UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

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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 THOMAS E. STERN

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The Division of Enforcement ("Division") respectfully submits this Reply Brief in Support of Its Claims Against Respondent Thomas E. Stern ("Stern").

INTRODUCTION

Stern aided and abetted and caused the securities violations committed by Respondents optionsXpress, Inc. ("optionsXpress") and Jonathan I. Feldman ("Feldman"). While Stern argues that he "had nothing to do with Reg. SHO compliance," Br. at 29-33,[1] the factual record belies this statement. Stern was substantially and personally involved in optionsXpress' Regulation SHO ("Reg. SHO") compliance and he knowingly assisted optionsXpress' and Feldman's violations.

Stern was optionsXpress' ***primary regulatory liaison*** and ***was personally involved in Reg. SHO compliance*** starting the day after Rule 204T was instituted in September 2008. He ***oversaw the implementation of optionsXpress' Reg. SHO procedures*** and personally ***monitored the trading*** at issue in this case. He participated in optionsXpress' responses to the regulatory investigations of the Customers' trading and participated on multiple calls with the regulators in which concerns were expressed about that trading. Indeed, Stern ***misled these regulators*** – a persistent issue with Stern – in describing the Customers' trading. Further, Stern took these actions knowing that there were problems. Stern understood the trading and he understood Reg. SHO. He was told by the Commission's Division of Trading and Markets ("Trading & Markets") that it could provide ***no comfort*** regarding the activity and that optionsXpress' customers may be engaging in ***"sham transactions"*** or ***"fraud."*** He knew optionsXpress was

[1] "Br." refers to Stern's Post-Hearing Brief in Response to the Division of Enforcement'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.

under investigation by both CBOE and FINRA. He knew that others had been held liable for similar conduct.

Despite all of this knowledge, at no time prior to March 2010, did Stern advise or direct optionsXpress to take what would be a "reasonably prudent" approach, *see* Br. at 28, and recommend that the firm shut down Feldman's and the Customers' trading activity. Instead, at all times, Stern took the reckless route and helped further facilitate the trading, going so far as to mislead regulators. Based on his actions, Stern should be held liable for aiding and abetting and causing optionsXpress' and Feldman's violations.

ARGUMENT

I. STERN AIDED AND ABETTED OPTIONSXPRESS' AND FELDMAN'S SECURITIES LAW VIOLATIONS

To establish aiding and abetting liability, the Division must show: (1) a securities law violation by a primary wrongdoer; (2) "substantial assistance" to the primary violator; and (3) that the accused provided the requisite assistance with knowledge of the securities law violation. *Howard v. SEC*, 376 F.3d 1136, 1143 (D.C. Cir. 2004) (holding that extreme recklessness is sufficient); *see also SEC v. Apuzzo*, --- F.3d ----, No. 11–696–cv, 2012 WL 3194303, at *6 (2d Cir. Aug. 8, 2012) (holding that the SEC must prove "that [the defendant] in some sort associate[d] himself with the venture, that [the defendant] participate[d] in it as in something that he wishe[d] to bring about, [and] that he [sought] by his action to make it succeed") (quoting *United States v. Peoni,* 100 F.2d 401, 402 (2d Cir.1938)). Here, optionsXpress violated Rules 204 and 204T of Reg. SHO and Feldman violated Section 17(a) of the Securities Act of 1933 ("Securities Act") and Section 10(b)(5) of the Securities Exchange Act of 1934 ("Exchange

Act") and Rules 10b-5 and 10b-21 thereunder.[2] And, Stern knowingly provided substantial assistance to optionsXpress and Feldman.

A. Stern Was Personally and Substantially Involved in optionsXpress' Rules 204 and 204T Non-Compliance and Feldman's Fraud.

Stern argues that he "had nothing to do with Reg. SHO compliance," had "no substantive involvement in Reg. SHO as regulatory liaison," and "[a]s a 'utility infielder,' . . . had no involvement in anything related to the alleged violations in this case." Br. at 29-33. This is simply not true.

The record is clear that Stern was actively involved from the very outset with the Customers' trading and optionsXpress' compliance with its delivery obligations under Reg. SHO. Indeed, he admits that immediately after Rule 204T was implemented on September 17, 2008, it was he – not the Compliance Department or anyone else at optionsXpress – who contacted the Chicago Board Options Exchange ("CBOE"), optionsXpress' primary regulator, with a question regarding option assignments and the firm's resulting delivery obligations. optionsXpress, Inc. Proposed Findings of Fact ("OXPS FOF") ¶ 114 (citing Div. Ex. 326).[3] CBOE responded to Stern – and Stern alone – telling him that optionsXpress needed to ***"meet[] its delivery obligations."*** *Id.* (emphasis added). When optionsXpress changed its Reg. SHO buy-in procedures to purportedly comply with the Rule 204T emergency order, optionsXpress' Chief Executive Officer asked Stern – not the Compliance Department or anyone else at the firm

[2] *See* the Division's Post-Hearing Brief, the Division's Post-Hearing Reply Brief in Support of Its Case Against Respondent optionsXpress, Inc., and the Division's Post-Hearing Reply Brief in Support of Its Case Against Respondent Jonathan I. Feldman, all incorporated herein by reference, for a discussion of the primary violations by optionsXpress and Feldman.

