UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-14848

In the Matter of

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

Respondents.

DIVISION OF ENFORCEMENT'S RESPONSE TO RESPONDENT JONATHAN I. FELDMAN'S MOTION FOR SUMMARY DISPOSITION

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The Division of Enforcement ("Division") respectfully submits this memorandum in opposition to Respondent Jonathan I. Feldman's ("Feldman") Motion for Summary Disposition ("Mot.").

INTRODUCTION

Respondent Feldman sold deep-in-the money call option contracts on publicly-traded "hard-to-borrow" stocks knowing that he had no intention of fulfilling his obligation to deliver shares when those option contracts were assigned to him. After the call options were assigned, as Feldman anticipated, Feldman repeatedly failed to either borrow or purchase shares in order to make the required delivery. Instead, Feldman engaged, with the assistance of respondent optionsXpress, Inc. ("optionsXpress"), in a series of "buy-writes" – simultaneously buying shares and selling more deep-in-the-money call options (the economic equivalent of selling shares short) – to give the appearance of having purchased shares for delivery while in fact not doing so and leaving Feldman's short (or "failure-to-deliver") position unchanged. These "paired reset" transactions were sham transactions and not bona fide purchases of stock. Their only purpose was to perpetuate Feldman's "naked" short position while giving the illusion of delivery, and amounted to a stock-kiting scheme that deprived true stock purchasers of the benefits of ownership and allowed Feldman to avoid the significant costs of purchasing stock or incurring hard-to-borrow fees to satisfy his delivery obligation. Feldman's deceptive and manipulative conduct violated Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act"), 15 U.S.C. § 78j(b), Rules 10b–5 and 10b-21 promulgated thereunder, 17 C.F.R. § 240.10b–5, § 240.10b-21, and Section 17(a) of the Securities Act of 1933 ("Securities Act"), 15 U.S.C. § 77q(a).

Feldman moves the Court for summary disposition on all counts. He argues that his trading was not deceptive or manipulative, and even if it was, he claims that optionsXpress

allowed his trading. Feldman also asserts that the Division improperly seeks to impose the delivery obligations of Regulation SHO of the Exchange Act ("Reg. SHO") on retail customers through its Rule 10b-21 allegations. Feldman's arguments lack merit – indeed, it strains credulity to suggest Feldman does not have the same delivery obligations as every other equity investor, particularly when his contract with optionsXpress explicitly imposes delivery obligations on him – and are not appropriate for resolution at summary disposition prior to trial. Moreover, Feldman's motion, which attaches declarations from himself and a purported expert that raise issues of disputed fact, claims there are no issues of material fact but, as explained below, The Division disagrees. Accordingly, the Division respectfully requests that the Court deny Feldman's motion for summary disposition so the Court may resolve this matter on the merits at trial after both parties have had a full and fair opportunity to present admissible evidence.

STANDARD OF REVIEW

Under Rule 250 of the Commission's Rules of Practice, "the facts of the pleadings of the party against whom the motion is made shall be taken as true." The Comment and Revision Comment to Rule 250 indicate that summary disposition is disfavored. The Commission stated that "[t]ypically Commission proceedings that reach litigation involve basic disagreement as to material facts . . . . [T]he circumstances when summary disposition prior to hearing could be appropriately sought or granted will be comparatively rare." Rule 250, Revision Comment, 60 Fed. Reg. 32738, 32767-68 (June 23, 1995).

BACKGROUND FACTS[1]

A. Feldman Is A Sophisticated Options Trader

Respondent Feldman is a sophisticated options trader who resides in Baltimore, Maryland, and was employed during the relevant time period as a Senior Vice President of a regional savings bank. OIP ¶¶ 7, 10, 40, 46, 76, 77, 106, 147-149, 151, 155. Feldman was one of the largest and most active customers of optionsXpress. *Id.* ¶¶ 76-77. In 2009 alone, he purchased at least $2.9 billion of securities and sold short at least $1.7 billion of options through his account at optionsXpress. *Id.* ¶¶ 7, 46.

Between at least June 2009 and March 18, 2010, Feldman engaged in a fraudulent scheme to extract a profit at the expense of true owners of stock. In carrying out this scheme, Feldman would buy a call option and sell a put option with identical strike prices and expirations referencing a hard-to-borrow stock. OIP ¶ 22. This gave him a position equivalent to a traditional "long" stock investor—a position known as a "synthetic long." *Id.* Like a traditional "long investor," Feldman would make money or lose money as the price of the stock increased or decreased, respectively. Because the stock was hard-to-borrow, the cost of buying the call was significantly less than the price of the put he sold, resulting in an "arbitrage" profit for Feldman. OIP ¶ 35. The prices of the call and the put were significantly different because the price of borrowing the hard-to-borrow stock was incorporated into the put options' price. *Id.*

Feldman, however, did not want any exposure to movement in the stock price so he hedged his "synthetic long" position by establishing a short position in the same stock. OIP ¶ 22. Generally this was done by him selling deep-in-the-money call options which are the economic equivalent of shorting stock. *Id.* ¶¶ 22, 28. Because the call options Feldman sold were deep-

[1] Pursuant to Commission Rule of Practice 250 the facts alleged in the OIP shall be taken as true.

in-the-money and referenced hard-to-borrow stock, they were virtually certain to be exercised by the purchaser. *Id.* ¶¶ 24, 27, 30, 31. Upon the exercise of these calls and subsequent assignment to Feldman, Feldman became a seller of these securities and was required to either borrow or purchase the securities in order to deliver them by settlement date. *Id.* ¶ 24; *see also* Ex. 1 (OCC Equity Options Product Specifications); Ex. 2 (CBOE Equity Options Product Specifications); Feldman failed to do so. OIP ¶¶ 3, 5, 25, 157. Instead, Feldman, with the assistance of optionsXpress, would enter into "buy-write" transactions, whereby Feldman would "buy" the amount of stock that he was obligated to deliver that day and simultaneously sell deep-in-the-money calls for an equivalent amount of shares. *Id.* ¶¶ 26, 158. These buy-writes did not cure Feldman's failures to deliver, but rather enabled Feldman to perpetuate a continuous failure to deliver – or "naked" short – position in these securities. *Id.* ¶¶ 4, 5, 30, 32, 39. The buy-writes were the equivalent of matched orders entered for the purpose of appearing to close out Feldman's delivery fails without actually delivering the shares. OIP ¶¶ 33, 158.

