UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of optionsXpress, Inc., Thomas E. Stern, and Jonathan I. Feldman, Respondents.	ADMINISTRATIVE PROCEEDING File No. 3-14848

RESPONDENT JONATHAN I. FELDMAN'S OPENING BRIEF TO THE COMMISSION

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TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases

Statutes and Rules

Other Authorities

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Respondent Jonathan I. Feldman, by his attorneys, hereby submits this Brief in support of his request that the Commission review the Initial Decision (cited as "ID") issued by the Chief Administrative Law Judge ("ALJ").

I. Summary of Bases for Reversal

The Initial Decision proposes to find a retail customer liable for fraud based on his broker's purported violations of Reg SHO. This unprecedented and novel finding is untenable in light of the ALJ's correct and indisputable finding that Mr. Feldman engaged in absolutely no deceptive conduct and complied with all requirements imposed on him by his broker:

> Mr. Feldman was candid about what he was doing; he did not engage in deceptive conduct or make any misrepresentations or omissions to the clearing brokers he dealt with, and he took whatever actions they required of him. Feldman never represented to optionsXpress that he had the ability to deliver shares, and he purchased shares every time optionsXpress required him to do so.

ID at 44 (internal citations omitted). Nonetheless, though employing incorrect and inconsistent terms, the Initial Decision finds that Mr. Feldman committed fraud because he submitted orders while purportedly knowing that optionsXpress would fail to comply with Rule 204. ID at 89. This finding cannot withstand any scrutiny whatsoever because of the following indisputable

facts in the record:

- optionsXpress (correctly) confirmed twice daily to Mr. Feldman that he covered any short position on which he was bought in;
- optionsXpress expressly (and correctly) communicated to Mr. Feldman on multiple occasions that it was complying with all applicable rules and delivery obligations, including Reg SHO; and
- optionsXpress (correctly) told Mr. Feldman explicitly that the SEC reviewed his trading strategy and found it caused no violations of Reg SHO.

As an individual retail customer, Mr. Feldman had no ability to confirm whether optionsXpress was complying with Reg SHO because, in addition to lacking the skillset to make a determination, Mr. Feldman did not have access to the necessary confidential and proprietary information. Such information would include optionsXpress's books and records relating to all trades by all of its customers. Thus, even if Mr. Feldman could have understood the complex requirements of Reg SHO, he could never know whether optionsXpress was violating Reg SHO. For this reason, the Commission itself acknowledged that retail customers rely on their broker-dealers for delivery:

> If a seller is relying on a broker-dealer to comply with Regulation SHO's locate obligation and to make delivery on a sale, the seller would not be representing at the time it submits an order to sell a security that it can or intends to deliver securities on the date delivery is due.

Rule 10b-21 Adopting Release, 73 FR 6166, 6172 (emphasis added). Here, there is no doubt that optionsXpress assumed all delivery obligations itself, and Mr. Feldman relied on optionsXpress completely.

Though not known to Mr. Feldman contemporaneously, regulators were providing inconsistent guidance and enforcement concerning Reg SHO and providing conflicting

interpretations of Reg SHO to the industry. In any event, both the SEC and CBOE contemporaneously told optionsXpress that the trading strategy used by Mr. Feldman did not cause violations of Reg SHO. Ultimately, the Commission sanctioned CBOE, because the CBOE, like optionsXpress, found that the trading did not violate Reg. SHO. Due process alone thus prevents adopting the fraud findings because Mr. Feldman's broker's primary regulator confirmed that it complied with Reg SHO.

At a foundational level, the Initial Decision wholly ignores that Mr. Feldman's trading was profitable only because his broker did not charge hard-to-borrow fees ("HTBs"), and the trading did not cause or profit from Reg SHO violations. This omission is no mere oversight: The foundation of the Division's case—and its expert opinions—is that Mr. Feldman sought to avoid HTBs. When confronted with the illogic of this foundation in light of optionsXpress's policy to not charge HTBs, the experts faltered during testimony, and one even conceded that Mr. Feldman would have made a profit whether or not his broker delivered to CNS.

Finally, the Initial Decision is legally deficient for no less than four sufficient reasons. First, optionsXpress fully complied with Reg SHO. Second, even assuming *arguendo* Mr. Feldman could be liable for fraud (which is wholly without support), he could not be held liable as a primary violator under *Janus Capital Group, Inc. v. First Derivative Traders*, 131 S. Ct. 2296 (2011). Third, the ALJ's disgorgement and penalty findings are wholly unsupportable and do not comply with Rule of Practice 600. Fourth, the Commission flouted the Dodd-Frank Act's 180-day requirement, rendering these proceedings a nullity.

II. Summary of Record Evidence

A. Feldman's Transparent Trading Strategies

Mr. Feldman and several other retail customers engaged in an entirely transparent trading strategy that involved purchasing and selling exchange-listed options and stock. Tr. 621:22-622:7 (Jeremy Coronado, trading specialist at optionsXpress); Tr. 4128:20-4129: 2 (Mark Zelezny, optionsXpress customer). Indeed, CBOE was aware that several other broker-dealers were allowing their customers to engage in the exact same trading strategies as Mr. Feldman. *See* Tr. 4769:14-4770:20 (Scott Lamm, former CBOE investigator). The trading strategies involved some combination of "reverse conversions" and "three-ways." Report of Dr. Erik Sirri, OPX-EX-915, ¶9. To enter into a reverse conversion strategy, a common strategy used by many traders, Mr. Feldman would: (1) establish a "synthetic long" position by selling puts and buying calls, and (2) short sell the stock. *Id.* at ¶¶27-28. To establish a three-way strategy, Mr. Feldman would: (1) establish a synthetic long by selling puts and buying calls, and (2) establish a "synthetic short" position by selling an in-the-money call. *Id.* at ¶37.

Mr. Feldman attempted to profit from the two strategies by capturing a relative mispricing of the put options versus the call options. *Id.* at ¶¶10, 31-33. That is, Mr. Feldman identified situations in which the option premium for a put exceeded the option premium for a call for the same strike price with the same expiration date. *Id.* Originally unknown to Mr. Feldman, the mispricing was largely due to the underlying securities being "hard to borrow." Tr. 2122:12-17 (Feldman). There is no regulatory definition of "hard to borrow," but the term is used commonly to mean a security that has a relatively low supply of shares available in the lending market. In turn, many broker-dealers charge their customers a fee for borrowing securities that are hard to borrow—HTBs. Tr. 233:10-22 (Risley). optionsXpress did not charge

its customers HTBs. *Id.* Many brokerage firms catering to self-directed retail customers—including E*TRADE, TD Ameritrade, Wells Fargo, Fidelity, and Charles Schwab—likewise have a policy not to charge customers HTBs. *See* Tr. 4127:2-5, 4161:19-21 (Zelezny); 4779:24-4780:1(Mikus, E*TRADE representative); Tr. 5003:4-6 (Division expert Dr. Lawrence Harris). There is no rule requiring a broker to charge HTBs, and thus there is nothing improper about seeking out a broker with a business model that does not charge HTBs. *See* Tr. 5003:4-6 (Harris).

Mr. Feldman would attempt to hold his position until expiration of the options. Sirri Report, ¶114. In that case, he would earn a profit derived from the relative mispricing of the calls, the puts, and the stock. Sirri Report, ¶¶ 33, 39, Exhibits 4-5. The strategy could only be profitable because optionsXpress did not charge HTBs. Tr. 2125:12-20 (Feldman).

The reverse conversions and three-ways rarely were held to expiration without involving additional transactions. Sirri Report, Exhibit 16. This is because American-style option holders can exercise any time before expiration and shares sold short can be called at any time. Beginning in or about May 2009, Mr. Feldman mostly sought to continue the strategy by entering "buy-write" orders to concurrently satisfy a buy-in by optionsXpress and reestablish his hedge. *Id.* at ¶¶119-121. The "buy" was for shares to satisfy the buy-in, and the "write" portion was an in-the-money call which acted as a synthetic short position to reestablish his hedge. *Id.* at ¶45. Buy-writes are very common and offered at every major brokerage. *E.g.*, Tr. 635:2-6 (Coronado); Sirri Report, ¶45. Similarly, in-the-money calls are listed on every exchange, and every options market maker offers in-the-money calls. Tr. 338:15-21 (Ronald Molnar, Director of Clearing Operations at optionsXpress).

optionsXpress randomly allocated the assignment of call exercises to its customers that

had written calls, including Mr. Feldman. Tr. 258:15-21 (Jay Risley, former Executive Vice President of Clearing at optionsXpress). Assignment resulted in the customers' having a short position in that security for the quantity assigned. Assignment did not mean that the customer would necessarily be required to buy-in. Tr. 343:5-24 (Molnar). If Mr. Feldman was assigned but optionsXpress had the shares in inventory or could borrow it, optionsXpress would take no action and Mr. Feldman could remain short, a circumstance that commonly occurred while Mr. Feldman traded at optionsXpress. *Id.*

The strategies were not risk free. Sirri Report, ¶34. The greatest risk to these strategies was the risk of assignment and buy-in of a call option or close-out of the short position prior to expiration. *Id.*; *see also* Tr. 4415:4-7 (optionsXpress expert witness Dr. Atanu Saha) (describing assignment as the "key risk" of the strategy). Every time a buy-in or close-out occurred, Mr. Feldman incurred transaction costs. Tr. 4502:23-4503:1(Saha). The transaction costs could completely eliminate Mr. Feldman's profit or result in a loss. Tr. 4415:8-11 (Saha). This risk was far from theoretical: The six optionsXpress customers that employed these strategies were forced to unwind their positions 60% of the time. Tr. 4415:12-16 (Saha). Indeed, the Division's expert conceded that the strategy not only had risk, but that Mr. Feldman lost money 30% of the time when executing the strategy. Tr. 4994:10-4995:1 (Harris).

Mr. Feldman was open and honest with his brokers at all times and made no misrepresentations or omitted any material facts, and he did not deceive them or anyone else. *See, e.g.*, Tr. 638:12-21 (Coronado); Tr. 452:12-23 (Scott Tortorella, optionsXpress clearing manager); Tr. 331:12-26 (Molnar); Tr. 1224:19-24 (Giovanni Stella, former optionsXpress trading specialist); Tr. 2065:21-2066:5 (August Payne, former optionsXpress trading specialist); Tr. 3458:10-3459:4 (Kevin Strine, optionsXpress Vice President of Compliance). Indeed,

witnesses from firms other than optionsXpress where Mr. Feldman executed his strategy confirmed Mr. Feldman was always open and honest. *See* Tr. 4833:15-19 (Mikus); *see also* Tr. 895:14-25 (Crain); Tr. 2556:16-21 (Feldman) (phone call in which Terra Nova representative confirming Mr. Feldman was open and honest).

