feldman's trades during the periods alleged in the OIP were only $807,213. Div. Ex. 310 (Harris Report) at Ex. 21.

integrity was undermined. His conduct was willful and was designed to profit at the expense of others. Further, there is clearly a need for deterrence – Feldman sought out other broker-dealers at which to conduct his activity ***after*** the Division had notified him that it intended to sue him for violating the anti-fraud provisions and he stopped only when he was kicked out of these broker-dealers. DFOF ¶¶ 286-89. Lastly, this is not the first time that Feldman has been in trouble with regulators. *Id.* ¶ 7. Feldman should be held accountable for his actions and the Court should order a substantial penalty.

C. The Court Should Issue a Cease-and-Desist Order.

The Court should issue a cease-and-desist order to prevent Feldman from conducting fraud in the future. *See* Div. Br. at 46. Feldman's arguments against such an order are without merit.

Feldman's first argument – that a cease-and-desist order should not be issued because he stopped his trading in 2012 – should be rejected for two reasons. Br. at 48. *First,* Exchange Act Section 21C authorizes the Commission to enter a cease-and-desist order against any person who "is violating, *has violated,* or is about to violate" any provision of the Exchange Act or rule or regulation thereunder. 15 U.S.C. § 78u-3 (emphasis added). *Second,* Feldman sought out other broker-dealers at which to conduct his activity ***after*** the Division had notified him that it intended to sue him for violating the anti-fraud provisions. DFOF ¶¶ 286-89. This clearly shows the need for a cease-and-desist order.

Feldman's second argument – that a cease-and-desist order is not appropriate because the Division did not identify a victim or harm to the market place – should also be rejected. Br. at 48. *First,* Feldman undermined market integrity when he traded billions of dollars of options contracts with no intention of delivering shares.[26] DFOF ¶¶ 301-05. *Second,* as discussed above,

[26] Feldman's claim that there was no harm to market integrity because there was no evidence of effect on price or volume, Br. at 15 and 17 and Feldman FOF ¶121, is meritless. First, there is evidence that volume was affected. DFOF ¶¶ 108-09, 274-75. Second, the price of a security need not be affected in order for there to be fraud. *See In re Amanat,* Exchange Act Rel. No. 54708 at *29 (rejecting the

Feldman's failure to deliver shares harmed other market participants by depriving them of timely delivery of their shares.[27] *Third,* the Division does not have to prove actual harm. *SEC v. Wolfson*, 539 F.3d 1249, 1256 (10th Cir. 2008) (SEC is not required to prove "injury in enforcement actions"); *SEC v. Savino*, 2006 WL 375074, at *15 (S.D.N.Y. Feb. 16, 2006) ("The SEC is not required to prove reliance or actual harm or damages resulting from conduct violating the securities laws in order to obtain relief.") (citations omitted).

Feldman's activities demonstrate that he will attempt to continue his deceptive conduct. In short, he poses a substantial, continuing risk of harm to investors and the marketplace. A cease-and-desist order should issue.

III. DODD-FRANK WAS NOT VIOLATED

As discussed in the Division's Response to Jonathan I. Feldman's Motion for Summary Disposition (June 18, 2012), the Division's Opposition to Respondent Feldman's Motion for Issuance of Subpoena (Aug. 14, 2012), and the Division's Opposition to Respondent Feldman's Motion for Reconsideration of the Court's August 20, 2012 Order (Aug. 23, 2012), all incorporated by reference herein, this action does not violate the Dodd-Frank Act. This Court has already ruled repeatedly that there is no Dodd-Frank violation and should do so again for the same reasons.

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argument that wash trading could not have violated Section 10(b) and Rule 10b-5 because it did not affect the market price).

[27] Feldman's claim that no one could have been harmed because the counterparties knew what was happening, Br. at 15, is specious. As Dr. Sirri explained in his report and Feldman admits in his findings of fact, because of the net clearing system, any purchaser of the same call option could have ended up not receiving shares after it exercised the option. Resp. Ex. 915 (Sirri Report) at ¶¶ 40-41 ("Therefore, the trader holding a three-way strategy faces the possibility of early assignment. This occurs when (i) investors who own call options at the same strike price and expiration date as the trader's written call option choose to exercise their options, (ii) the Options Clearing Corporation's ('OCC') random allocation algorithm assigns the exercise to the clearing broker representing the trader, and (iii) the clearing broker assigns the exercise to the trader."); Feldman FOF ¶ 40 ("There is no correlation between a firm that fails-to-deliver at CNS and a firm that fails-to-receive, because the firms that have fails-to-receive are constantly changing as they move up on the priority list.").

CONCLUSION

As the foregoing demonstrates, Feldman's trading was a manipulative and deceptive scheme that violated Section 10(b) of the Exchange Act, and Rules 10b-5 and 10b-21 thereunder, as well as Section 17(a) of the Securities Act. The Court should order disgorgement, enter a cease-and-desist order regarding his conduct, and impose a substantial civil penalty.

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Respectfully submitted,

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