Feldman profited from his scheme to perpetuate a continuous failure to deliver. *Id.* ¶ 34. By entering into buy-writes and perpetuating a continuous failure to deliver position in these hard-to-borrow securities, Feldman was able to avoid the significant borrowing (or purchasing) costs that would be necessary to make delivery on his short sales, thus enabling him to retain virtually all of the substantial "arbitrage" profits that he gained by setting up the "synthetic long" position at the outset. *Id.* ¶¶ 34, 36, 37. While Feldman benefited from his failures to deliver, others were harmed. *Id.* ¶¶ 20, 38, 159, 161. Purchasers of the securities that Feldman sold, but did not deliver, were deprived of the benefits of stock ownership, such as voting and lending

rights.[2] *Id.* ¶ 20. The purchasers reasonably presumed that they would receive the securities Feldman sold within the standard three-day settlement period, when in fact they did not. *Id.* ¶ 159; *see also* Ex. 3 (Rule 10b-21 Adopting Release, No. 34-587740, 73 Fed. Reg. 61666) at 61672 ("purchasers [of securities] have the right to the timely receipt of securities that they have purchased"). In this way, Feldman's failure to deliver the securities he sold by their respective settlement dates unilaterally converted these securities (which were expected to settle within three days) into an undated futures-type contract, to which the buyer might not have agreed, or which may have been priced differently altogether. OIP ¶ 161.

B. Feldman Asserts Facts That Are Disputed

In support of his motion, Feldman relies on purportedly "uncontested facts" (including those outside the OIP) which the Division contests. These facts are contradicted either by the OIP – the factual allegations of which must be taken as true, *see* Commission Rule of Practice 250(g) – or by other facts adduced during the investigation.[3] Summary disposition is thus inappropriate at this juncture.[4] *Id.* at Rule 250(b) ("The hearing officer may grant the motion for summary disposition if there is no genuine issue with regard to any material fact.").

Particular "facts" that the Commission disputes include Feldman's statement that "he believed at all times that optionsXpress complied with all delivery and regulatory requirements." Mot. at 3. Far from being uncontested, there are numerous allegations in the OIP that dispute

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[2] The value of the lending rights in these hard-to-borrow stocks was significant, and in fact was approximately the value that Feldman extracted for himself through his fraudulent trading scheme.

[3] Specific "facts" that the Division disputes include but are not limited to, paragraphs 5, 7, 8, 9, 10, 11, 12, 13, and 14 of Feldman's affidavit and paragraphs 44, 45, 49, and 51 to 55 of Erik Sirri's affidavit.

[4] In this motion, the Division does not address all of the factual disputes arising from the attached affidavits, only those that it believes are relevant to the pending motion.

this. OIP ¶¶ 27, 89, 90, 109, 110, 111, 112, 115, 116, 118, 121, 122, 154, 156; *see also* Feldman Aff. (6/4/2012) at Ex. D ("By shorting options deep in the money, to get assigned, your trade date position stays constant, and *the settled position never closes or go long.*") (emphasis added). Feldman also asserts in his motion and affidavit that he had no control over his account, *see, e.g.,* Mot. at 8; Feldman Aff. at ¶¶ 10, 11, but this is contradicted by evidence in the record and by common sense. *See, e.g.,* OIP ¶ 26; Feldman Aff. at Ex. A at 5. In addition, Feldman claims that optionsXpress did not rely on him to deliver shares and that he never assumed any obligation to deliver securities, *see* Mot. at 9; Feldman Aff. at ¶ 9, but this too is controverted by the record. *See* OIP ¶ 24; Ex. 2 ("Exchange traded equity options are 'physical delivery' options. This means that there is a physical delivery of the underlying stock to or from your brokerage account if the option is exercised."); Ex. 1 ("Exercise notices . . . will result in delivery on the underlying stock on the third (T+3) business day following exercise."), Ex. 4 at 6 ("The account holder agrees . . . that the account holder will deliver the securities on or before settlement date."); Feldman Aff. at Ex. A at 5 ("[I]t is your intention and obligation, in every case, to deliver certificates to cover any and all sales.").

Likewise, Feldman asserts that "optionsXpress's executive vice president Peter Bottini told Mr. Feldman that the SEC had no problems with Mr. Feldman's trading." Mot. at 10; Feldman Aff. at ¶ 14. However, according to Mr. Bottini's testimony: "I spoke several times [with Feldman] about my concerns about being involved in an investigation into the trading behavior that they were engaged in. I indicated that I was concerned about market risk and one of the market risks would be an interpretation by a regulator that the action of selling calls and buying stock in a hard-to-borrow security might be scrutinized and that the actions might be deemed not appropriate." OIP ¶ 90.

Finally, Feldman's motion relies on unsubstantiated and factually inaccurate statements made by his purported expert, Erik Sirri. First, Feldman relies on his purported expert's assertion that "it is generally not possible for the broker-dealer to determine which of its customers' accounts gave rise to a fail-to-deliver." Mot. at 4; Sirri Aff. (6/4/2012) at ¶ 45. However, there are ample allegations and evidence that both optionsXpress and Feldman's other broker-dealer's clearing broker knew exactly which accounts (Feldman) were causing the failures to deliver. *See, e.g.,* OIP ¶¶ 67, 76, 80, 84, 89, 108, Ex. 5; Ex. 6; Ex. 7. Second, Feldman relies on Sirri to assert that "it is not possible for a customer who sells short to know whether the clearing broker has a net deliver or a fail-to-deliver in the CNS system." Mot. at 4; Sirri Aff. at ¶ 44; Feldman Aff. at ¶ 12. Feldman, however, did know his brokers had failed to deliver and had a failure to deliver in CNS. *See* OIP at ¶¶ 27, 109, 111, 112, 117, and 121; *see also* Feldman Aff. at Ex. D. Such unsubstantiated and factually controverted assertions by Feldman's purported expert are the type of *ipse dixit* testimony that the Supreme Court has advised may be properly excluded. *See General Electric Co. v. Joiner*, 522 U.S. 136, 146 (1997) ("[N]othing in either *Daubert* or the Federal Rules of Evidence requires a district court to admit opinion evidence that is connected to existing data only by the *ipse dixit* of the expert.").