[3] Stern adopted, and incorporated by reference, optionsXpress' Proposed Findings of Fact and Post-Hearing Brief. Br. at 3, n.2.

– to review the implementation of the new procedures.[4] Stern complied. As a result, he personally monitored compliance with the firm's Reg. SHO procedures. Stern's Proposed Findings of Fact ("Stern FOF") ¶ 40 & n.8.[5]

Despite the new procedures that Stern implemented and monitored, optionsXpress and one of its customers soon fell under investigation by CBOE for potential Rule 204T delivery violations. DFOF ¶ 135. As optionsXpress' primary regulatory liaison, Stern was involved in discussions with CBOE and in the firm's response to CBOE's investigation. As a result, he became personally familiar with the Customers' trading strategies. *Id.* ¶¶ 135-36; Div. Ex. 162 (Stern Investigative Testimony) at 426-27. Shortly thereafter, beginning in May 2009, FINRA also began investigating optionsXpress' compliance with its delivery obligations under Rule 204T relating to some of the very same customer trading at issue in this lawsuit. DFOF ¶ 140.

While optionsXpress was under investigation by CBOE and FINRA, Stern was involved in discussions about the frequent Reg. SHO buy-ins being issued to Feldman and the other Customers not only because he was optionsXpress' primary regulatory liaison and a self-described "utility infielder," but also ***because Stern had responsibility for the effect of failures to deliver on the firm's DTCC settlement figure.*** *Id.* at ¶ 167; Tr. at 425:5-14 (Tortorella). Indeed, in 2009 alone, Stern requested information from the trading desk concerning Feldman's

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[4] Stern's attempt to deflect attention from himself by pointing at others, Br. at 24, 32, is of no moment. Even if others also caused the securities law violations, it does not excuse Stern. *In the Matter of Harrison Securities, Inc., Frederic C. Blumer and Nebrissa Song*, Rel. 256, 2004 WL 2109230, at *47 (Nov. 3, 2006) ("[T]he Division does not fail to meet its burden of proof as to Song merely because Blumer was 'an equal cause' or even 'a greater cause' of Harrison's violations.") (quoting *Erick W. Chan*, 77 SEC Docket 851, 867 (Apr. 4, 2002) ("the mere fact that others may also have caused [a primary violation of] the securities laws does not insulate Chan from liability for his own acts and omissions").

[5] Disingenuously, Stern claims in his proposed findings of fact that he "knew nothing about optionsXpress' buy-in process prior to seeing CBOE's letter of caution in September 2009." Stern FOF ¶ 53. This is blatantly not true.

daily buy-ins in Sears Holdings Corporation ("SHLD") on more than 15 separate occasions. DFOF ¶ 167; Tr. at 2041-42 (Payne).[6]

When the SEC instituted the *Hazan* and *TJM* actions in August 2009, Stern was involved in communications and discussions with optionsXpress' Compliance Department about the similarity between the trading in those cases and the trading by the Customers. DFOF ¶ 150. By that time, the Compliance Department had already opined on multiple occasions that buy-writes were not appropriate, *id.* at ¶¶ 172, 266, including:

- "[W]e . . . must execute the buy-in on the open for the specified amount to cover the fail. The customer then can do whatever other transaction they want but it is a separate transaction." *Id.* at ¶ 169.

- "[T]he answer is ***absolutely not.*** We do not want to be an active party in the call transactions. We are fulfilling our obligation to issue the buy-in. If we process the buy-write, regulators could consider the buy-ins as sham transactions." *Id.* at ¶ 170.

Indeed, based on this advice, the optionsXpress traders had already stated that we can "no longer allow customers to conduct their own buys. . . . We have to tell the Zeleznys and Feldmans that the old way of doing this is no longer possible." Div. Ex. 102; DFOF ¶ 155. Stern confirmed not only that he was involved in the August 2009 discussions about prohibiting Feldman and the other Customers from conducting their own Reg. SHO buy-ins, but that it was his personal view that it was improper for them to do so. DFOF ¶ 160.

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[6] Stern points to the investigative testimony of trader August Payne ("Payne") to suggest that he and Payne never discussed Feldman's positions in SHLD or Reg. SHO. Stern FOF ¶ 50. Stern's argument is unavailing. First, Payne unequivocally responded "yes" at the hearing when he was asked if Stern had asked him "for information about Feldman over 15 times that year" in 2009 that "related to the buy-in lists and the number of shares that needed to be covered in Feldman's account," and "in particular, [if] Mr. Stern has requested on multiple occasions information on Sears stock and how many shares of Sears need to be covered in Feldman's account." DFOF ¶ 167; Tr. at 2042 (Payne). Second, Payne's investigative testimony relied upon by Stern does not support the proposition that Payne said he "never discussed Mr. Feldman's Sears ('SHLD') position with Stern." Stern FOF ¶ 50.