It is undisputed that Mr. Feldman made no misrepresentations to the counterparties to his trades—indeed, he did not even know who they were. *See* Tr. 636:6-19 (Coronado); Tr. 1219:22-25 (Stella); Tr. 1318:9-20 (John Lapertosa, managing partner of OnPoint Executions, LLC). Also of note, none of the counterparties knew who Mr. Feldman was, because optionsXpress did all trades in its own name.

The public could view Mr. Feldman's trading along with other traders engaged in similar strategies. Any marketplace participant could look at the "open interest" and determine that a high volume of call options were being written and assigned frequently. *See* OPX-EX-916(d) at 3-7. Moreover, Mr. Feldman openly described his trading to the media, as reported in a July 2009 Dow Jones Newswire Column:

> Some simply shorted the common and bought preferreds, Feldman said, and he also has played using synthetic short positions by selling short Citi's deep-in-the-money call options.

OPX-EX-866 (emphasis added). Mr. Feldman also posted a comment on a noted Internet blog using his own name and publicly revealed how he was conducting his strategy:

> I have been in this Citi/Preferred Arb trade for 3 months now.[] While I some[how] am not paying the "cost to borrow" fees (don't ask me how), the risk of "buy[-]in" is huge. You've done a great job of using the analogy of the loan that does not renew. I went 2 months with zero buy-ins (miraculously), but the past 2-3 weeks the buyins have been fast and furious. However, when[e]ver I get a buy-in (I'm talking hund[re]ds of thousands of shares sometimes), I recreate the position by selling in-the-money calls, which of cou[rse] then get assigned, leaving me short again. It's a viscious [*sic*] cycle, [b]ut worth the trx ciosts [*sic*] (and the .01-.02 loss per round turn) in order to make the .785/share profit (now closer to .50 as the gap narrowed yesterday).

Div. 383.

B. optionsXpress Assumed All Delivery Obligations

For all of the options trading at issue, delivery could only be effected by a broker-dealer—optionsXpress—through the Options Clearing Corporation ("OCC"). Sirri Report, ¶¶99-101. For all of the stock trading at issue (including buy-ins), delivery could only be effected by a broker-dealer—optionsXpress—through the CNS system that is governed by Reg SHO. *See* Tr. 114:11-17, 116:25-117:7 (Louis Colacino, Depository Trust and Clearing Corp. representative); Sirri Report, ¶¶58, 75; *see also* Div. 212 (internal Penson e-mail, "We have a CNS delivery obligation regardless of what was agreed upon with the customer."). The CNS system is based on the aggregate, net delivery obligations of each participating firm. Sirri Report, ¶¶87, 126-127. Therefore, it is impossible to map any delivery failure by a participating firm to an individual customer. Tr. 3264:3-8 (Sirri). This is particularly true because optionsXpress is one of the largest brokerage firms, with thousands of customers. Tr. 3278:9-12 (Strine).

The mechanics of settlement for options and stock sales are intricate and required no less than twenty-five pages in Dr. Sirri's report to full explain. Sirri Report at 12-29, 34-36. In sum, only optionsXpress, and not Mr. Feldman, could settle trades, and optionsXpress at all times had absolute authority to accept or reject Mr. Feldman's trades. *See* Tr. 468:12-469:10 (Tortorella). Once Mr. Feldman placed his orders with optionsXpress, he had no control over settlement. *See* Tr. 247:7-9, 251:1-22 (Risley); Tr. 335:13-19 (Molnar); Tr. 639:14-18 (Coronado); Tr. 1223:21-1224:4 (Stella). Mr. Feldman's obligation cover any short position ended as soon as optionsXpress accepted his buy order. *See* Tr. 638:22-639:18 (Coronado); Tr. 2074:15-20 (testimony of August Payne, former optionsXpress trading specialist). The obligations of

customers are wholly governed by the agreement the customer has with is broker. None of Mr. Feldman's brokers claim that he breached any obligation he owed to them.

Dr. Harris—the Division's own expert—confirmed that retail customers like Mr. Feldman rely on their brokers for settlement:

> Q. You would agree that brokers and not customers typically handle logistics of delivery of securities, right?
>
> A. To settlement, yes.
>
> . . . .
>
> Q. . . . And you understand based on the record in this case that optionsXpress, not Mr. Feldman, assume[d] the obligation for logistics of delivery?
>
> A. Yes, that's correct.
>
> Q. And, therefore, you understand that Mr. Feldman relied on optionsXpress to effect delivery of the securities?
>
> A. That's correct.

Tr. 1497:25-1498:20 (Harris).

C. optionsXpress Confirmed Twice Daily Feldman's Covering Short Positions

Mr. Feldman received two confirmations every day that any buy-in on a short position was covered: (1) a trade confirmation for buying shares when optionsXpress notified him of a buy-in, and (2) a daily position recap every night confirming that he was "net flat" for shares he bought in.

Every morning that Mr. Feldman was assigned, he received a notice of assignment. *See, e.g.,* OPX-EX-919-921. If he was bought in, Mr. Feldman would next receive an e-mail notifying him of the buy-in. *See id.* Once Mr. Feldman bought in the shares as directed, he received an email confirmation that he had "bought to cover." *Id.*; *see also* OPX-EX-893. At around 9:30 P.M. every evening, Mr. Feldman received a "Daily Position Recap," which displayed for Mr. Feldman what his positions were with all securities in his account. Tr. 2604:1-6 (Feldman).

Daily position recaps showed Mr. Feldman to be "net flat" for securities he had bought to cover that day. Tr. 2614:2-24 (Feldman); *see also* OPX-EX-919-921. Importantly, Mr. Feldman's account showed a "net flat" position at the end of every day when Mr. Feldman placed a buy-write order to cover a buy-in. Tr. 2072:19-2073:21, 2078:11-20 (Payne); *see also* Tr. 461:24-462:3 (Tortorella).

D. Assignments Not Predictable and Initial Decision Addresses Selective Data

Mr. Feldman engaged in his strategies in 14 securities ignored by the Initial Decision, but Mr. Feldman's experiences in trading in these additional 14 securities informed his expectations for his trading. Tr. 2402:6-2405:12, 2405:16-2407:21 (Feldman). Indeed, both of the Division's experts agreed that a trader's prior trading experience would factor into the trader's expectation. Tr. 1523:12-23 (Harris); Tr. 712:15-713:14 (Division expert Brendan Sheehy).

The selective trading addressed in the Initial Decision includes a high incidence of assignment. However, these periods are not typical or representative of Mr. Feldman's strategies. Dr. Sirri conducted a fulsome analysis of Mr. Feldman's trading and found that for many stocks, assignments were sporadic, often occurring frequently at some points and rarely at other points. Sirri Report, Exhibit 16; *see also* Tr. 1321:17-1322:25 (Lapertosa) (testifying the rate of the buy-writes changed frequently, the contract count would change daily, and some days there were no buy-writes). Moreover, Dr. Sirri concluded that that no two stocks had the same rate of assignment and varied greatly. Sirri Report, Exhibit 13. To be sure, assignment was not guaranteed, and there was no certainty that an in-the-money standard option would be exercised prior to expiration. *Id.* at ¶51.

E. optionsXpress Confirmed Reg SHO Compliance and SEC Approval

Every witness with knowledge confirmed that optionsXpress conveyed to Mr. Feldman on multiple occasions in multiple ways that it was complying with Reg SHO:

> Q. And there were communications with Mr. Feldman regarding the timing of -- of the buy-ins and the procedures, not infrequently; right?
>
> A. Right.
>
> Q. And all throughout those communications, were you attempting to convey to Mr. Feldman that optionsXpress was complying with its obligations under Reg SHO?
>
> A. Yes.

Tr. 2073:22-2074:5 (Payne); *see also* Tr. 1225:7-10 (Stella); Tr. 3460:21-3461:5 (Strine).

In the fall of 2009, optionsXpress told Mr. Feldman that the SEC reviewed his trading strategy and concluded that it did not cause violations of Reg SHO. Tr. 2521:15-16 (Feldman). Specifically, optionsXpress' Executive Vice President of Trading/Customer Service, Peter Bottini, told Mr. Feldman that the SEC did not have any problems with Mr. Feldman's trading strategy. OPX-EX-890; Tr. 2527:7-2528:2 (Feldman); *see also* OPX-EX-870; OPX-EX-871; OPX-EX-875; OPX-EX-876.

F. Commission Sanctioned CBOE for Approving optionsXpress's Compliance

Four days after the issuance of the Initial Decision, the Commission issued *In re CBOE, Inc.*, SEC Release No. 69726, 2013 WL 2540903 (June 11, 2013) (the "CBOE Order"). The CBOE Order contains a series of sanctions against CBOE concerning the trading and investigation at issue in the Initial Decision. The Commission found that the CBOE staff wrongly concluded that optionsXpress complied with Reg SHO delivery obligations. *Id.* at 7. Moreover, the Commission found that the CBOE staff members "were confused as to whether Reg SHO applied to a retail customer" and "erroneously focused on whether the member firm's

customer, as opposed to the member firm itself, was in violation of Reg. SHO." CBOE Order at 7. The Commission also found that the CBOE staff "did not have a basic understanding of what a failure to deliver was." CBOE Order at 6.

III. Argument

A. Feldman Covered Short Positions and Did Not Fail to Deliver to CNS

The Initial Decision is internally inconsistent on the most material point concerning fraud. The ALJ correctly found that Mr. Feldman always covered his short positions by purchasing shares when bought in:

> [H]e purchased shares every time optionsXpress required him to do so.

ID at 44. The ALJ nonetheless concluded that he committed fraud by not covering his short position:

> Feldman's actions constitute fraud because by writing calls he represented to the market as a whole and to purchasers of his deep-in-the-money calls that he was going to make delivery if his calls were exercised and assigned when he had no intention of doing so, and, in fact, by entering buy-writes, he did not cover his short position.

ID at 89 (emphasis added).

To find fraud, the Initial Decision falsely conflates the delivery obligations of customers with the obligations of brokers under Reg SHO. *Id.* Neither Mr. Feldman, nor any retail customer, is able to deliver shares to CNS, and no one in the marketplace believes that individual customers are delivering shares. Absent an explicit agreement otherwise, the only obligations customers have is to purchase securities as directed by their broker-dealers, pursuant to their customer agreements. *See* Sirri Report, ¶¶68, 124-125, 127. To be absolutely clear: No one, including the ALJ, contends that Mr. Feldman failed to deliver to his broker or complete a buy-in. ID at 44.