ARGUMENT

Feldman attempts to argue that he did not engage in violative conduct because he did not, and could not, violate Reg. SHO. But the OIP makes no allegations that Feldman violated Reg. SHO. Instead, the OIP alleges that Feldman engaged in an abusive naked short selling scheme in violation of the anti-fraud provisions of the federal securities laws. While Feldman's scheme could be viewed as marginally (but immaterially) distinguishable from other abusive, naked short selling cases, this is no defense to the Division's claims. The Supreme Court has long recognized that the securities laws should be interpreted broadly and flexibly to preclude

fraudulent conduct. *Herman & MacLean v. Huddleston*, 459 U.S. 375, 386-87 (1983) (citations omitted). Moreover, as highlighted above, the proceedings against Feldman clearly involve a "basic disagreement as to material facts." Accordingly, Feldman's motion should be denied in its entirety.

I. FELDMAN'S TRADING VIOLATED SECTION 10(b) OF THE EXCHANGE ACT, RULES 10b-5 AND 10b-21, AND SECTION 17(a) OF THE SECURITIES ACT

Feldman argues that the Division's claims under Section 10(b), Rules 10b–5 and 10b-21, and Section 17(a) fail because he "made no representation concerning his intention or ability to deliver," Mot. at 18-19, 23, and "the allegedly deceptive conduct – the alleged failure to deliver – was not in his control." *Id.* at 23-24. However, the Division's claims are not based on allegations that he made material misrepresentations. Rather, it is Feldman's own conduct of abusive naked short-selling – which he himself effected by knowingly and intentionally failing to deliver securities and engaging in paired reset transactions to avoid both his delivery obligations and purchasing (or borrowing) costs – that is manipulative and deceptive. In an attempt to further distance himself from that conduct, Feldman spends page after page in his motion discussing the intricacies of Reg. SHO and the delivery responsibilities of his broker-dealer, optionsXpress. But Feldman ignores a simple reality as alleged in the OIP – he engaged in a deceptive scheme and his use of buy-writes operated as a manipulative device. The law is and has been clear – schemes to deceive and the use of manipulative devices violate the anti-fraud provisions of the securities laws.

A. Feldman's Trading Was Manipulative and Deceptive Securities Fraud

In order for a person to be liable under Section 10(b) and Rule 10b–5, that individual must have "(1) made a material misrepresentation or a material omission as to which he had a duty to speak, *or used a fraudulent device*; (2) with scienter; (3) in connection with the purchase

or sale of securities." *SEC v. Monarch Funding Corp.*, 192 F.3d 295, 308 (2d Cir. 1999) (emphasis added). The Supreme Court has stated that Section 10(b) reflected "overall congressional intent to prevent 'manipulative and deceptive practices which . . . fulfill no useful function," *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 206 (1976). It was intended as "a catch-all clause to prevent manipulative devices" and was designed "to enable the Commission 'to deal with new manipulative (or cunning) devices.'" *Id.* at 202-03 (quoting Thomas G. Corcoran, a spokesman for the drafters of Section 10(b), during hearings prior to the enactment of the Exchange Act). Thus, Section 10(b) and Rule 10b-5 prohibit, among other things, (a) employing any device, scheme, or artifice to defraud, or (b) engaging in any act, practice, or course of business that operates or would operate as a fraud or deceit upon any person. *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 847, 857-62 (2d Cir. 1968) Section 10(b) and Rule 10b-5 do not require that there be a specific oral or written statement; "[c]onduct itself can be deceptive." *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148, 158 (2008).[5] Similarly, Rule 10b-21 prohibits the use of manipulative or deceptive devices. 17 C.F.R. § 240.10b-21.

In a scheme case, such as this, the same elements required to establish a Section 10(b) violation and a Rule 10b–5 violation suffice to establish a violation under Section 17(a), with the exception that scienter is not required to enjoin violations under subsections 17(a)(2) or 17(a)(3). *See Monarch Funding*, 192 F.3d at 308. As with Section 10(b), the reach of Section 17(a) is

[5] For example, selling an option while secretly intending not to fulfill one's obligations under the options contract is securities fraud. *See, e.g., The Wharf (Holdings) Ltd. v. United Int'l Holdings, Inc.*, 532 U.S. 588, 596-97 (2001) ("To sell an option while secretly intending not to permit the option's exercise is misleading, because a buyer normally presumes good faith."); *Walling v. Beverly Enter.*, 476 F.2d 393, 396 (9th Cir. 1973) (entering "into a contract of sale with the secret reservation not to fully perform it is fraud cognizable under § 10(b)"); *A.T. Brod & Co. v. Perlow*, 375 F.2d 393, 397 (2d Cir. 1967) (holding that broker stated a claim under Section 10(b) by alleging that it had been defrauded by a customer who purchased securities with the intent to pay only if the market value of the securities increased by the time payment was due).

broad and bars "any person in the offer or sale of any securities [from] . . . directly or indirectly . . . employ[ing] any device, scheme or artifice to defraud," 15 U.S.C. § 77q(a)(1), or "engage[ing] in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person." *Id.* § 77q(a)(3).