When new buy-in procedures were instituted in August 2009, Stern once again "took it upon himself" to spend two or three days personally overseeing the actual implementation of the new buy-in procedures for the "Zeleznys and Feldmans" and in the process, became even more familiar with the Customers' trading activity. *Id.* at ¶ 166; Tr. at 1679-80 (Stern) (admitting that he stood over other employees' shoulders to watch the new procedures be put into effect); Stern FOF ¶ 46.[7] Like the earlier procedures Stern had overseen, the new buy-in procedures instituted in August 2009 did not mitigate or eliminate optionsXpress' CNS failure to deliver positions – optionsXpress still had persistent and extended failures to deliver at CNS until the trading stopped in March 2010. DFOF ¶ 168.

Stern claims that the following month, optionsXpress' Head Trader and its Chief Compliance Officer "pulled" him "into a discussion *they* were having about the buy-writes, and *their* reasoning for bundling the trades as buy-writes" for "best execution" purposes, ostensibly so that Stern could provide a "sanity check" to their assessment without being asked whether the buy-writes were legally appropriate. Stern FOF ¶ 20 (emphasis added). This explanation, however, defies common sense and Stern's previous involvement in Reg. SHO compliance.

Stern apparently would have the Court believe that he was asked to be the "sanity check" simply because he was the firm's "utility infielder." Such an argument would strain credulity to the breaking point and ignore Stern's extensive experience in the options-trading business and his significant leadership and management role at optionsXpress. Moreover, it would require the Court to ignore the roughly one year Stern had spent by that time (since the very implementation of Rule 204T in September 2008) becoming familiar with the Customers' trading strategy, reviewing the implementation of optionsXpress' Reg. SHO buy-in procedures, his direct

[7] Again, these facts demonstrate that Stern makes a gross misrepresentation when he professes he "knew nothing about optionsXpress' buy-in process prior to seeing CBOE's letter of caution in September 2009." Stern FOF ¶ 53.

communications with CBOE about optionsXpress' delivery obligations, his participation in responding to Reg. SHO investigations related to the Customers' trading, and his involvement in the discussions of *Hazan* and *TJM*.

On the same day as Stern's discussion with the Chief Compliance Officer and Head Trader, ***Stern*** and several others from optionsXpress, spoke to FINRA and the SEC about the trading. Indeed, it was ***Stern*** – not the Head Trader or the compliance officers – who "diagramed the customers' trades at issue and explained the OCC's random assignment process" to both regulators. Stern FOF ¶¶ 24, 31. Likewise, it was ***Stern*** – not the Head Trader or the compliance officers – who "attempted to explain that optionsXpress was entering the order for the stock buy-in, and the customer was entering the order to sell calls." *Id.* at ¶ 32. And it was ***Stern's*** misleading characterizations of the Customers' trading and optionsXpress' Rule 204 compliance efforts that led to the alleged "comfort" provided by Trading & Markets,[8] which was unequivocally rescinded roughly one week later when Trading & Markets learned from FINRA the extent of ***Stern's*** and optionsXpress' misstatements. Indeed, when Trading & Markets called optionsXpress to tell them that Trading & Markets could provide no comfort about the activity, it was ***Stern*** that optionsXpress' in-house counsel asked to be on the call – not the Head

[8] Among other things, Stern failed to advise Trading & Markets that optionsXpress had a failure to deliver at CNS for over 120 straight days in SHLD, DFOF ¶ 200; Tr. at 3592 (Tao), and falsely told Trading & Markets that Feldman's and the other Customers' assignments did not match up with their buy-in activity. DFOF ¶ 200; Tr. at 1740 (Stern) (admitting that he gave an example of the trading to try to show that the amount of the buy was not related to the amount of calls being written); Div. Ex. 168 at 327 (Stern admitting in investigative testimony that the example he gave to Trading & Markets was an attempt to show that the buy-in amount was not linked to the amount of assignment). Yet, according to optionsXpress' expert, even a grade school student could see that the trading matched. *See* Tr. at 4511:2-8 (Saha) ("[I]f you have a short position and if you buy, the short position is resolved. It's common sense. I mean, its finance 101. I mean, if you have a short position, you bought, that's a positive. Negative and positive cancels out and gives you zero. Even my son can do that math."); Tr. at 4701:18-19 (Schmeltz) ("As Dr. Saha said yesterday, simple grade school math.").

Trader or the compliance officers.[9] Tr. at 1758 (Stern) (admitting that Trading & Markets called optionsXpress back and that he was asked to come into the room).