Broker-dealers have separate obligations to deliver securities to the National Securities Clearing Corporation ("NSCC") pursuant to Reg SHO (a rule that only applies to broker-dealers). *See* Sirri Report, ¶125 ("[d]elivery to NSCC by a Clearing Member is different from delivery by a customer to a broker, and these two forms of delivery occur independently of each other."). The Rule 10b-21 Adopting Release confirms that "delivery" for customers is not delivery to NSCC, but rather delivery to their brokers:

> Rule 10b-21 as proposed was not based on whether a fail to deliver occurred in CNS.
>
> . . . .
>
> . . . Thus, Rule 10b-21's focus is on whether or not there is a fail to deliver by the seller, rather than on whether or not there is a fail to deliver in the CNS system.

Rule 10b-21 Adopting Release at 61672. The Initial Decision's finding that Mr. Feldman represented to the market "that he was going to make delivery" when "in fact, by entering buy-writes, he did not cover his short position" is thus unsupportable because Mr. Feldman has no delivery obligation and it is undisputed that he always purchased shares when bought-in. ID at 89.

Not only did Mr. Feldman have no delivery obligations to CNS, but he also had no ability to know whether optionsXpress was failing to meet its delivery obligations. Mr. Feldman did not receive CNS reports, and he had no reliable view at all into optionsXpress's operations and thus could not tell if optionsXpress was complying with Reg SHO—which it was. Tr. 115:20-116:17 (Colacino). Specifically, Mr. Feldman did not have access to optionsXpress's books and records and thus could not tell if optionsXpress was "net flat" or if there were other reasons optionsXpress may not have to purchase to deliver (e.g., if optionsXpress had shares in inventory to lend). Sirri Report, ¶¶131, 144. Mr. Feldman also could not have known whether his broker was buying him in "to address an existing closeout requirement his broker may have faced under

Rule 204, whether his broker was buying him in to avoid an imminent delivery failure that had not yet occurred, or some other reason." *Id.* at ¶84.

Mr. Feldman's lack of a CNS delivery obligation, and his disconnect from the entire CNS delivery process, is further demonstrated by the fact that a clearing firm with a fail-to-receive could not request a buy-in from Mr. Feldman. optionsXpress, like all clearing firms, trades in its own name, and delivery at CNS is in the aggregate for each firm. *Id.* at ¶¶87, 126-127; *see also* Tr. 2999:2-13 (Sirri). Correspondingly, clearing firms with fails-to-receive can only request a CNS buy-in, which is transmitted to a clearing firm, but cannot request buy-ins from particular customers. OPX-EX-906.

B. Submission of Order Not a Personal Representation of CNS Delivery

Submission of trade orders is the only purported representation by Mr. Feldman identified by the Initial Decision. ID at 89-91. Thus the Initial Decision found that Mr. Feldman's submission of the call orders constituted a promise that delivery would occur if exercised. *Id.* Such a finding is defective on its face because the submission of a trade order to optionsXpress is not a representation or a promise to the marketplace. Equally true, the submission of a call order is also not a promise to refrain from submitting subsequent orders. No evidence or witness testimony supports the Initial Decision's faulty premise that Mr. Feldman made a representation when he submitted a call order that he would not subsequently write another call if he was assigned and bought-in.

The Commission's unambiguous Rule 10b-21 Adopting Release explicitly provides that a seller is not making a representation by submitting an order if, as here, the seller is reliant on a broker-dealer:

> If a seller is relying on a broker-dealer to comply with Regulation SHO's locate obligation and to make delivery on a sale, the seller would not be

> representing at the time it submits an order to sell a security that it can or intends to deliver securities on the date delivery is due.

Rule 10b-21 Adopting Release, 73 FR at 6166-6172 (emphasis added). The Rule 10b-21 Adopting Release is in accord with case law finding that submission of an order alone cannot serve as a basis for liability under Rule 10b-5. *See United States v. Finnerty*, 533 F.3d 143, 148 (2d Cir. 2008).

The Initial Decision makes the unsupportable comparison of Mr. Feldman's trading to the trading at issue in *Wharf (Holdings) Ltd. v. United Intern. Holdings, Inc.*, 532 U.S. 588 (2001). *Wharf* addressed a private, negotiated sale, not the sale of exchange-listed options on the open market through a broker. The defendant/seller in *Wharf* sold the plaintiff/buyer an oral option to purchase 10% of its stock in return for services provided. But the seller secretly never intended to allow the buyer to exercise the option, and it refused to perform as promised. *Id.* The *Wharf* Court held: "To sell an option while secretly intending not to permit the option's exercise is misleading, because a buyer normally presumes good faith." *Id.* at 596.

The comparison to the oral, negotiated options between two businesses is unsupported. Exchange-listed, standard call options are not negotiated between a writer and a purchaser. Instead, the OCC acts as the counterparty to both the purchaser and the writer of call options. Sirri Report, ¶95. That is, the OCC sells the options to the purchaser, while simultaneously buying the same number of options from the option writer. *Id.* When a purchaser exercises, the OCC randomly assigns the exercise to the pool of options writers for the call series, which are held in the brokers' names (not the customers'). *Id.* at ¶101. The exercise then creates a sale of the stock to be settled at the NSCC by the broker assigned. *Id.* at ¶102. The NSCC's CNS system is governed by Reg SHO. All analysis then ends with the same question: Did optionsXpress comply with Reg SHO? It did. But in any case Mr. Feldman did not sell anything

with any promise to comply with Reg SHO or secret intent to not comply with Reg SHO.

Further, unlike *Wharf*, Mr. Feldman had no secret intention. He intended to sell additional options when assigned and bought in to re-establish his hedge for the duration of his strategy. He was open and honest with everyone about his intentions, including being quoted in the media and on blogs using his own name. Further, his trading activity was included in the publicly reported open interest such that the marketplace could infer his intention from his consistent pattern.

Even more important, Mr. Feldman did not fail to deliver securities, and he certainly did not inhibit or disallow the exercise of an option. Mr. Feldman had only one obligation: to buy-in as directed by his broker, and it is undisputed that he complied fully with this obligation. Further, no one guaranteed CNS delivery for options sold by Mr. Feldman by T+3, and certainly Mr. Feldman did not guarantee this. Sirri Report, ¶¶76-78.

C. Assurance of Compliance and SEC Approval Render Findings Unsupportable

The Initial Decision disregards the undisputed evidence that optionsXpress explicitly confirmed delivery and told Mr. Feldman that the SEC approved of its compliance efforts. In *Howard v. S.E.C.*, 376 F.3d 1136 (D.C. Cir. 2004), the Court of Appeals reaffirmed that there can be no recklessness where: (a) "rather than red flags, [the respondent] encountered green ones"; (b) "the [applicable law] . . . has never been clear"; or (c) the theory of liability turns on whether the respondent "should have known . . . the legal requirements" under a securities "rule whose language was silent on the subject." *Id.* at 1145, 1147-49. Further, reasonable reliance by laypeople on trusted professionals negates scienter, a necessary element to a finding of fraud, if the lay person fully discloses all pertinent facts and relies on the professional's opinion in good faith. *See generally id.* at 1148; *S.E.C. v. Caserta*, 75 F.Supp.2d 79, 94 (E.D.N.Y. 1999) ; *S.E.C.*

v. Snyder, 292 F. App'x 391, 406 (5th Cir. 2008). Moreover, due process is not satisfied where, as here, "different divisions of the enforcing agency disagree about their meaning." *Gen. Elec. Co. v. E.P.A.*, 53 F.3d 1324, 1332 (D.C. Cir. 1995). This is true when an agency fails to provide "clear, rational decision making that gives regulated members of the public adequate notice of their obligations." *S.G. Loewendick & Sons, Inc. v. Reich*, 70 F.3d 1291, 1297 (D.C. Cir. 1995).

1. optionsXpress Told Feldman That Regulators Approved

Mr. Feldman's reliance on his broker's explicit representations that the regulators had reviewed the trading strategy and approved it is a complete defense to the charges against him. Here, the Initial Decision acknowledges that Mr. Feldman was completely candid with his brokers. ID at 44. Mr. Feldman's reliance was reasonable and in good faith because the unrebutted evidence in the record demonstrates that optionsXpress made repeated, written, explicit, and fulsome representations to Mr. Feldman that it was taking all necessary steps to comply with Reg SHO. The representations included the following:

- "I know this seems unfair to you, but we are acting as we are required per SEC Rule 204, which I have attached for you." OPX-EX-870.
- "I apologize for this unfortunate change, but the SEC won't budge on these rules." OPX-EX-871.
- "Buywrites are okay as long as we get them filled at market-open." OPX-EX-875.
- "As long as we have a fill we can continue to work your orders, but we have to get them filled at the open . . . . That's the rule that's been implemented by our compliance department." OPX-EX-876.
- "In the past, we didn't even have to issue buy-ins that early, but in this new era, with the implementation of the SEC's Reg SHO Rule 204, we have to be much more proactive."

OPX-EX-902.

In the middle of the trading at issue, these representations culminated in explicit confirmation by optionsXpress to Mr. Feldman that the SEC had reviewed his trading strategy and did not find any violations. On September 23, 2009, Mr. Bottini told Mr. Feldman that optionsXpress had a call scheduled with the SEC to discuss whether optionsXpress was complying with Reg SHO in relation to Mr. Feldman's trading strategy. Tr. 2524:3-11 (Feldman). Mr. Feldman e-mailed Mr. Bottini on September 27, 2013 and asked:

"[H]ow the meeting or call w[ith] the SEC[] went[?]

OPX-EX-890. Mr. Bottini responded:

"Things look positive."

Id. Two days later, Mr. Bottini confirmed in a phone call with Mr. Feldman that the SEC told optionsXpress that "it's fine, it's okay to continue, we're good to go." Tr. 2527:7-2528:2 (Feldman). Of note, the ALJ concludes that the SEC subsequently stated to optionsXpress that it could give no comfort on this issue. Tr. 3741:5-8 (Tao). There is no evidence that optionsXpress informed Mr. Feldman of this.

The evidence in the record on this point is completely unrebutted and undisputed. No witnesses testified that Mr. Feldman was told anything other than that optionsXpress was fully compliant. The Initial Decision acknowledges that optionsXpress "assured Feldman on many occasions that there was nothing wrong with buy-writes." ID at 45; *see also* Tr. 2073:22-2074:5 (Payne) (testifying that he conveyed to Mr. Feldman that optionsXpress was complying with Reg SHO); Tr. 1225:7-10 (Stella); Tr. 3460:21-3461:5 (Strine). There is correspondingly no evidence whatsoever in the record to support the conclusion that Mr. Feldman knew optionsXpress was purportedly not complying with Reg SHO or that his belief that

optionsXpress was compliant was unreasonable. Mr. Feldman had no reason to second-guess his broker. Mr. Feldman is not a securities professional, does not hold any securities licenses, has never worked for a broker-dealer, and does not have any background in broker-dealer compliance. Tr. 2351:13-2352:1 (Feldman).