As alleged in the OIP, Feldman engaged in a fraudulent and deceptive scheme. His sham reset transactions were designed to give the appearance of having delivered shares without doing so, had no actual economic consequence, and instead perpetuated his failure-to-deliver position. Despite their apparent complexity, these transactions are precisely the type of matched orders long understood to be manipulative practices. *See Ernst & Ernst,* 425 U.S. at 205 n.25 (defining illegal matched orders as "orders for the purchase [and] 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"). And while one improper purpose for matched orders may be to "artificially create a market condition and then [] take advantage of that artificially created condition," (Mot. at 24), Feldman's trades defrauded market participants – both the purchasers who actually owned (but could not yet possess) the hard-to-borrow stocks and thus could not receive significant fees to lend them, and the investing public whose observations of the volume spikes caused by his trading Feldman ridiculed: "I read the latest [internet] thread on the [Sears] 'volume spikes'. ***Very entertaining.*** (***Until someone notifies the SEC and they shut down the strategy!!***)." *Id.* ¶ 154 (emphasis added); *see also, e.g., In the Matter of Amanat,* S.E.C. Rel. No. 34-54708, 89 S.E.C. Docket 683, 2006 WL 4958610 (Nov. 3, 2006) (finding that Amanat violated Section 10(b) when he generated thousands of wash trades and matched orders for the purpose of deceiving Nasdaq in connection with a rebate program because the trades had the effect of

defrauding other participants in the program who stood to receive a proportionally lower rebate as a result of the trades); *see also Graham v. SEC*, 222 F.3d 994 (D.C. Cir. 2000) (holding that wash trades and matched orders violate Section 10(b) where their purpose is deceiving broker-dealers in a scheme similar to check-kiting).

Feldman cites a criminal securities fraud case, *United States. v. Finnerty*, 533 F.3d 143 (2d Cir. 2008), for the proposition that "[b]road as the concept of 'deception' may be, it irreducibly entails some act that gives the victim a false impression." Mot. at 20. Feldman's reliance on *Finnerty* is misplaced. Not only are the facts of *Finnerty* inapposite – the Second Circuit overturned a criminal conviction where Finnerty had surreptitiously interposed his company between the buyers and sellers of publicly-traded stock to conduct otherwise arms-length stock transactions and profit from both transactions[6] – but the Second Circuit has given *Chevron* deference to the Commission's post-*Finnerty* adjudicatory decision finding Finnerty's conduct to be deceptive, which the Second Circuit has held "'trumps' our prior interpretation in *Finnerty*." *See Van Cook v. SEC,* 653 F.3d 130, 141 (2d Cir. 2011) (citing *David A. Finnerty,* Exchange Act Release No. 59998, 95 SEC Docket No. 2534, 2009 WL 1490212, at *3 (May 28, 2009)).

[6] In *Finnerty*, the court found that the purchasers and sellers of the stock received the benefit of their bargain. Here, unlike in *Finnerty*, the purchasers of Feldman's sales did not. It is reasonable to assume that the purchasers of those options and stock believed, based on Feldman's offer of sale, that he would deliver what he had sold. As the court in *S.E.C. v. Simpson Capital Mgmt., Inc.,* 586 F.Supp.2d 196, 204 (S.D.N.Y 2008) noted in distinguishing *Finnerty:* "[A]ll that Finnerty did was to execute trades at disclosed terms. . . he . . . did not deceive either the buyer or the seller with respect to the terms of their trades. Each side of the trade knew what it got—the shares purchased or sold and at what price." *Id.* at 204. That is not the case here—clearing brokers and the ultimate purchasers of open market stock did not receive what they bought, *i.e.,* they were deceived as to the terms of their trades.

B. Feldman's Deceptive Conduct Was Undertaken With Scienter

Feldman appears to argue that he had no scienter because he relied on optionsXpress to deliver shares in compliance with applicable requirements of Reg. SHO and had no control over how optionsXpress met those requirements. Mot. at 8-9, 18-22. Further, Feldman claims he received specific instructions from optionsXpress concerning delivery (in the form of buy-ins), and optionsXpress had authority to buy him in without his consent per his customer agreement with optionsXpress. Mot. at 19. Feldman also asserts that optionsXpress had represented to him both that it was complying with Reg. SHO's delivery requirements *and* that it had sought guidance from regulators on the issue. Mot. at 9-10. Feldman's arguments ignore facts that demonstrate he played anything but a passive role in the deceptive conduct – in fact, he was fully involved in the trades and knew the impact on the market that resulted from them. He was also personally aware of sufficient information to know (or be reckless in not knowing) that his trading violated federal securities laws.

Feldman knew that when he sold deep-in-the money call options, they would be assigned to him and he would become a seller of these securities. *Id.* ¶¶ 27, 80, 113, 114, 121, 143, 144, 146, 157; *see also* Feldman Aff. at Ex. D ("*By shorting options deep in the money, to get assigned*, your trade date position stays constant, and the settled position never closes or go long.") (emphasis added). Feldman also knew that the 13 securities for which he sold deep-in-the-money calls were generally hard-to-borrow and knew that the costs to borrow them were high. OIP ¶¶ 24, 35, 36, 90. Contrary to Feldman's assertions, as a seller of these call options, Feldman had an obligation to deliver securities to optionsXpress if the options were exercised—a fact that he contractually agreed to with optionsXpress.[7] Yet when Feldman sold these

[7] *See* Feldman Aff. at Ex. A ("If we make a sale of any security . . . at your direction, ***and if you [Feldman] fail to deliver to us any securities*** . . . *that we have sold at your direction*, we

securities, he had no intention of delivering these securities by settlement date. OIP ¶¶ 3, 5, 25, 109, 157. He also knew the intended consequences of his trading – that his buy-writes resulted in a continuous failure to deliver and that the only purpose (and result of) his buy-writes was to perpetuate an improper naked short position and avoid delivering the shares he sold. *Id.* ¶¶ 27, 37, 39, 109, 111, 112, 121; *see also* Feldman Aff. at Ex. D ("By shorting options deep in the money, to get assigned, your trade date position stays constant, and *the settled position never closes or go long.*") (emphasis added); *id.* ("doing the buy-writes is crucial to maintain the neutral hedge"); *SEC v. U.S. Environmental, Inc.*, 155 F.3d 107 (2d Cir. 1998) (denying motion to dismiss and finding allegation that defendant "knowingly or recklessly participated in and furthered a market manipulation by . . . effecting 'wash sales' and 'matched orders'" and "intentionally engaged" in "manipulative conduct" plainly sufficient to satisfy Section 10(b)'s scienter requirement). Feldman even expressed surprise when he learned that a clearing broker planned to settle/deliver a stock he had sold short. OIP ¶ 110.