Stern claims that he spoke on the calls with the regulators because optionsXpress' in-house counsel asked him to do so due to his trading experience. Stern FOF ¶ 24. However, it is unlikely that this was the only reason. Stern was the face of the firm to the regulators. DFOF ¶ 5. He was the firm's primary regulatory liaison. *Id.* He was familiar with the Customers' trading. *Id.* at ¶ 136. And he was involved in the firm's Reg. SHO buy-in procedures. *Id.* at ¶¶ 160, 166. It is no wonder that he not only was an active participant on the calls with FINRA and the SEC on September 24, 2009 (where he was told the Customers may be engaging in a fraud), but also participated in: (a) the October 2, 2009 call with Trading & Markets in which the SEC stated they were providing no comfort about the trading; (b) the January 2010 call with FINRA in which concerns were expressed about the trading; and (c) the March 9, 2010 call with CBOE which precipitated optionsXpress shutting down the customer trading on March 10, 2010. *Id.* at ¶¶ 204, 227-29, 236.

Despite his involvement in the implementation of optionsXpress' Reg. SHO procedures and the multiple times he was consulted about Reg. SHO compliance, at no point in time prior to March 2010, did Stern advise or direct optionsXpress to take what would be a "reasonably prudent" approach, *see* Br. at 28, and recommend that the firm shut down Feldman's and the Customers' trading activity.[10] Instead, at all times, Stern took the reckless route and helped

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[9] Incredibly, despite this evidence, Stern goes so far as to claim that his "only interaction with the trading at issue in this case in his capacity as the primary regulatory liaison was that he was copied on correspondence between the optionsXpress [sic] and its regulators." Br. at 30-31.

[10] Notably, Stern, who had 35 years of experience with options trading, testified during the investigation that he thought it would be highly unlikely to have frequent assignments on deep-in-the-money calls. Div. Ex. 162 (Stern Investigative Testimony) at 200:7-15 (testifying that he would "almost never" expect the "long option holder of a deep-in-the-money call to exercise"). Nevertheless, despite seeing for himself that the Customers' calls were assigned on a daily basis, he never advised

further facilitate the trading, going so far as to mislead regulators for "cover" in order for optionsXpress to allow the buy-writes to continue.

In short, the record makes clear that far from having "no involvement in anything related to the alleged violations in this case," Stern was actively and substantially involved.

B. Stern Knew or Should Have Known that His Conduct Contributed to Securities Law Violations.

The evidence in this case makes clear that Stern either knowingly, or with extreme recklessness, allowed optionsXpress and Feldman to violate the federal securities laws.

Stern knew what optionsXpress' delivery obligations were and the effect the trading was having at DTCC:

- In September 2008, Stern personally contacted CBOE about optionsXpress' obligations under Rule 204T and was told that optionsXpress needed to ***"meet[] its delivery obligations."*** OXPS FOF ¶ 114 (citing Div. Ex. 326) (emphasis added).

- Stern oversaw optionsXpress' implementation of its Reg. SHO procedures. DFOF ¶¶ 160, 166.

- Stern was involved in discussions regarding *Hazan* and *TJM*. *Id.* at ¶ 191.

- Stern had responsibility for the effect of failures to deliver on the firm's DTCC settlement obligations. *Id.* at ¶ 167; Tr. at 425 (Tortorella).

Stern understood the Customers' trading strategy:

- As a result of the CBOE investigation, Stern became personally familiar with the Customers' trading strategies. DFOF ¶¶ 135-36; Div. Ex. 162 (Stern Investigative Testimony) at 426-27.

- In August 2009, Stern spent two or three days personally overseeing the implementation of the new buy-in procedures for the "Zeleznys and Feldmans" and in the process, became even more familiar with the Customers' trading activity. DFOF ¶ 166; Tr. at 1679-80 (Stern).

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optionsXpress personnel to discontinue the trading. In fact, he facilitated its continuance by authorizing and overseeing new procedures and misleading regulators when purportedly seeking guidance from them.

- Stern was a seasoned and sophisticated options trader with 35 years of industry experience. Stern FOF ¶¶ 13-14.

- In 2009 alone, Stern requested information from the trading desk concerning Feldman's daily buy-ins in SHLD on more than 15 separate occasions. DFOF ¶ 167; Tr. at 2041-42 (Payne).

Stern also knew the regulators were concerned about the trading and could provide no comfort:

- Stern was personally involved in CBOE's investigation of Mark Zelezny's ("Zelezny") trading by CBOE and optionsXpress' response to that investigation. DFOF ¶ 136.

- Stern participated in discussions about the *TJM* and *Hazan* cases. *Id.* at ¶ 191.

- Stern participated on a call with FINRA where he was told that FINRA was continuing to investigate the activity. *Id.* at ¶¶ 195-97.

- Stern participated on a call with the SEC where Trading & Markets indicated that optionsXpress' customers may be engaging in "sham transactions" or "fraud." *Id.* at ¶¶ 198-99; Tr. at 3588, 3592 (Tao); Resp. Ex. 729 (handwritten notes).

- Stern participated in a second call with Trading & Markets where he was told Trading & Markets could provide "no comfort." DFOF ¶¶ 204-05.

- Stern participated in another call in January 2010, where FINRA continued to ask questions about the activity. *Id.* at ¶¶ 227-29.

Stern clearly knowingly provided substantial assistance to optionsXpress and Feldman.