As another customer at optionsXpress who executed the same strategy as Mr. Feldman but was not charged testified:

> Q. . . . Were you relying on optionsXpress then to effect delivery of these shares?
>
> A. Yes.
>
> Q. And what did you do to confirm that, in fact, optionsXpress was satisfying whatever delivery obligation arose from your trading?
>
> A. I didn't confirm that.
>
> Q. Why?
>
> A. There was no reason to.
>
> Q. Why?
>
> A. Well, because if I have to buy back X number of shares and I buy them back, that's it. I'm done. Whatever happens on their end is up to them. I wasn't involved in that.
>
> Q. Did you make assumptions as to whether, in fact, they were complying with whatever delivery obligations arose from your trading?
>
> A. I assume that was the case, yes.

Tr. 4113:16-4114:8 (Zelezny).

The Initial Decision unsupportedly found that Mr. Feldman should have distrusted his brokers and sought "an independent opinion as to the legality of his activities" because optionsXpress profited from his trading. ID at 90. Brokers profit from every trade by every customer, and thus this is of no probative value. Moreover, optionsXpress is one of the largest

broker-dealers dedicated to options trading; it has been in business for 12 years; Mr. Feldman had no knowledge of any regulatory issues for optionsXpress of any sort; and this finding disregards that optionsXpress communicated restrictions to ensure compliance. *See* Tr. 3278:11-12 (Strine); *see also, e.g.*, OPX-EX-870, OPX-EX-871, OPX-EX-876. optionsXpress showed no reticence in limiting Mr. Feldman's trading—though it resulted in less commissions for optionsXpress—in order to comply with the rules.

The Initial Decision's finding that Mr. Feldman could not rely on his broker because he holds a degree in computer science and was a chief lending officer at a bank (and is thus "sophisticated") is similarly confounding. ID at 90. Mr. Feldman's 32-year old degree in computer science and experience in mortgage lending are not relevant to his ability to decipher exceedingly complex rules concerning back-office compliance by clearing firm participants.

Likewise, the Initial Decision's finding that Mr. Feldman should have sought independent guidance from regulators is unreasonable and based on a faulty factual basis. ID at 90. Individual retail customers are expected by the industry and by regulators to rely on their brokers, and Mr. Feldman had no means to confirm optionsXpress's representations concerning its interactions with regulators. Tr. 3262:20-22 (Sirri). Testimony from SEC, CBOE, and FINRA representatives confirmed that they would have refused to comment and would not have given Mr. Feldman guidance. Tr. 2889:2-14 (FINRA); Tr. 2932:2-5 (FINRA); Tr. 3909:25-3910:8 (CBOE); Tr. 2771:16-25 (FINRA); Tr. 3760:9-19 (SEC).

Mr. Feldman's inability to obtain reliable information from regulators is confirmed by his February 17, 2010 phone call with Division attorney Jill Henderson, who falsely told him that the Division was conducting an "informal inquiry." Tr. 2667:10-19, 2668:13-15(Feldman). In fact, a Formal Order of Investigation had already been issued when Ms. Henderson called Mr.

Feldman. Hearing Tr. 4784:23-4785:4. Moreover, Mr. Feldman was completely open and honest with Ms. Henderson about his trading and trading strategy during that call. Tr. 2347:14-2348:4 (Feldman). Had Mr. Feldman believed he engaged in any improper or deceitful conduct, he would not have readily and voluntarily spoken with attorneys from the Division.

In the fall of 2010, Mr. Feldman in fact consulted the preeminent authority concerning Reg SHO: Dr. Erik Sirri, who was the Commission's Director of Trading and Markets when Rule 204 was adopted. Tr. 3001:13-3002:2 (Sirri). Dr. Sirri gave a presentation to the Staff of the Division of Enforcement and opined that Mr. Feldman's trading was not improper, a presentation that Mr. Feldman was aware of. Tr. 3245:14-3246:14. If Mr. Feldman engaged Dr. Sirri in 2009 the answer would have been the same.

2. Regulators Did Approve, Showing Feldman's Reasonableness

Testimony showed that optionsXpress did in fact receive confirmation from the SEC and CBOE, further bolstering Mr. Feldman's reasonable reliance. *See* OPX-EX-89, OPX-EX-152 (letters from CBOE to optionsXpress finding no violation). The Initial Decision's finding that optionsXpress was not fully candid with the SEC or CBOE even strengthens the conclusion that Mr. Feldman was reasonable. *See* ID at 81. If the SEC and CBOE were not purportedly provided with enough information to analyze whether optionsXpress was compliant with Reg SHO, how could a retail customer be expected to reach a different conclusion?

Moreover, the evidence demonstrates that the regulators were in disagreement as to what Reg SHO required. FINRA and CBOE representatives testified at the hearing that the SEC staff told them that trading substantially identical to Mr. Feldman's trading did not violate Reg SHO. Tr. 3951:8-19 (Overmyer) (explaining that he was told at least 10 times by the SEC that the trading strategy did not cause violations of Reg SHO, and he eventually agreed because the SEC

wrote the rule); Tr. 3997:3-22 (MacDonald) (CBOE representative testifying that the SEC's mantra was that there was no violation of Rule 204 caused by the trading strategy); Tr. 2843:17-20 (Huber) (testifying that the SEC told FINRA that based on the facts optionsXpress presented, the SEC determined there was no violation of Rule 204 caused by the trading strategy); OPX-EX-675 at 1 (FINRA representative's contemporaneous notes from call with CBOE stating that the SEC told the CBOE that the buy-write trading was "not officially violating a rule").

A May 2009 GAO report corroborated the testimony from the CBOE and FINRA witnesses that there was general confusion among regulators concerning Reg SHO and no clear guidance. The GAO report found that the industry was "inconsistently implementing" Reg SHO and not receiving timely and clear interpretive guidance from the SEC. *See* Tr. 3745:16-3746:10 (Tao) (quoting the GAO report). It is thus impossible to ascribe to Mr. Feldman an understanding of Reg SHO given the general confusion in the industry and among regulators as to the meaning of this complex rule. *See* Tr. 3261:4-3262:14 (Sirri).

3. CBOE Order Compels Rejecting Initial Decision

The binding conclusions in the CBOE Order prohibit the Commission from adopting the inconsistent findings in the Initial Decision. The Commission definitively found in the CBOE Order that the CBOE misunderstood and misapplied Reg SHO and had incorrectly determined that optionsXpress did not violate Reg SHO. CBOE Order at 6-7. The CBOE Order points out that Reg SHO training is necessary for regulators because one cannot understand Reg SHO by simply reading the rules. *See* CBOE Order at 6; *see also Howard*, 376 F.3d at 1148 (even securities professionals "should not be 'expected to display finished scholarship in all of the fine points'" of securities law) (quoting *In re Charles C. Carlson*, 46 S.E.C. 1125, 1132-33 (1977)).

It is beyond cavil then that Mr. Feldman, a retail customer, could know that optionsXpress was purportedly violating Reg SHO when optionsXpress's own regulator did not.

Moreover, the binding conclusions in the CBOE Order conflict with the Initial Decision's heavy reliance on CBOE witnesses. The Initial Decision relied heavily on testimony by CBOE witnesses, whom it found to be "experienced" regulators who "believed strongly" that the trading "was illegal, harmed option market makers, and that regulatory action as needed." ID at 79. In light of the binding finding that CBOE utterly failed in every material respect concerning its oversight, the Initial Decision's reliance on CBOE witnesses to find that Mr. Feldman's trading caused a Reg SHO violation must be rejected *in toto*.

4. Initial Decision Misconstrues Feldman's Comments

Against the sea of exculpatory evidence, the Initial Decision misconstrues a few statements by Mr. Feldman to support its finding of scienter. These statements are taken wholly out of context and do not support the Initial Decision's findings, as explained below:

- Mr. Feldman's lack of response to a blogger that asked him how he "got around" being bought-in. ID at 90. Explanation: There is no evidence in the record that Mr. Feldman saw the post, and his failure to respond to an anonymous poster is not evidence of his knowledge or scienter. *See* Tr. 2339:24-2340:11 (Feldman).

- An early 2010 e-mail Mr. Feldman sent to a friend concerning Yahoo! Message Board comments regarding trading volume spikes. ID at 91. Explanation: Given the timeline of events, the comment was a joking reference to the SEC's prior inquiry to optionsXpress regarding the trading strategy, which Mr. Feldman knew at that point had ended with the SEC's finding that the trading did not cause violations of Reg SHO. *See* Div. 29.

- An e-mail to an optionsXpress employee asking him to do the same order as the day before and stating that the same "applies tomorrow." ID at 90. Explanation: As explained above, there were periods where Mr. Feldman knew he had a very high likelihood of assignment, and he was indicating that if he was assigned the next day, he wanted to place a buy-write. This statement is innocuous, and it does not indicate whatsoever that Mr. Feldman knew delivery was not occurring.

- E-mail correspondence from Mr. Feldman to his broker at Terra Nova discussing "rolling" and "avoiding settlement." ID at 90. Explanation: There is unrebutted testimony that

Mr. Feldman had entered into an arrangement with Terra Nova wherein he would not have to pay HTBs if he bought to cover his position on the day after he sold the call (T+1) and did not wait until the settlement date (T+3). Thus, the Initial Decision's finding ignores the unrebutted testimony that Mr. Feldman was not referring to avoiding delivery in these e-mails, but rather was referring to a measure of time within which he would not have to pay HTBs. *See* Tr. 2480:22-2481:18 (Feldman); Tr. 893:13-23 (Crain); Div. 212 (Internal Penson e-mail stating that "[t]hey [Terra Nova] are covering this the day that they get their assignment report so they are processing these as we agreed."); Div. 296 at 3 ("he has already covered the short that we say that we are buying him in on is what they are saying which is correct.").

- A statement from Mr. Feldman that he was entering and canceling orders repeatedly. ID at 91. Explanation: This statement was referring to opening new positions and is no way related to buy-writes or market confusion. *See* Div. 89 at 2-3.

- Mr. Feldman's complaints concerning the high commissions charged after he began trading again at optionsXpress. ID at 90. Explanation: This in no way evidences scienter, but rather simple pricing pressures. Mr. Feldman felt that the commission rates were too high because he placed the same types of trades repeatedly and thus his trading did not consume a great deal of optionsXpress's employees' time. Tr. 2181:14-2182:4, 2183:8-15.