Compounding what Feldman knew and intended with his trading scheme, Feldman knew that his specific trading posed regulatory risk. In August 2009, he was provided a copy of Rule 204 of Reg. SHO, *id.* ¶ 79, and was then instructed by optionsXpress to the limit the number of option contracts he sold as part of his buy-writes due to risk that his trading was illegal. *Id.* ¶¶ 89-90. Feldman asked optionsXpress if there were "different strategies" he could implement to continue his buy-writes but "avoid buyins [from his failures to deliver], or 'restart the

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are authorized to borrow or otherwise obtain the securities . . . necessary to enable us to make delivery"); Ex. 4 at 6 ("***The account holder agrees*** that any order which is not specifically designated as a short sale is a sale of securities owned by the account holder, and ***that the account holder will deliver the securities on or before settlement date***, if not already in the account. If the account holder should fail to make such delivery in the time required, [the clearing broker] is authorized to borrow such securities as necessary to make delivery for the account holder's sale. . . .").

[settlement] clock'." *Id.* ¶ 122. He learned from another broker-dealer that regulators were "starting to get heavy on" this type of buy-write trading and that a broker-dealer's clearing broker did not want to clear Feldman's buy-writes. *Id.* ¶¶ 118, 120. Indeed, in late 2009, no other broker-dealer would allow his trading because of regulatory concerns about his failures-to-deliver and he was forced to return to trading with optionsXpress. *Id.* ¶¶ 115, 116.

Even more basic proof of Feldman's scienter, he actually read the Commission's action *In the Matter of Hazan Capital Management, LLC and Steven M. Hazan*, Exchange Act Release No. 34-60441 (Aug. 5, 2009), which sanctioned Hazan for using buy-write trading in hard-to-borrow securities to avoid delivery requirements and hard-to-borrow fees, and Feldman read internet blogs indicating his "manipulative" activity was "consistent with the illegal 'reset' transaction" described in *Hazan*. *Id.* ¶¶ 54, 97, 156. And, more notably, Feldman reviewed internet message boards discussing his trading in Sears Holding Corp. and possible violations of Reg. SHO and proceeded not only to ridicule the public concerns about the effect his trading was having on the trading volume, but he rightly predicted that the Commission would find his activity illegal. "I read the latest [internet] thread on the [Sears] 'volume spikes'. ***Very entertaining. (Until someone notifies the SEC and they shut down the strategy!!)***." *Id.* ¶ 154 (emphasis added).

In short, Feldman's "my broker let me do it" defense simply does not withstand scrutiny when he was provided with more than enough information to know (or be reckless in not knowing) that his conduct violated federal securities law. *See, e.g., SEC v. Pentagon Capital Mgmt. PLC*, No. 08 Civ. 3324, -- F. Supp. 2d --, 2012 WL 479576, at *40 (S.D.N.Y. Feb. 14, 2012) (finding defendants liable for securities fraud because they knew or had sufficient "red flags" that their late-trading activity violated federal securities law because they had received and

reviewed relevant academic articles and had been told their proposed trading was "crap" and were cautioned to "be discreet"); *Simpson Capital Management, Inc.*, 586 F. Supp. 2d at 208 (denying motion to dismiss fraud claims based on late trading in mutual funds because defendants "devised the scheme to defraud" the funds and "proceeded to deal only with brokers who agreed to continue to join with them in the scheme to defraud").

II. FELDMAN'S FAILURE TO DELIVER SHARES VIOLATED RULE 10b-21

In his motion for summary disposition, Feldman makes four primary arguments for why he did not violate Rule 10b-21: (1) he had no obligation to deliver the shares he sold as this was the sole responsibility of optionsXpress, Mot. at 11-13; (2) Rule 10b-21 can only be violated when a customer deceives his/her broker-dealer about delivering shares, Mot. at 16-17; (3) he relied on optionsXpress to make delivery, Mot. at 14-16; and (4) Rule 10b-21 does not apply to the writing of call options, Mot. at 26-27. Each argument is without merit.

First, the law is clear under both Rule 10b-21 and the other anti-fraud statutes that sellers of securities have an obligation to deliver shares that they sell. *Second*, Rule 10b-21 is not limited to the narrow circumstances identified by Feldman – where a customer deceives his/her broker-dealer Mot. at 16-17 – but instead precludes all kinds of naked short-selling, including the scheme perpetuated by Feldman. *Third*, it is no defense that Feldman was allegedly relying on optionsXpress to deliver shares he sold – Feldman failed to deliver to optionsXpress the securities he himself sold. Moreover, even if Feldman claims he was relying on optionsXpress to deliver, his reliance is unreasonable because Feldman knew or should have known that optionsXpress was failing to deliver the securities he sold. If Feldman's reliance defense were accepted, customers who know their broker-dealers are violating the law and profit from it would escape any liability. This is not the law. *Finally*, Rule 10b-21 applies to the writing of calls and Feldman cannot cite any law to the contrary.

A. Sellers Are Required to Deliver Shares That They Sell

Feldman claims that he did not have an obligation to deliver shares because this was optionsXpress' sole obligation. Mot. at 11-14. Feldman is wrong, he, like all sellers, had an obligation to deliver shares that he sold. Rule 10b-21 of the Exchange Act provides that it "shall . . . constitute a 'manipulative or deceptive device or contrivance' as used in section 10(b) of this Act for ***any person*** to submit an order to sell an equity security if such person deceives a broker or dealer, a participant of a registered clearing agency, or a purchaser about its intention or ability to deliver the security on or before the settlement date, and such person fails to deliver the security on or before the settlement date."[8] 17 C.F.R. § 240.10b-21 (emphasis added); *see also* OIP ¶ 18. Thus, from the plain language of the rule, "any person" who sells securities has an obligation to deliver, not just a broker-dealer.