Although Stern attempts to excuse his conduct by looking at the conduct of "others in the community," Br. at 34, doing so does Stern no favors. Stern's contemporaries and optionsXpress' peer firms shut down Feldman's trading activity shortly after Feldman's trading pattern became apparent. DFOF ¶¶ 97, 213-17, 279-91. Indeed, Penson Financial Services' ("Penson") representative, Robert Crain ("Crain"), testified that he had never seen trading like Feldman's before even though he looked at customer trading on a daily basis. *Id.* at ¶ 281. Some quick internet research into failures to deliver led Crain to a memorandum discussing the violative

activity in the *Hazan* and *TJM* cases, which he believed was almost identical to Feldman's trading. *Id.* at ¶¶ 281, 285. Crain, who was neither a compliance officer nor a head trader, but instead, like Stern worked in financial risk, was able to determine within a matter of weeks that Feldman's trading violated the law. *Id.* at ¶ 285. By contrast, Stern claims to have never figured out whether the buy-write trading was unlawful. Tr. at 2052-53 (Stern).

Feldman's effort to engage in the same trading at E*Trade in 2011 was equally short-lived. DFOF ¶ 287. Like Penson, E*Trade took a conservative approach to Rule 204 compliance and stopped Feldman's trading because it did not believe Feldman's use of buy-writes or a same-day "buy" and "write" would satisfy E*Trade's delivery obligations to CNS. *Id.* at ¶ 288. TD Ameritrade similarly shut down Feldman's trading within a matter of months, advising Feldman that with "the nature of frequent assignment of the short calls creat[ing] an obligation for delivery of shares that lags the closing transaction of the short position by one day," the "frequent sizable and aged fails to deliver" required the firm to "absorb[] significant market, economic, and ***regulatory risk.***" *Id.* at ¶ 286. Dr. Atanu Saha ("Saha") even testified that if brokers like TD Ameritrade had regulatory concerns or "heard through the grapevine that the SEC is creating some stir on this issue, they will be very cautious," and "their compliance and their risk management department [may] decide[] that[] [shutting down the trading is] a prudent thing to do." Tr. at 4635:7-15 (Saha). Clearly, Stern's thinking (and resulting conduct) was not in line with "others in the community." Br. at 28, 34.

Simply put, Stern at the very least recklessly, if not knowingly and intentionally, caused and aided and abetted optionsXpress' violations of Reg. SHO Rules 204 and 204T and Feldman's securities fraud violations.

C. Stern Has a Record of Intentionally Deceiving Regulators and Therefore Lacks Any Credibility.

Stern tries to present himself as an upstanding professional with a nearly unblemished 35-year career in the securities industry, going so far as to claim that it was his practice to be forthright and forthcoming with optionsXpress' regulators. Stern FOF ¶ 18. The record is clear, however, that in addition to his misleading statements during the September 2009 call with Trading & Markets, Stern has a history of deceiving regulators that militates against any credibility inferences in his favor.

Stern does not dispute that he submitted a Wells response to CBOE on August 12, 2011 that falsely contended he had provided CBOE with an exculpatory memorandum on March 8, 2010. Stern FOF ¶ 17. He also not only knowingly allowed, but in fact, approved optionsXpress to similarly represent to CBOE in its Wells response that this memorandum had been provided to CBOE on that date. DFOF ¶ 347. In reality, this document was not created on March 8, 2010 – it was created by Stern on July 8, 2011, after he received a Wells notice from CBOE. *Id.* On September 25, 2012, CBOE announced disciplinary actions against Stern for a range of violative conduct, including making false statements to CBOE in connection with Stern's August 12, 2011 Wells response. DFOF ¶ 351. Stern was censured and permanently barred from CBOE as a result. *Id.*

Stern claims the "Wells response incident of 2011 was an anomaly–Mr. Stern has never made such mistakes in the course of his lengthy career." Stern FOF ¶ 18. ***This assertion is demonstrably false.*** In response to another Wells notice, this time from the SEC, involving an affiliate of optionsXpress where Stern was the CFO and ***Chief Compliance Officer*** – Stern provided optionsXpress' counsel with another fabricated document to include in his and the affiliate's Wells response to the SEC. DFOF ¶ 349; Tr. at 1798 (Stern) (admitting that the document was fabricated). When optionsXpress counsel discovered that the document was likely

fabricated and confronted Stern, he confessed. *Id.* Importantly, Stern was not disciplined by anyone at optionsXpress for this conduct at that time, Tr. at 1806 (Stern), which indicates just how much power and authority Stern had at the firm.[11]