5. Receipt of *Hazan* Settlement Assured Feldman of Compliance

The Initial Decision erroneously relies on the *In the Matter of Hazan Capital Management, LLC et al.* settlement for finding scienter, but the facts surrounding Mr. Feldman's learning of *Hazan* demonstrate his good faith. Mr. Feldman received the *Hazan* settlement and other materials concerning Rule 204 immediately prior to his being told explicitly by senior executives and compliance officers at optionsXpress that the SEC had reviewed the trading strategy and found no problems with it. *Compare* OPX-EX-888 (9/23/09 email sending *Hazan* settlement to Mr. Feldman) *with* OPX-EX0890 (9/27/09 email from Mr. Bottini confirming the SEC had reviewed the trading). Mr. Feldman immediately recognized several distinguishing factors between his trading and the trading in *Hazan*:

> I do have some questions which I would like to discus with you. (One of the main ones is, the fact that they were creating these "FLEX" options which in essence had 1-day expiration, was really very different, as they wanted them to be assigned or exercised. We are of course selling legitimate listed standard options, and, in fact, many times they do not get assigned 100%. (In fact, some of my Oct 20's were left open, unassigned) In many instances, (thinking back to the AIG

> options in AUG) they are assigned only 50-80%. I assume this is thus very legitimate, and is indeed [m]ore arms length than those "FLEX" options. (Never heard of those). Additionally, they were claiming a market maker exemption[.]

OPX-EX-888.

Mr. Feldman's analysis in fact was correct. The Respondents' use of the FLEX options in *Hazan* was especially significant because it also indicated they were colluding with the counterparty to create these "sham resets," a fact not even alleged here. Tr. 3345:8-23, 3346:5-3348:1 (Strine) (unlike the optionsXpress customers, the counterparties were conspiring to perpetuate this activity and knew there would be no delivery).

The term "sham reset" is an undefined characterization, but a sham transaction of any sort requires the collusion of both parties to generate an appearance that is not the actual economic substance. *See, e.g.*, *Yoshikawa v. S.E.C.*, 192 F.3d 1209, 1212 (9th Cir. 1999) (in a sham parking transaction a firm sold stock from its own account to a customer under an agreement that the firm will buy back the stock once it has filed its report with regulators); *Regents of University of California v. Credit Suisse First Boston*, 482 F.3d 372, 377 (5th Cir. 2007) (off-balance sheet transactions to distort Enron's revenue required that both the reporting company and the counterparty agreed to the sham); *In re Charter Communications, Inc. Securities Litigation*, 443 F.3d 987, 989-990 (8th Cir. 2006) (describing sham roundtrip transaction designed to inflate cash flows). Indeed, the settlements relied on by the Initial Decision and other "sham" transactions are strikingly dissimilar to this action. All of these settlements involved arrangements between market makers trading on their own accounts —now expressly prohibited by Rule 204(f)—with the sole purpose of avoiding stock delivery. No one even alleged that any such arrangement existed here.

Also of note, the Initial Decision relies heavily on other regulatory actions and

pronouncements, none of which Mr. Feldman was aware of, including *In the Matter of Scott H. Arenstein* and *In the Matter of TJM Proprietary Trading LLC et al.* ID at 83. Thus, while it may have appeared to compliance professionals in the industry that there were a string of similar settlements bearing on the issues presented, it did not appear that way to Mr. Feldman. Moreover, these settlements were different for the same reasons that *Hazan* was.

The Initial Decision also focuses heavily on the testimony of witnesses concerning fails-to-deliver in the CNS system, internal discussions among various backroom compliance personnel at optionsXpress and Penson, and regulatory guidance given to industry insiders to find that optionsXpress had violated Reg SHO. ID at 13-17, 76-84. Mr. Feldman had none of this information. At best, Mr. Feldman received bits of information, all of it reflecting (correctly) that optionsXpress was compliant.

D. Feldman Engaged in No Deception

The finding that Mr. Feldman was open and honest undermines the Initial Decision's finding of fraud. A finding of fraud requires some proof of deception, and "broad as the concept of 'deception' may be, it irreducibly entails some act that gives the victim a false impression." *Finnerty*, 533 F.3d at 148; *see also Santa Fe Indus., Inc. v. Green*, 430 U.S. 462, 473-74 (1977) (where manipulation is not at issue, deception is required to prove a Section 10b-5 violation). Indeed, the mere execution of a trade (even if it has an improper purpose, which is not the case here) cannot establish a Section 10(b) violation. *Finnerty*, 533 F.3d at 149. It must be accompanied by some misleading impression or statement. *Id.*

1. Strategy Did Not Cause or Depend on Reg SHO Violations

The Initial Decision is based on the flatly wrong conclusion that Mr. Feldman caused and profited from Reg SHO violations. The unrebutted evidence establishes that Mr. Feldman had

no delivery obligation under Reg SHO and no control over optionsXpress's delivery, and thus he correspondingly could not and did not "cause" optionsXpress' purported Reg SHO violations. Sirri Report, ¶¶75, 80-81. The substantial unrebutted evidence also establishes that Mr. Feldman's success or failure in his strategies did not depend on whether or not optionsXpress complied with Reg SHO. Mr. Feldman made a profit utilizing the same strategy at Penson/Terra Nova, E*TRADE, and TD Ameritrade, though there is no allegation that those firms violated Reg SHO. Tr. 2386:12-19 (Feldman); *see also* Tr. 4831:22-4832:8 (Mikus) (E*TRADE did not have a Reg SHO violation or fails-to-deliver as a result of Mr. Feldman's trading). On that point, the Initial Decision erroneously states that E*TRADE felt that Mr. Feldman did not meet his obligation to satisfy his short position when assigned. ID at 80. In fact, the E*TRADE representative testified that there was nothing about Mr. Feldman's trades that was violative of a rule and at no time did Mr. Feldman fail to comply with his obligations to E*TRADE. Tr. 4831:22-4832:4; 4834:3-6. (Mikus).

The Initial Decision's heavy reliance on Dr. Harris and Dr. Sheehy is misplaced because, among other reasons, they wrongly assumed that it was the customer who would automatically pay the HTBs and that Mr. Feldman placed buy-writes to "extend his short-term positions so that he could avoid paying the hard-to-borrow stock loan fees." Harris Report, Div. 310, ¶31 (emphasis added). This fact is simply false, and opinions based on it are consequently inherently flawed.

Because of optionsXpress's business model, Mr. Feldman would not have had to pay HTBs regardless of whether optionsXpress borrowed, a fact that did not enter these experts' analysis. Tr. 977:1-11, 978:4-21 (Sheehy); Tr. 1536:1-5 (Harris). When confronted with these facts, Dr. Harris agreed that Mr. Feldman would have made the same amount of money whether

or not his broker complied with Reg SHO:

> Q. And [Mr. Feldman] would have netted that amount whether his broker-dealer had delivered shares to the CNS system, right?
>
> A. That's correct.
>
> Q. And so, from Mr. Feldman's perspective, whether or not delivery occurred in the CNS system, had no effect on the amount of profit from the strategy, correct?
> A. That's correct.
> . . . .
>
> Q: Well, then I'll put it differently. The avoidance of delivery is not what made Mr. Feldman a profit then, correct?
>
> A: That's correct. If the shares had been delivered and the arrangement with optionsXpress remained as it was, as you represented it, then Feldman would have made these profits.

Tr. 1556:6-13 (Harris).

To be sure, optionsXpress agrees Mr. Feldman's strategies would not have been affected even if optionsXpress had to pay to borrow shares to comply with Reg SHO:

> Q. So based on [the Division's] theory of what Reg SHO requires that you understood, sitting here today and why we're here, you could have taken a step that would have been compliant that Mr. Feldman wouldn't even been aware of, correct?
>
> A. Correct.
>
> Q. So his trading could have occurred precisely the way it did and he would have made whatever profit or suffered whatever loss that he did, irrespective of whether optionsXpress took action consistent with what the Division alleges is required by Reg SHO or not?
>
> A. Correct.

Tr. at 3456:24-3457:11(Strine) (emphasis added). And Mr. Feldman had no ability to control or restrict which alternatives optionsXpress selected to comply with Reg SHO, as confirmed by witnesses from the SEC's Division of Trading and Markets:

> Q. And the broker-dealer no matter how frequent the trading was or how frequent

> the buy-writes were, the broker-dealer could have taken different alternatives to comply with those obligations [under Reg SHO], right?
>
> A. Yes.
>
> . . . .
>
> Q. And those alternatives were alternatives that it could choose on its own, right?
>
> A. To purchase or to borrow, yes.
>
> Q. And your understanding, at that time, as you had this communication, is that the customer had no ability to restrict which alternative optionsXpress may or may not take, right?
>
> A. Well, it's the broker-dealer's requirement.

Tr. at 3773:7-12, 3775:5-12 (Tao).

The extended periods that Mr. Feldman was not assigned in various stocks also demonstrate that his trading strategy was not the cause of any alleged Reg SHO violations. The Division selected periods and stocks that had a high-incidence of assignments for inclusion in the Order Instituting Proceedings while ignoring the fact that Mr. Feldman executed his strategy in 14 other issuers and was not assigned for extended periods of time. Sirri Report, ¶138; Tr. 2401:4-24015:15 (Feldman). Even for the issuers at identified in the Initial Decision, no two stocks had the same rate of assignment, with some stocks having no assignments 73% of the time while others had no assignments 25% of the time or 3% of the time:

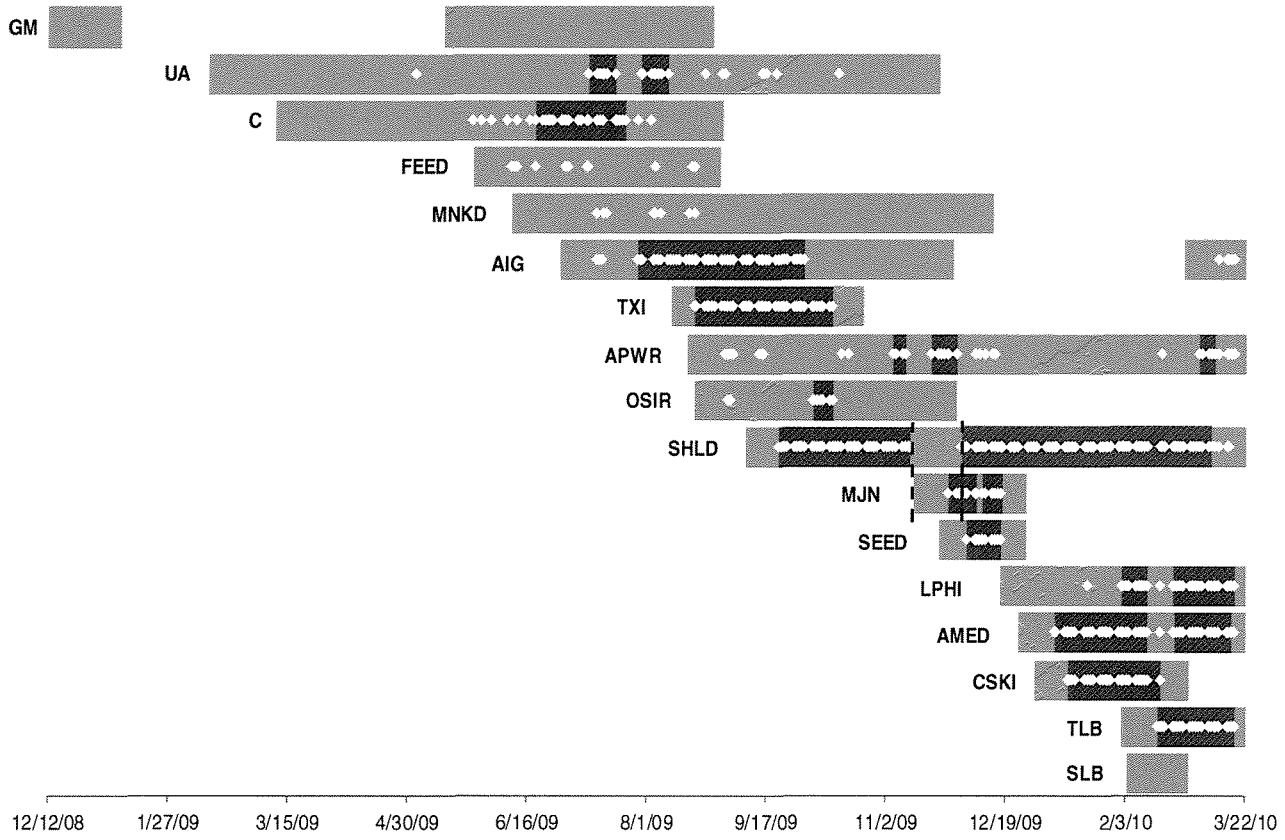
Distribution of Buy-Write Calls Assigned on the Day of Issue

Security	Written Calls Assigned in Full	Some Written Calls Assigned	No Written Calls Assigned
AIG	43%	54%	3%
AMED	55%	43%	2%
APWR	23%	55%	23%
CSKI	86%	5%	9%
C	61%	37%	2%
FEED	0%	27%	73%
GM			
LPHI	66%	25%	9%
MJN	57%	43%	0%
MNKD	63%	13%	25%
OSIR	67%	33%	0%
SEED	90%	10%	0%
SHLD	65%	32%	3%
SLB			
TLB	77%	23%	0%
TXI	71%	24%	5%
UA	33%	50%	17%

Sirri Report, Exhibit 13.

Even worse, the Initial Decision ignores that the Division cherry-picked the data by only including limited date ranges for Mr. Feldman's trading strategies, not the full date range of trading dates. This selection skewed the evidence to make it appear that the assignments were far more frequent and predictable:

Periods of Interest Identified in the Order are Not Representative of Mr. Feldman's Overall Trading Record



Source: optionsXpress records for Mr. Feldman's account; Order
Note: The dark blue area indicates the date range listed by the Division in the Order, while the light blue indicates the full range of trading dates. The white marks indicate buy-writes. The vertical dashed lines indicate the time period when some positions were temporarily transferred to broker-dealer Terra Nova.

Sirri Report, Exhibit 16, ¶138. This selective use of data to support the fraud findings is beyond unreasonable.

The Initial Decision similarly ignores that Mr. Feldman was often only partially assigned or not required to buy-in at all though he was assigned. Sirri Report, Exhibit 13; *see also*Tr. 343: 13-24 (Molnar). If Mr. Feldman was assigned but optionsXpress had the stock in inventory or could borrow it, it would take no action and Mr. Feldman could remain short, a circumstance that commonly occurred while Mr. Feldman traded at optionsXpress. Tr. 343: 13-24 (Molnar). The Division's expert witness conceded that Mr. Feldman's trading did not result in a 100% assignment rate. Tr. 4982:6-17, 4982:22-4983:1 (Harris). Even assuming mapping to an

individual customer was possible, it is indisputable then that Mr. Feldman's strategy did not always result in delivery failures. Thus, it could not have Mr. Feldman's strategy that "caused" fails-to-deliver or any purported violation of Reg SHO.

2. Strategy Involved No Collusion or Price Manipulation

It is undisputed that Mr. Feldman's trading involved no collusion with any counterparty. *See* Tr. 636:6-19 (Coronado); Tr. 1219:22-25 (Stella); Tr. 1318:9-20 (Lapertosa). It is undisputed that Mr. Feldman did not know who the counterparties to his trades were. *See* Tr. 636:15-637:11 (Coronado); Tr. 1219:22-25 (Stella); Tr. 1318:9-20 (Lapertosa); Sirri Report, ¶61. Nonetheless, the Initial Decision made the false analogy to wash trades and match orders based on the erroneous belief that they do not involve price manipulation. ID at 92.

The purpose of wash trades and matched orders is to artificially affect market activity to either increase or decrease stock prices. *Schreiber v. Burlington Northern, Inc.*, 472 U.S. 1, 6 (1985); *see also Santa Fe Indus.*, 430 U.S. at 476 (practices such as wash sales and matched orders "are intended to mislead investors by artificially affecting market activity."). It is undisputed and acknowledged by the Initial Decision that Mr. Feldman's trading did not affect the price of the stock and was not intended to manipulate stock price. *See* ID at 90; Tr. 4425:1-25 (Saha); *see also* Saha Report, OPX-EX-248 at 38-39 (confirming that economic analysis showed that the stock prices were not adversely affected by the trading); *see also* Harris Report, ¶39.

Matched orders and wash trades are also sales for the same security, in the same size, and at the same price. *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 205 n.25 (1976) (matched orders are "orders for the purchase sale of a security that are entered with the knowledge that orders of substantially the same size, at substantially the same time and price, have been or will be entered

by the same or different persons for the sale/purchase of such security"). Mr. Feldman's buy-write orders were not matched orders or wash sales: the writing of the call was not a transaction in the same security because it was a call option, not the underlying equity security. Moreover, the calls were not always options for the same number of shares bought (for example if Mr. Feldman was partially assigned) and were not at the same price as the buy.

More important, unlike wash sales and matched orders, Mr. Feldman's buy-writes had a legitimate economic purpose. The buy satisfied Mr. Feldman's buy-in requirement and the written call reestablished Mr. Feldman's hedge, thus offering a legitimate means to reduce risk in Mr. Feldman's options strategy. Sirri Report, ¶54. The strategy exposed Mr. Feldman to risk of loss, the "hallmark of any legitimate economic strategy." Tr. 4408:8-15 (Saha). In contrast, wash sales and match orders have no legitimate economic purpose—the actual trade is meaningless and exists only to manipulate the market.

Finally, Mr. Feldman's buy-writes were not analogous to wash trades and matched orders because wash trades and matched orders involve conduct that is inherently deceptive and not dependent on the violation of another rule. Here, the purported fraud resulted from knowingly failing to deliver in violation of Reg SHO. If optionsXpress did not violate Rule 204, then there can be no fraud even if there were CNS fails-to-deliver. Tr. 3061:16-3062:10 (Sirri). The Initial Decision found that it was Mr. Feldman's submission of orders that he knew would result in a violation of Reg SHO that was allegedly fraudulent. ID at 88. This is not analogous at all, because the perpetration of wash trades and matched orders is fraudulent alone whether or not other securities rules are violated. This is especially relevant to Mr. Feldman's liability, because his liability for fraud is dependent on the interpretation of Rule 204, a complex rule that even regulators misunderstood.

3. Others' Executing Same Strategy Impacted Delivery

The Initial Decision ignores that others were using buy-writes in response to in-the-money call option assignments both at optionsXpress and at other firms. Tr. 4769:14-4770:2 (Lamm); Tr. 4108:7-4109:7 (Zelezny). The Division singled Mr. Feldman out—he is the only customer charged as a result of this trading strategy—though many others were engaged in it. The ALJ's decision to overlook the other traders engaged in this strategy is no minor oversight. Because CNS delivery is accomplished on a net basis for each firm, it is impossible to tell which supposed delivery failures occurred as a result of Mr. Feldman's trading and which occurred as a result of other customers' trading. Sirri Report, ¶¶87, 126-127; *see also* Tr. 3264:3-8 (Sirri). By ascribing all of optionsXpress's fails-to-deliver in the securities at issue to Mr. Feldman, though other customers were engaged in the same trading, the ALJ holds Mr. Feldman to account for alleged violations that (under her flawed theory) other customers "caused."

4. No Deception of Broker Precludes Rule 10b-21 Charge

The Initial Decisions' conclusion that Mr. Feldman violated Rule 10b-21 is completely inconsistent with its earlier findings that Mr. Feldman did not deceive his broker-dealer. ID at 44, 93. Rule 10b-21 applies in the exceptional circumstance in which a seller provides affirmative assurances to the broker-dealer and thus "elects to provide its own locate source to a broker-dealer." Rule 10b-21 Adopting Release at 61671 (emphasis added); *see also* Sirri Report, ¶127. The ALJ found as a matter of fact:

> Feldman never represented to optionsXpress that he had the ability to deliver shares, and he purchased shares every time optionsXpress required him to do so.

ID at 44. Moreover, Rule 10b-21 only applies to submitting orders to sell, not options assignments. Finally, the ALJ wholly disregarded Dr. Sirri's opinion, as well as testimony from the Commission's General Counsel when the rule was proposed, that a violation of Rule 10b-21

requires deception of the broker-dealer. *See* Div. 401 at 9 ("a key element to establish the primary violation [of Rule 10b-21] is that the broker/dealer was deceived").

E. Marketplace Neither Deceived nor Harmed

The Initial Decision ignores the unrebutted evidence that the marketplace fully understood the trading strategy at issue based on publicly available information. This evidence conclusively proves that no one was deceived or harmed by the strategy. The marketplace had full view of the strategy via the reporting of "open interest" and the volume of written calls. The open interest in the call options showed the number of contracts each day that remained open and were not closed through exercise or otherwise. *See* OPX-EX-916(d) at 3-7. Through this daily report, the marketplace was aware of high-volume trading and frequent same-day exercise of the written calls. Tr. 1327:6-23 (Lapertosa) (testifying that anyone in the marketplace could look at the open interest and see the frequent opening and closing of the in-the-money calls). For example, data showed that on one day, 3,755 calls were written on a security, but only 395 remained unexercised that night; thus, most had been exercised on the date written. *See* OPX-EX-916D at 3.