This point is further supported by the fact that Rule 10b-21 was adopted, among other things, to address abusive "naked" short selling and failures to deliver by sellers. *Id.* ¶ 19; Ex. 3 at 61667. Abusive "naked" short selling generally refers to a seller selling stock short without having stock available for delivery and failing to deliver stock within the standard three-day settlement cycle. *Id.* Sellers sometimes intentionally fail to deliver securities as part of a scheme to avoid borrowing costs associated with short sales, especially when the costs of borrowing stock is high. Ex. 3 at 61667; OIP ¶ 20. In addition, failures to deliver can create a misleading impression of the market for an issuer's stock. *Id.* Here, Feldman's trading (a) resulted in failures to deliver, *id.* ¶ 25, 26, 32, 37, 38, (b) enabled him to avoid significant purchasing (or

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[8] The term "participant" has the same meaning as in Section 3(a)(24) of the Exchange Act. *See* 15 U.S.C. § 78c(a)(24). The term "registered clearing agency" means a clearing agency, as defined in Section 3(a)(23) of the Exchange Act, that is registered as such pursuant to Section 17A of the Exchange Act. *See* 15 U.S.C. §§ 78c(a)(23)(A), 78q-1 and 15 U.S.C. § 78q-1(b), respectively.

borrowing) costs, *id.* ¶ 34, and (c) misleadingly created increased volume in the market for the securities he sold, *id.* ¶ 45, 153-155. In short, Feldman engaged in the very conduct that Rule 10b-21 was enacted to address.

Furthermore, according to Rule 10b-21's Release, ***"[a]ll sellers of securities should promptly deliver, or arrange for delivery of***, securities to the respective buyer and all buyers of securities have the right to expect prompt delivery of securities purchased." Ex. 3 at 61667. (emphasis added). Again, the term "sellers" is not limited to broker-dealers who execute sale orders by their customers. Without prompt delivery from ***all sellers of securities***, failures to deliver may deprive shareholders of the benefits of ownership, such as voting and lending. Ex. 3 at 61669; OIP ¶ 20. "In addition, where a seller of securities fails to deliver securities on settlement date, in effect the seller unilaterally converts a securities contract (which is expected to settle within the standard three-day settlement period) into an undated futures-type contract, to which the buyer might not have agreed, or that might have been priced differently." OIP ¶ 161; Ex. 3 at 61669. Simply put, Rule 10b-21 and its adopting release make clear that all participants in the market, not just broker-dealers, have an obligation to deliver securities they sold. This includes Feldman.

B. Feldman's Narrow Reading of Rule 10b-21 is Unwarranted

Feldman claims that Rule 10b-21 can only be violated when a customer makes affirmative misrepresentations to his broker-dealer. Mot. at 16-17. This argument misses the mark for three reasons.

First, the Rule's release makes clear that broker-dealers can be held liable for aiding and abetting a customer's fraud under Rule 10b-21. Ex. 3 at 61673 (stating that broker-dealers could be liable for aiding and abetting a customer's fraud under Rule 10b-21). Thus, Feldman's

argument that Rule 10b-21 can only be violated if a broker-dealer is deceived by a customer makes no sense. How could a broker-dealer be an aider and abettor of conduct that deceived that very broker-dealer?

Second, the OIP clearly states how Feldman violated Rule 10b-21. Under Rule 10b-21, it is a manipulative or deceptive device or contrivance for "any person to submit an order to sell an equity security if such person deceives a broker or dealer, a participant of a registered clearing agency, or a purchaser about its intention to deliver the security on or before the settlement date, and such person fails to deliver the security on or before the settlement date." 17 C.F.R. § 240.10b-21. This is what Feldman did. A core element of exchange-traded call options, such as those Feldman was selling, is that the seller will deliver shares to the buyer if and when the buyer asks for them. Feldman sold options knowing that he had no intention of actually fulfilling this contractual obligation to deliver shares when his options were assigned; instead, Feldman knew he was going to do another buy-write and prolong his naked short position. OIP ¶ 157. This is manipulative and deceptive conduct for which he should be held accountable. *See The Wharf (Holdings),* 532 U.S. at 596-97 ("To sell an option while secretly intending not to permit the option's exercise is misleading, because a buyer normally presumes good faith"); *Walling,* 476 F.2d at 396 (entering "into a contract of sale with the secret reservation not to fully perform it is fraud cognizable under § 10(b)").

Third, Rule 10b-21 is not limited to the examples of violative conduct contained in the Rule's adopting release. Feldman cites to those examples and claims his conduct does not fit them. Mot. at 16-17. But those examples do not constitute the ***entirety*** of conduct barred by Rule 10b-21. Those non-exhaustive examples are merely illustrations of the type of conduct that

Rule 10b-21 was attempting to address.[9] The Rule itself is broader. As the Commission stated in the adopting release: "[Rule 10b-21] is aimed at short sellers . . . who deceive specified persons, such a broker or dealer, about their intention or ability to deliver securities in time for settlement and that fail to deliver securities by settlement date." Ex. 3 at 61667. The Commission then noted that "Rule 10b-21 will cover those situations where a seller deceives a broker-dealer, participant of a registered clearing agency, or a purchaser about its intention to deliver securities by settlement date . . . and the seller fails to deliver securities by settlement date." *Id.* at 61676. There is nothing in Rule 10b-21 or its release that can be read to limit the Rule exclusively to the situations described by Feldman.