D. Stern's Defenses Are Unavailing.

1. Ruth's Conclusions Are Counter-Factual and Improper.

Stern proposes findings of fact and legal argument based on opinions by his proffered industry expert, John Ruth ("Ruth"), which are counter-factual and legally impermissible. For example, Stern asks the Court to adopt Ruth's opinion that a CFO of a trading firm like Stern would not reasonably be expected to know the details of the firm's trading policies and procedures, including the customers' trading strategies or the manner in which the firm closed out short positions. Br. at 15. However, Ruth's conclusion is irrelevant because the record is clear that Stern did personally develop a detailed understanding of optionsXpress' customers' trading activity. DFOF ¶¶ 24, 31-32, 166-67. Stern not only knew about, but was involved in decision-making regarding optionsXpress' Reg. SHO buy-in policies and procedures and monitored the procedures when implemented. *Id.* at ¶¶ 150, 160, 166. Indeed, Stern understood the trading with such a level of detail that he made optionsXpress' factual presentations regarding the trading activity to FINRA and Trading & Markets. Moreover, Ruth's opinion completely ignores the fact that someone else with risk-related job responsibilities, Mr. Crain at

[11] As noted in the Division's January 11, 2013 Request to Take Judicial Notice, the Investment Industry Regulatory Organization of Canada ("IIROC") recently found – and optionsXpress' affiliate, OPXS Canada Corp. ("OPXS Canada"), admitted – that Stern, OPXS Canada's President and Chief Compliance Officer, falsely told IIROC examination staff that he approved all orders from Canadian residents that were accepted verbally by U.S. representatives. *See* 12/19/12 IIROC Settlement Agreement available at http://docs.iiroc.ca/DisplayDocument.aspx?Language=en&DocumentID=C25EBF4D414F434FAF1E5A2 0A3459688 at 23. After being notified of these misrepresentations, and after conducting an internal investigation, OPXS Canada "determined that Stern had provided false and misleading information" to the examination staff, and Stern was terminated in part due to this misconduct. *Id.* at ¶¶ 15, 29.

Penson, was able to figure out within a matter of weeks that Feldman's buy-write trading violated the law and was not resulting in any delivery of shares. *Id.* at ¶¶ 281-85. Crain, in contrast to Stern, recommended that his firm immediately terminate its relationship with Feldman. Tr. at 774-75; 826-27 (Crain).

Equally unavailing is Ruth's conclusion that CBOE "gave [optionsXpress] comfort that its use of the buy-writes was appropriate." Br. at 16. This conclusion finds no support in the factual record. Indeed, at no point during or after CBOE's investigation of Zelezny's trading did anyone from CBOE indicate to optionsXpress that Zelezny's use of buy-writes was "appropriate" or that optionsXpress could continue doing them. DFOF ¶ 187; Reply FOF ¶ 161. Instead, CBOE informed optionsXpress that it had violated its own buy-in procedures. DFOF ¶¶ 183-87. In similar circumstances, the court in *Graham v. SEC*, 222 F.3d 994 (D.C. Cir. 2000), rejected the defendants' claim that they should not be held liable because the NASD had reviewed the trading. The court found that the NASD, like CBOE here, did not give the trading a "clean bill of health." *Id.* Instead, a NASD examiner, like CBOE here, had reviewed the trading, found that it "didn't smell right" and it was "fishy," and concluded in an internal memo that it did not violate a NASD rule. *Id.* The court in *Graham* held that:

> ***[W]hat we have here in this case is nothing more than a series of investigations into [the defendant's] trades***, which ultimately provided the SEC with sufficient understanding of the underlying scheme to file the complaint now before us. Neither [the defendant] ***nor the petitioners can be said to have been cleared along the way.*** And the SEC's failure to prosecute an earlier stage does not estop the agency from proceeding once it finally accumulated sufficient evidence to do so.

Id. at 1008 (emphasis added); *see also* DFOF ¶ 138.

In addition, Ruth's reliance on other letters from CBOE that Respondents claim found no Reg. SHO violations should be afforded no weight – those letters came months after optionsXpress had already stopped the Customers' trading (and, thus, in no way could

optionsXpress or Stern have relied on these letters to justify the trading). Reply FOF ¶ 180. Further, these letters were letters sent by a single CBOE staffer who did only a cursory review of limited and incomplete information sent to him by optionsXpress in connection with a routine surveillance. *Id.* at § VII.

Lastly, the Court should afford no weight to Ruth's conclusions that (a) the trading strategies were "legitimate," Br. at 15; (b) the trading in this case differs from that in prior enforcement actions like *Arenstein*, *Hazan* and *TJM*, Br. at 16; (c) the law was not clear at the time of the trading in this case, Br. at 16; and (d) it was reasonable for optionsXpress to believe that the buy-writes were an appropriate way to cover short positions, Br. at 16-17. These opinions are both factually incorrect[12] and reflect improper legal conclusions.[13] *Densberger v. United Techs. Corp.*, 297 F.3d 66, 74 (2d Cir. 2002) ("It is a well-established rule in this Circuit that experts are not permitted to present testimony in the form of legal conclusions."); *Pfizer, Inc. v. Teva Pharmaceuticals 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).

2. Any Reliance on Counsel Defense Should Be Rejected Because Stern's Counsel Represented to the Court that Reliance on Counsel Was Not Part of Stern's Defense.

At several points in his response, Stern makes reference to the involvement of attorneys in evaluating the propriety of the buy-write trading, and even points to the testimony of his

[12] *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.