There is similarly no evidence in the record that anyone in the marketplace suffered any harm as a result of Mr. Feldman's trading. Analysis of trade data showed that optionsXpress timely cured any CNS fails-to-deliver somewhere between 99.3% and 99.8% of the time. Tr. 4390:24-4391:3 (Saha). Thus, assuming *arguendo* any fails could be mapped to Mr. Feldman, his trading might have resulted in delayed delivery an insignificant percentage of the time. Moreover, the trading had no impact on market integrity and share prices, voting and dividend rights were not affected, and the counterparties to these trades continued to place these orders knowing the trading practices involved. Tr. 113:23-114:2 (Colacino); Tr. 4429:4-9, 4431:20-23

(Saha); Tr. 1551:12-1547:5 (Harris) (testifying that he had no data to support statement in his expert report that Mr. Feldman's trading undermined market integrity because market participants would have not traded or negotiated lower purchase prices).

Further, though Mr. Feldman was not privy to it, the marketplace could similarly view the number of fails-to-deliver at CNS in every security on the SEC's own website. *See* Tr. 3473:14-3474:17 (Strine). This is in addition to the fact that the clearing firm participants themselves were aware every day of their own CNS positions.

Of note, the existence of fails-to-deliver do not evidence harm to the market, nor does a "fail-to-deliver" mean that there was necessarily a "fail-to-receive." Sirri Report, ¶62, n.29.

> There is no relationship between the failing to deliver a party in CNS to the failing to receive party in CNS. So, once you initiate that intent, your priority level goes up, and basically if there is any allocations made, you are going to go to the top of the list to receive shares.

Tr. 141:3-9 (Colacino). Likewise, it is unremarkable for a clearing member to have fails-to-deliver at CNS, and there are countless and commonplace circumstances in which CNS fails-to-deliver persist for consecutive days without violating Reg SHO. Sirri Report, ¶78; OPX-EX-937 (showing that in October 2008 there were 130,910,534,495 fails-to-deliver in the CNS system); Tr. 4961:18-4962:2 (Harris). Rule 204 allows for delivery on T+3 or purchasing or borrowing on T+4, which means that delivery can occur consistent with Reg SHO on T+7. *See* Siri Report, ¶78. Thus, no purchasers had a basis to expect shares would be delivered on T+3.

F. optionsXpress Had Total Control and Responsibility

The Initial Decision is legally defective under *Janus*. In *Janus*, the Supreme Court held that a person must have control over a misleading statement to be a primary violator. *Janus* 131 S. Ct. at 2301-2302. The *Janus* Court determined that to "make" means having "ultimate control" over the allegedly misleading statement, including its content and dissemination. *Id.* at

2301-2302 ("Without control, a person or entity can merely suggest what to say, not "make" a statement in its own right"); *see also In the Matter of Flannery et al.*, Adm. Proc. File No. 3-14081 (Initial Decision Dated Oct. 28, 2011) (applying the *Janus* standard to charges brought under Section 10b of the Securities Exchange Act and Section 17(a) of the Securities Act).

optionsXpress bore complete responsibility for delivery and assumed the obligation to deliver shares *in toto*. Correspondingly, optionsXpress gave itself complete control over Mr. Feldman's account so that it could take any action necessary to comply with Reg SHO. *See* Tr. 335:13-19 (Molnar); Tr. 639:14-18 (Coronado); Tr. 1223:21-1224:4(Stella); Div. 98 at 5-6 (emphasis added); Tr. 251:1-22 (Risley); Tr. 2077:7-10 (Payne) (optionsXpress would not have allowed Mr. Feldman to take actions inconsistent with Reg SHO). To be sure, Mr. Feldman's agreement with optionsXpress gave it complete authority regarding whether to allow a short sale and whether to do a buy-in (with or without Mr. Feldman's consent). Div. 98 at 5-6 (emphasis added). Mr. Feldman's lack of control was further confirmed by experts for both the Respondents and the Division. *See* Tr. 1497:25-1498:3 (Harris). Similarly, the Division's witness from the SEC's Division of Trading and Markets agreed that optionsXpress could have complied with Reg SHO by either purchasing or borrowing stock; neither option required approval from the customer. *See* Tr. 3773:7-12, 3775:5-12 (Tao) (agreeing that no matter how frequent the buy-writes the broker-dealer could have chosen different alternatives to comply with their obligations, and it was the broker-dealer's requirement not the customer's).

The Initial Decision found that Mr. Feldman made a representation by submitting a trade order, but he had no control over its dissemination because optionsXpress had control over his account and complete control over settlement. Mr. Feldman had no control over the alleged instruments of deception, and thus he cannot be a primary violator.

G. No Violations of Reg SHO by optionsXpress

1. Dr. Sirri's Unrebutted Testimony that Buy-Writes Satisfied Rule 204

The Initial Decision baselessly ignores the credible testimony of Dr. Erik Sirri, the only expert who testified at the hearing as an expert on Reg SHO. Dr. Sirri is the former Chief Economist for the Commission and the former Director of the Commission's Division of Trading & Markets, the Division that drafted and implemented Rule 204 and Rule 10b-21 under his leadership. *See* Tr. 3007:19-3008:2, 3226:16-3227:1 (Sirri). As such, Dr. Sirri is one of the preeminent experts on compliance with Reg SHO and the application of Rule 10b-21. By contrast, the Division offered the expert testimony of Dr. Harris, who readily acknowledged that he was not an expert on Reg SHO. *See* Tr. 1485:18-22, 1619:14-1620:4 (Harris) (Dr. Harris is not "closely familiar" with Rule 204, has "no specific knowledge" of whether conduct is permissible under Rule 204).

Dr. Sirri provided credible and clear testimony that debunked critical misunderstandings and misinterpretations of Reg SHO on which the Division based its charges. The Initial Decision, however, disregarded Dr. Sirri's testimony, despite the fact that the core of Dr. Sirri's analysis and expert opinions concerning Reg SHO went unrebutted:

- Reg SHO compliance is the measure of whether delivery of shares occurs in a timely manner. Sirri Report, ¶75.
- Mr. Feldman's trading did not cause a Reg SHO violation. Tr. 3217:8-3218:20 (Sirri).
- Reg SHO permits delivery after T+3, until at least T+7 or later, under common circumstances. Sirri Report, ¶78.
- A CNS fail-to-deliver, even if for multiple consecutive days, does not mean that the clearing member violated Reg SHO. *Id.*

The Initial Decision's finding that optionsXpress violated Reg SHO rests on the

erroneous assumption that the buy-writes were "shams" that did not satisfy a broker's Rule 204 close-out requirement. ID at 84. As Dr. Sirri testified, however, the "buy" portion of the buy-write satisfied the closeout requirements of Rule 204 under any plain language reading of the rule. *See* Tr. 3176:20-24; 3186:19-23 (Sirri).

The Division presented no evidence to contradict Dr. Sirri's opinion that the buy-writes complied with Reg SHO because Reg SHO does not require the broker-dealer to clear up its CNS position:

> But the thing that's notable here it [Rule 204(a)] doesn't require the broker to make progress on its CNS position. That's not what it says. You could have said that. It could have been written in terms of CNS. It talks about delivering shares.
> . . . .
> The requirement of SHO isn't that it change your CNS delivery position. The requirement is that you buy shares of like kind and quantity. And those shares of like kind and quantity and were bought when a buy-write is executed.

Tr. 3176:20-25, 3186:19-23 (Sirri) (emphasis added).

The Initial Decision erred in finding that Dr. Sirri testified that whether a buy-write causes Reg SHO is an unresolved issue. ID at 69. Dr. Sirri's testimony was unequivocal that a buy-write satisfies a broker's delivery obligation under Reg SHO and remains unrebutted by the Division. *See* Tr. 3217:20-24 (Sirri) ("you buy securities of the like kind and quantity, you execute the buy-write, you purchase the shares, therefore you've satisfied your obligation under SHO."). The simultaneous writing of a call does not negate that the shares were bought as required by Reg SHO. Tr. 3218:12-20 (Sirri). Thus, the buy-in satisfied Rule 204, and there was no delivery failure under Reg SHO. *Id.* Because Reg SHO permitted the buy-writes, no one could have been deceived by them because they were not violative of any rule. *See* Tr. 3061:16-3065:10 (Sirri).

The Initial Decision also ignores other key testimony by Dr. Sirri, including that (1) it is

impossible to map a particular customer's trading to deliveries at CNS, and thus it is impossible to determine if Mr. Feldman's trading caused a Reg SHO violation; and (2) had Mr. Feldman been optionsXpress's only customer (*i.e.*, if mapping were not necessary because only his trading occurred), his trading would not have caused a violation of Reg SHO. Tr. 2999:2-13, 3217:8-24 (Sirri). The inability to map CNS fails to a particular customer is significant because it means that the Division could not possibly have shown that it was Mr. Feldman's trading that was causing the CNS fails. For example, the Division alleged that optionsXpress had 238 "consecutive fails at CNS" in SHLD stock between April 8, 2009 and March 18, 2010. Division's Findings of Fact ("DFOF") at 19-20. The Division argued that "the buy-writes were not done on T+1, they were done on T+6, T+10, or T+227." Division Post-Hearing Brief ("DPB") at 17. It is not possible, however, that Mr. Feldman's trading caused these 238 days of CNS fail-to-delivers, or even 227 days of CNS fails, because Mr. Feldman's first buy-write in SHLD was placed in October 2009. *See* OPX-EX-834 at 105; Sirri Report, Exhibit 16. It is impossible then that Mr. Feldman's trading caused the 238 "consecutive fails at CNS" because that number includes trading in SHLD for almost six months prior to when Mr. Feldman began executing buy-writes in SHLD. The SHLD trading demonstrates that it is impossible to show which fail-to-delivers occurred as a result of Mr. Feldman's trading versus other customers' trading—in truth, the answer to both is "zero."

2. optionsXpress' Books and Records Determine Reg SHO Compliance

The Initial Decision erred in relying on the evidence of CNS fails-to-deliver on CNS reports instead of optionsXpress's books and records. When determining whether a broker bought securities to comply with Rule 204's closeout requirement, the appropriate inquiry is to look to the broker's books and records, not its CNS position:

> [T]o meet its close-out obligation a participant also must be able to demonstrate on its books and records that on the applicable close-out date, it purchased or borrowed shares in the full quantity of its fail-to-deliver position and, therefore, that the participant has a net flat or net long position on its books and records on the applicable close-out date.