As alleged in the OIP, Feldman deceived a participant of a registered clearing agency and purchasers about his intention to deliver securities by settlement date and then in fact failed to deliver securities by settlement. OIP ¶¶ 157-159. This allegation by itself should be enough to defeat Feldman's motion for summary disposition. After all, the Supreme Court has long recognized that securities laws and rules must be read broadly and flexibly and not "technically and restrictively." *SEC* v. *Zandford*, 535 U.S. 813, 819 (2002). The reason for this is these laws are enacted for the purpose of protecting against fraud and are designed to prevent "all the ingenious variations of security fraud that arise." *United States v. Jensen*, 608 F.2d 1349, 1354 (10th Cir. 1979). Feldman's scheme is just the latest in a long line of "variations" of securities fraud. While Feldman's scheme might not be included in the examples in the adopting release for Rule 10b-21, this is because "practices constantly vary and where practices legitimate for some purposes may be turned to illegitimate and fraudulent means, broad discretionary powers in

[9] For example, the Commission stated that "[a]mong other things" Rule 10b-21 applied to sellers who deceived their broker-dealers about their locate source. Ex. 3 at 61667.

the regulatory agency have been found practically essential." *Superintendent of Ins. of State of New York v. Bankers Life & Casualty Co.*, 404 U.S. 6, 12 (1971).

C. Feldman's "Reliance on optionsXpress to Deliver" Argument Is Misplaced

Feldman claims that he cannot be liable for violating Rule 10b-21 because he was relying on optionsXpress to make delivery. Mot. at 16. In making this argument, Feldman cites to a limited portion of Rule 10b-21's adopting release that states "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." Mot. at 16 (emphasis added). Feldman's argument and citation to this part of the release is misplaced.

First, the quotation cited by Feldman refers to Rule 203's requirement to locate shares *before* they are sold short.[10] *See* 17 C.F.R. § 242.203(b)(1). But Feldman is not charged with violating Reg. SHO Rule 203, nor is optionsXpress. optionsXpress is being charged with violations of Reg. SHO Rules 204 and 204T, and Feldman is charged with violations of the anti-fraud provisions. Thus, Feldman's reliance on a quotation referring to Rule 203's locate requirement is nothing more than a red herring.

Second, Feldman's contractual agreement with optionsXpress reflects that he expressly agreed to make delivery of securities he sold to the broker-dealer. *See* Feldman Aff. at Ex. A at 5. Consequently, his argument that Rule 10b-21 applies "if, and only if, the customer has made a representation to the broker-dealer that the customer will deliver securities to the broker-dealer,"

[10] Feldman also cites Exchange Act Rel. No. 50103 (Jul. 28, 2004), 69 Fed. Reg. 48008 in support of his argument. Mot. at 14. However, this is the release for Rules 200 through 203 of Reg. SHO, not Rule 10b-21 or Rules 204 or 204T.

Mot. at 2, and "Feldman never made a representation to optionsXpress about his ability to locate or deliver shares," Mot. at 17, is belied by the record and the allegations in the OIP.

Third, Feldman cannot escape liability under Rule 10b-21 by blaming his broker-dealer for his failure to deliver shares.[11] Indeed, Rule 10b-21 was specifically aimed at individual sellers who were failing to fulfill their contractual obligations. "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." Ex. 3 at 61672 (emphasis added). Thus, when determining whether a failure to deliver has occurred under Rule 10b-21, the question is not whether there is a failure to deliver by the broker-dealer in the CNS system as it is for violations of Reg. SHO, but whether there is a failure to deliver by the seller. *Id.* This is because, as the adopting release makes clear, "some sellers may be able to postpone delivery [in violation of the rule] if another customer's purchase is received the same day. Thus, a person engaging in abusive 'naked' short selling may be able to avoid detection for a period of time." *Id.* at 61672. Put simply, the question under Rule 10b-21 is not whether optionsXpress or the "other broker dealer," OIP ¶ 109, delivered the shares sold by Feldman or whether they complied with Reg. SHO, ***but whether Feldman himself delivered the shares that he sold.*** And the answer in this case is he did not. *Id.* ¶ 157. Indeed, in his motion Feldman never claims that he delivered shares to his broker-dealer, or to anyone else, by settlement date.

Fourth, there is no evidence, despite Feldman's assertions in his motion, that either of his broker-dealers accepted full responsibility for delivering his shares by settlement date. In fact, as noted above, the very documents that Feldman attaches to his motion show that he was responsible for delivering shares by T+3: "All orders for the purchase and sale of securities and

[11] As with any sale, sellers of stock are responsible for delivering what they have sold. Thus, sellers of stock are responsible for delivering stock in the first instance.

other property will be authorized by you and executed with the understanding . . . ***that it is your intention and obligation, in every case, to deliver certificates to cover any and all sales or to pay for transactions upon our demand.***" Feldman Aff. at Ex. A at 5 (emphasis added). It was only after Feldman failed to deliver securities by settlement date that his broker-dealer was allowed to step in: "If we make a sale of any securities, and/or other property at your direction, and if you fail to deliver to us any securities . . . ." *Id.* If Feldman's argument is that optionsXpress never asked for delivery, then this argument relates to his scienter and should not be resolved on a motion for summary disposition.

Finally, even if Feldman claims he was relying on optionsXpress to deliver, his reliance is unreasonable because Feldman knew or should have known that optionsXpress ultimately failed to deliver the securities that he sold. If Feldman's defense were accepted, customers who know their broker-dealers are violating the law and profit from it would have a complete defense to fraud charges. This is not the law. *See, e.g., Silverman v. Motorola, Inc.*, 798 F. Supp. 2d 954, 969-70 (N.D. Ill. 2011) (citing cases from the First, Second, Seventh, Ninth and D.C. Circuits finding that a reliance defense does not negate scienter where there is knowledge (or reckless disregard) of fraud and that reliance is not, even without such knowledge, a complete defense).

Feldman's argument also ignores the fact that the Division is alleging that optionsXpress aided and abetted Feldman's fraud. Rule 10b-21's proposing release specifically addresses this issue: "[A]s with any rule, broker-dealers could be liable for aiding and abetting a customer's fraud." 73 Fed. Reg. at 15379-80; *see also* Ex. 3 at 61673. This result follows from the fact that Rule 10b-21 lists several categories of persons who can be deceived. These include not only an option seller's own broker-dealer, but also another broker or dealer, a participant of a registered

clearing agency, or a purchaser. 17 C.F.R. § 240.10b-21. The OIP alleges that Feldman did indeed deceive participants of clearing agencies and purchasers. OIP ¶¶ 157-159. In short, any reliance Feldman claims to have placed on optionsXpress was unreasonable as they were complicit in carrying out his naked short selling scheme.