[13] The Division moved at the hearing to strike improper legal conclusions from Ruth which the Court initially overruled but agreed on reconsideration to further review the motion after returning to chambers. Tr. at 4168-71.

expert that reliance on these individuals means Stern was not reckless, but was reasonable, in not requiring that optionsXpress stop using buy writes. Br. at 35 (noting that Benjamin Morof, Hillary Victor, and Kevin Strine were all attorneys who purportedly concluded the buy-writes were appropriate). Putting aside the impropriety of Stern proffering legal conclusions from an expert, *see, e.g.*, *SEC v. Daifotis*, 2012 WL 2051193, at *2 (N.D. Cal. June 7, 2012), it is the height of chicanery for Stern to make "reliance on counsel" arguments in his post-hearing brief. Not only did Stern himself testify that he did not recall ever relying on counsel, Tr. at 1762-63 (Stern), but Stern's own counsel made it crystal clear in his representations to the Court that reliance on counsel was no part of Stern's defense:

> [A]s his counsel ***we haven't put anything forward as reliance on Ms. Victor's advice as part of Stern's defense***. So, I think Mr. Block is capable of reading our pretrial brief as anyone else. And ***we didn't mention reliance on Ms. Victor one single time as part of our defense in this case***.

Tr. at 1765 (Schmeltz). Such representations constitute an express waiver of any advice of counsel defense. *See, e.g.*, *ESI Montgomery County, Inc. v. Montenay Int'l Corp.*, 899 F. Supp. 1061, 1066 (S.D.N.Y. 1995) (noting that an express waiver is effective in waiving a defense under federal securities law). Further, optionsXpress' express refusal during the same questioning to waive any attorney-client privilege concerning communications between Stern and any attorneys working at optionsXpress, Tr. at 1762-65 (Klein), further precludes the assertion of such a defense, *see, e.g.*, *In the Matter of the Application of Howard Brett Berger c/o Andrew T. Solomon, Esq. Sullivan & Worcester LLP For Review of Disciplinary Action Taken by NASD*, Rel. 34-58950, 2008 WL 4899010, *11 n.65 (Jan. 25, 2008) (Decision of the Commission) (the attorney-client privilege "cannot at once be used as a shield and a sword") (quoting *United States v. Bilzerian*, 926 F.2d 1285, 1292 (2d Cir. 1991)); *see also United States v. Exxon,* 94 F.R.D. 246, 248-49 (D.D.C. 1981) (finding a subject matter waiver of the attorney-

client privilege when a defendant raised a good faith reliance defense based on information from a government entity).

II. STERN CAUSED OPTIONSXPRESS' AND FELDMAN'S VIOLATIONS

To establish causing liability, the Division must only show that: (1) a primary violation occurred;[14] (2) an act or omission by the respondent contributed to the violation; and (3) the respondent knew, or should have known, that his or her conduct would contribute to the violation. *Howard*, 376 F.3d at 1143 (holding that extreme recklessness is sufficient for a *scienter*-based primary violation); *In the Matter of Harrison Securities, Inc.*, Rel. 256, 2004 WL 2109230, at *46 ("[n]egligence is sufficient to establish liability for causing a primary violation that does not require *scienter*"). The evidence supporting Stern's liability for aiding and abetting optionsXpress' and Feldman's violations confirms his liability for causing Feldman's securities violations, which requires a similar showing of extreme recklessness as the aiding and abetting claim. At a minimum, Stern should be found to have been a cause of optionsXpress' Reg. SHO violations, which only requires a showing of negligence by Stern.[15]

III. STERN'S PRE-FAIL CREDIT ARGUMENT LACKS MERIT

Stern argues that Rule 204(e) only requires optionsXpress to "demonstrate that it has 'purchase[d] or borrow[ed] a quantity of securities sufficient to cover the entire amount of that broker-dealer's fail to deliver position . . . in that security.'" Br. at 19 (quoting 74 Fed. Reg. 38266 at 28276)). In support of his argument, Stern maintains that delivery to CNS is irrelevant for Rule 204 compliance, including under Rule 204(e)'s pre-fail credit provision. Br. at 19.

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[14] *See supra* note 2.

[15] Notably, even optionsXpress' own expert, Dr. Saha, testified that he "would be hesitant" if he knew regulators were investigating, as a "commonsensical guy who has seen how these brokerages work" to allow the buy-write trading to continue. Tr. at 4634-35 (Saha).

However, Stern's argument relies on a fundamental mischaracterization of Rule 204(e). Stern's suggestion that delivery to CNS is irrelevant could only make sense if the Court were willing to overlook the "at a registered clearing agency" language that Stern deceptively omitted in his quote from the Federal Register, Br. at 19, *see* 74 Fed. Reg. 38266 at 38276 ("Thus, ... Rule 204(e)(3) provides that a broker-dealer must purchase or borrow a quantity of securities sufficient to cover the entire amount of that broker-dealer's fail to deliver position ***at a registered clearing agency*** in that security") (emphasis added). The omission of this language by Stern is glaring, when the Federal Register discussion makes clear that that the purpose of Rule 204(e) is "to encourage broker-dealers to ***close out*** fail to deliver positions." *Id.* (emphasis added).[16]

For these reasons and those incorporated by reference from the Division's other briefing, Stern's "no primary violation" argument lacks merit.