74 Fed. Reg. 38266, 38272 (emphasis added). Dr. Sirri explained during the hearing:

> [The Rule] speaks to, it speaks to the books and records of the broker-dealer. It does not speak to the net position at CNS. The rule has explicitly not put the requirement on to flatten yourself at CNS at the end of the day.

Tr. 3215:21-25 (Sirri).

The Initial Decision's focus on CNS fails-to-deliver was also incorrect because it is commonplace to have a CNS fail-to-deliver even though the customer has already been bought in and is net flat:

> [W]e have to execute trades today that take three days to settle. A customer can sell today and buy tomorrow. Neither trade has settled yet, because those trades take three days to settle. When that [sale] settles, the customer will appear 100 shares short. The firm could appear to have a fail of a hundred shares, but the customer is already flat, and there is nothing for us to execute next. So then the next day when his buy settles, then we flatten out at CNS at well.

Tr. 372:24-373:10 (Tortorella) (emphasis added). Because CNS is a net, continuous system and delivery does not occur for three days after the trade date, it is possible to have what look like "continuous" fails-to-deliver at CNS without violating Reg SHO. *Id.* It is frequently impossible to tell if a fail-to-deliver originated on the date of the report or is a fail-to-deliver that has existed for days. *Id.*; Tr. 90:9-91:25 (Colacino).

Dr. Saha explained that the number of days of CNS fails is irrelevant, because a fail-to-deliver in a particular stock could appear on the books at CNS not because it remained uncured, but because new fails arose:

> JUDGE MURRAY: So you would say that the CNS, the number of days of CNS fails is really irrelevant?

> THE WITNESS: Exactly.
>
> . . . .
>
> THE WITNESS: It is a quotation straight out of SEC's web site says: From looking at the fail number, you cannot determine the age of the fail or the source of the fail as it's clear here, too. Here we know where they're coming from because you have the assignment date and trade date and all that data. But if you just had the data on CNS fails which is the last row, you wouldn't know what's going on. All you see is negative thousand, negative 500, negative 500, et cetera. And yet the key point is this fail is happening or staying in the books at CNS not because the thousand fail was uncured, but because new fails arose.

Tr. 4399:9-12, 4399:20-4400:7 (Saha) (emphasis added); *see also* Ruth Report, OPX-EX-250, ¶¶3, 36 (testifying that the evidence showed the fails-to-deliver at CNS were new fails because the data showed that "optionsXpress owed stock to different contra-parties on a daily basis, indicating that deliveries were being made."); Tr. 85:25-86:20, 91:9-25, 118:9-119:1 (Colacino). It is impossible to tell from the CNS reports whether a firm is net short from that day or because of a prior day's trading. Tr. 89:25-90:17 (Colacino). Thus it is impossible to tell if a fail-to-deliver originated on the date of the report or is a fail that has existed for several days. Tr. 90:9-91:2 (Colacino). For all these reasons, the Initial Decision's focus on fails-to-deliver at CNS in order to determine whether optionsXpress violated Reg SHO was improper.

The unrebutted evidence at the hearing showed that optionsXpress's books and records showed that "in more than 99.3% of the cases, the short stock positions (resulting from assignments) were cured by the end of T+3 through legitimate purchases of the stocks by the customers." OPX-EX-248 at 32. Thus, optionsXpress responded to its CNS failures-to-deliver by timely purchasing stock on T+4 in accordance with the plain language of Rule 204(a).

H. Disgorgement and Sanctions Unsupported

The disgorgement amount awarded by the Initial Decision is not a reasonable approximation of the amount Mr. Feldman profited from alleged delivery failures and does not comply with Rule of Practice 600(a). Moreover, the disgorgement figures are inherently wrong

because they are based on the false foundation that Mr. Feldman avoided HTBs. Tr. 1555:9-17 (Harris).

The evidence showed that optionsXpress timely delivered under Reg SHO between 99.3% and 99.8% of the time. Tr. 4389:1-4391:4 (Saha). Thus, even if mapping customers' trades was possible, only .7% of Mr. Feldman's trading profits could possibly have been attributable to delivery failures. The disgorgement and sanctions based on 100% of profits is thus unsupportable. *See S.E.C. v. Robinson*, 00 CIV.7452 RMB AJP, 2002 WL 1552049, *9 (S.D.N.Y. July 16, 2002) (the SEC's disgorgement figure was not reasonable because it did not present evidence that the amount only included funds from defrauded investors). Moreover, the Initial Decision inexcusably did not specify the violations that form the basis for the disgorgement amount or the amount for each violation as required by Rule 600(a) and due process. Indeed, the Division did not present evidence during the hearing of which of Mr. Feldman's transactions resulted in fails-to-deliver (and thus purportedly violated the securities laws). Given the impossibility of mapping, no evidence could be presented. The Initial Decision's disgorgement sum is thus not based on any actual violations, or even on Mr. Feldman's buy-writes, but rather is a purely speculative figure.

The Initial Decision's reliance on Dr. Harris' calculation of Mr. Feldman's expected profits between December 2, 2009 and March 18, 2010 is patently flawed because this calculation is based upon a 100% assignment rate and 100% fail-to-deliver rate, which Dr. Harris admitted was in error:

> Q. So this analysis assumes 100 percent delivery failure every day for all these trades, correct?
>
> A. Yes.
>
> Q. And we know that's false, don't we?

A. Yes, it wasn't 100 percent. I don't personally know that, but I can't imagine that it was.

Q. Because, in fact, even based on whatever logic you're employing, there was not 100 percent assignment to Mr. Feldman for his calls, correct?

A. That's correct.

. . . .

Q. And you didn't do any analysis to determine what amount should that 100 percent be reduced by, did you?

A. So the question -- the answer is no, but I don't believe such analysis was necessary.

Tr. 4982:6-17, 4982:22-4983:1 (Harris). Incredibly, the ALJ notes that Dr. Harris' recalculated profit estimate is unreliable because it assumes 100% delivery failure, but she relied on it anyway. ID at 57, n.96. Moreover, the ALJ ignored that Dr. Harris made this same error in calculation for his earlier profit estimate that the ALJ ultimately accepts as the appropriate disgorgement figure, and thus this figure is entirely unsupportable. *See* Harris Report, ¶¶153-154.

Also, the Initial Decision also arbitrarily relies on a casual statement by Mr. Feldman that the proceeds on his IRS Form 1099 would be over $2 billion to support doubling the profits calculated by Dr. Harris. It is elementary that gross proceeds have no probative value because a trader can as likely suffer net losses versus net profits for trading that results in any amount of gross proceeds.

Similarly, the Initial Decision's statement that Mr. Feldman made "three to four million" off of his buy-writes is not supported by any evidence in the record. ID at 44. The unrebutted testimony at the hearing was that Mr. Feldman had made a guess of what his overall profits were at optionsXpress (from all of his trading, including many other strategies not at issue here such

as reverse conversions, merger stocks, and other options trading) during his testimony before the Staff in 2010, but that he was unsure of what his actual profits at optionsXpress were because he had never calculated it and he did a high volume of other unrelated trading. Tr. 2324-2325 (Feldman).

Finally, Mr. Sheehy's opinion that Mr. Feldman earned $877,919.00 over a six month period lends no support to a disgorgement amount of $2,656,377.00. ID at 98. The Initial Decision triples Mr. Sheehy's calculation, thus including 18 months (from October 2008 to March 2010) in its disgorgement amount. This is patent error because Mr. Feldman did not open an account at optionsXpress until late December 2008, did not begin using buy-writes until June 2009, and the first of the purported "red flags" the Initial Decision asserts could have alerted Mr. Feldman to the Reg SHO violations occurred in August 2009. ID at 90.

In setting the civil penalty, the ALJ erroneously relied on evidence that Mr. Feldman conducted "390 buy-writes" and uses that as a multiplier. This approach is arbitrary for most of the same reasons as the approach for disgorgement. Even under the illogic in finding fraud, there is no basis to conclude that every buy-write caused a delivery failure. Moreover, buy-writes are not illegal. It is undisputable that delivery sometimes occurred even under the Reg SHO misinterpretation employed in the Initial Decision.

Finally, the prejudgment interest calculation is inherently wrong because the ALJ calculates the full disgorgement amount beginning on the first trade, and instead any profit was earned over more than nine months.

Relatedly, the disgorgement and civil penalties are based on Mr. Feldman's knowledge of delivery failures upon entering his first buy-write, which there is no evidence to support. Tr. 2991:20-2993:25 (Sirri). The Division implicitly acknowledged this flaw by having Dr. Harris

calculate a new, lesser disgorgement amount—$1,389,422.00—which is based on Mr. Feldman's trading beginning in December 2009. Tr. 49855:14-22 (Harris). Though fatally flawed for all the reasons already addressed, this figure is less wrong and should be used if the Commission adopts one of the numbers offered by the Division. The number of buy-writes beginning December 1, 2009 was not presented in evidence, and thus there is no similar alternative method to reduce the overstated civil penalty.

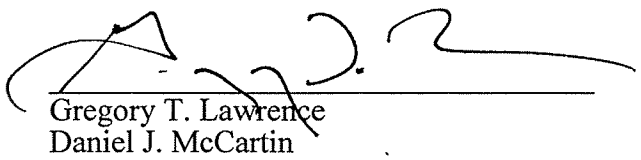
I. Proceedings Violate Dodd-Frank Act

The Initial Decision erred in excusing the Commission's blatant violation of the 180-day rule under Section 929U of the Dodd-Frank Wall Street Reform and Consumer Protection Act. ID at 74-75. Section 929U provides a bright-line deadline, and therefore the conclusion that the Division acted reasonably is meaningless. These proceedings are a nullity because the Commission authorized the proceedings before the expiration of the second 180-day period, but did not file within the second 180-day period.

IV. Conclusion

For the foregoing reasons, Mr. Feldman respectfully requests that the Commission reject the adverse findings in the Initial Decision and dismiss these proceedings.

Respectfully submitted,



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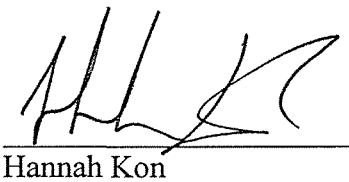
CERTIFICATE OF COMPLIANCE WITH RULE 450(d)

I, Hannah Kon, certify that this brief complies with the word limitation set forth in Commission Rule of Practice 450(c), as it contains 13,778 words, excluding the parts of the brief exempted by the Rule. 17 C.F.R. § 201.450(c).



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