IV. THE COURT SHOULD ORDER STERN TO PAY PENALTIES AND IMPOSE OTHER EQUITABLE RELIEF

A. Stern Should Be Ordered to Pay Civil Money Penalties.

Exchange Act Section 21B(a) authorizes the Commission to assess a civil money penalty where a respondent has willfully violated, or aided and abetted violations of, the Securities Act, the Exchange Act, or rules and regulations thereunder. A willful violation of the securities laws means the intentional commission of an act that constitutes the violation. Put another way, there is no requirement that the actor "must also be aware that he is violating one of the Rules or Acts." *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (internal quotations marks and citation omitted). As demonstrated in the Division's opening post-hearing brief and findings of fact and this reply brief concerning the Division's claims against Stern, Stern acted with extreme

[16] Stern's arguments regarding Rule 204(e) also fail for the same reasons as 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., incorporated herein by reference.

recklessness and willfully aided and abetted optionsXpress' and Feldman's violations of the securities laws. It serves the public interest to impose a second-tier penalty of $75,000 against him.[17]

B. Stern Should Be Ordered to Cease-and-Desist.

Exchange Act Section 21C authorizes the Commission to enter a cease-and-desist order against any person who is "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. In considering whether a cease-and-desist order is appropriate, the Court looks to see whether there is some risk of future violations. *KPMG Peat Marwick LLP*, 54 S.E.C. 1135, 1185 (2001). The risk of future violations required to support a cease-and-desist order is significantly less than that required for an injunction. *Id.* at 1191. In fact, a single violation can be sufficient to indicate some risk of future violation. *In the Matter of Ofirfan Mohammed Amanat*, Exchange Act Rel. No. 54708, 2006 WL 3199181, at *11 n.64 (Nov. 3, 2006). The Commission has indicated that other factors may also demonstrate the need for a cease-and-desist order such as the seriousness of the violation, the degree of harm to investors or the marketplace resulting from the violation, the sincerity of assurances against future violations, the opportunity to commit future violations and the remedial function to be served by the cease-and-desist order in the context of other sanctions sought in the proceeding. *Id.* at *12.

In this case, while Stern no longer works at optionsXpress, he has given no assurances against future violations and indeed has testified that he hopes to work in the securities industry again. Tr. at 1800 (Stern). Stern has refused to acknowledge that his conduct violated the securities laws. He misled regulators and had a cavalier attitude regarding regulatory

[17] In the unlikely event the Court were to find only that Stern caused optionsXpress' and/or Feldman's securities law violations, but did not aid and abet those violations, the Division would not be seeking to have the Court impose penalties against Stern.

requirements. Stern poses a substantial, continuing risk of harm to investors and the marketplace. Accordingly, a cease-and-desist order should issue because it is in the public interest.

C. Stern Should Be Barred.

Exchange Act Section 15(b)(6) authorizes the Commission to bar a person associated with a broker-dealer if he has willfully violated the federal securities laws and such sanction is in the public interest. In determining whether an industry bar is in the public interest, courts consider the factors identified in *Steadman v. SEC*, 603 F.2d 1126, 1140 (5th Cir. 1979). Those factors include: (1) the egregiousness of the respondents' actions; (2) the degree of scienter involved; (3) the isolated or recurrent nature of the violations; (4) the sincerity of assurances against future violations; (5) the respondents' recognition of the wrongful nature of his conduct; and (6) the likelihood that a respondent's occupation will present opportunities for future violations. *Id.*

Stern aided and abetted violations of the antifraud provisions of the securities laws as well as the close-out requirements of Reg. SHO. Stern's actions helped optionsXpress avoid paying millions of dollars in hard-to-borrow fees, which caused harm to other market participants. Stern misled regulators and continued to allow Feldman and other optionsXpress customers to engage in the trading in question despite numerous red flags. Stern has offered no assurances against future violations, indeed he has not even acknowledged that what he did was a violation. He has been involved in the financial industry for decades and testified that he would like to resume work within the industry. Without an industry bar, Stern will have the opportunity to commit more violations of the securities laws.[18]

[18] The Division asks that Stern be permanently barred from associating with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized rating organization. Stern should also be barred from acting as an employee, officer, director,

CONCLUSION

As the foregoing demonstrates, Stern had an active role in optionsXpress' Rules 204 and 204T compliance and understood Feldman's and the other Customers' trading activity. Stern also had an active role in the investigations concerning the trading at issue and attempted to mislead the regulators. In so doing, Stern caused and aided and abetted both optionsXpress' violations of Reg. SHO and Feldman's violations of the securities laws. The Court should permanently bar Stern from activity in the securities markets, impose substantial civil penalties, and issue a cease-and-desist order.

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member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter. Finally, Stern should be barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance of trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.