D. Rule 10b-21 Applies to Feldman Selling Deep-in-the-Money Calls

Feldman claims that Rule 10b-21 "does not apply to writing options." Mot. at 26. Feldman is wrong. Rule 10b-21 applies to options including the deep-in-the-money call options sold by Feldman.

First, according to the plain language of Rule 10b-21 it applies to the sale of "an equity security." Section 3(a)(11) of the Exchange Act defines "equity security," as that term is used in Rule 10b-21, to include "any stock or similar security; or any security future on any such security; or any security convertible with or without consideration, into such a security, or carrying any warrant or ***right to subscribe to or purchase such a security; or any such warrant or right.***" 15 U.S.C. § 78c(a)(11) (emphasis added). A call option is by definition the right, but not the obligation, to buy a specified amount of an underlying security at a specified price within a specified time. Sirri Aff. ¶ 6. Moreover, under Rule 3a11-1 of the Exchange Act, the term "equity security" includes "any put, ***call***, straddle, or other option." 17 C.F.R. § 240.3a11-1 (emphasis added). Therefore, a call option is an "equity security" under Rule 10b-21.

Second, despite Feldman's arguments to the contrary, he can and did fail to deliver on the option orders he submitted. Mot. at 26-27. Under the contract specifications for an exchange-traded equity call, delivery is effected by delivery of shares on the third business day following exercise (T+3). *See* Ex. 1 (OCC Specifications); Ex. 2 (CBOE Specifications). Feldman did not deliver the shares by the third business day following exercise. OIP ¶ 25. As a result, Feldman

violated Rule 10b-21 by submitting orders to sell options, *id.* ¶ 22, while deceiving a broker or dealer, a participant of a registered clearing agency, or a purchaser about his intention or ability to deliver the security on or before the settlement date, *id.* ¶¶ 26-27, and in fact failing to deliver the security on or before settlement date, *id.* ¶ 25.

III. THE OIP WAS FILED IN COMPLIANCE WITH DODD-FRANK DEADLINES

Feldman argues that the Division violated the Dodd-Frank filing deadlines because this action was not filed before October 21, 2011, the date on which the Division Director's initial 180-day extension period expired.[12] Mot. at 27-30. Feldman acknowledges, as he must, however, that the Commission made a decision on October 13, 2011 to approve the Director's request to extend the deadline to April 17, 2012. Ex. 8 (Tarasevich Affidavit (6/13/2012)) at ¶ 5. The Director's request for a further extension to April 17, 2012, and the Commission's October 13 decision to approve that request, was made in accordance with the express provisions of Section 929U, 15 U.S.C. § 78-5(a)(2), rendering the previous October 21 deadline a nullity and the April 16, 2012 institution of these proceedings proper. It does not follow, and Feldman has nothing but supposition to suggest, that the Commission's October 20 decision to grant authority to institute these proceedings, one week after approving the Director's request for extension, means that the Director "not only made the determination to file within the second 180-day period [that would have expired on October 21], but that the determination to file was made on or before the [October 13] date that the Commission approved the extension to add a third 180-day period." Mot. at 29.

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[12] Section 929U provides that within 180 days of providing a written Wells notice to any person, the investigative staff must either "file an action against such person or provide notice to the Director of the Division of Enforcement of its intent not to file an action." 15 U.S.C. § 78-5(a)(1). The Director may extend the 180-day deadline for another 180 days for complex cases where a determination cannot be made to file or give notice of intent not to file, *id.* § 78-5(a)(2). Further extension requires Commission approval. *Id.*

In any event, even if the Division had violated the Dodd-Frank deadlines in Section 929U, which it did not, such a violation of deadlines for internal agency actions would not bar claims against Feldman that were brought within the applicable statute of limitations. *See United States v. James Daniel Good Real Prop.*, 510 U.S. 43, 62-65 (1993); *Brock v. Pierce County*, 476 U.S. 253, 266 (1986); *see also SEC v. Scammell*, No. 11-Cv-6597, Order Denying Motion to Dismiss (C.D. Cal., Nov. 15, 2011) (rejecting Dodd-Frank violation argument because "[i]t is well established that a violation of statutory deadlines for internal agency actions does not bar a claim by the agency if it is otherwise brought within the statute of limitations") (citing *James Daniel Good Real Prop.*, 510 U.S. at 62-65). Feldman can make no claim that the applicable statute of limitations has expired. As a result, the Dodd-Frank arguments in his motion should be rejected by the Court.

IV. THE OIP'S ALLEGATIONS AS TO AN OTS ACTION AGAINST FELDMAN FOR FRAUDULENT CONDUCT SHOULD NOT BE STRICKEN

Feldman asks the Court to strike allegations in the OIP relating to a $125,000 fine he paid to settle Office of Thrift Supervision ("OTS") allegations that he made material misrepresentations or omissions as part of a scheme to defraud a federal savings bank when he altered a personal guaranty (to remove his liability) on a loan that eventually defaulted, OIP ¶10; *see also* Ex. 9 (OTS Notice of Action). Feldman argues that such allegations are "patently false," "defamatory," and "impertinent and scandalous." Mot. at 31. The OIP's allegations concerning the OTS action were, short of being quotations, taken directly from the notice of action against Feldman that OTS ***publicly issued*** in June 2010. Feldman cannot dispute he was ***publicly*** charged with fraud by the OTS and resolved those claims (on a neither admit nor deny basis) by paying the $125,000 fine that OTS levied against him in June 2010. *See* Ex. 10 (OTS

Stipulation and Consent). Accordingly, the Court should reject Feldman's motion to strike these allegations from the OIP.

The Court need not resolve Feldman's premature argument against the admissibility of any evidence relating to the OTS's allegations and Feldman's settlement of those claims because the Division has made no decision (much less any effort) to present evidence on that issue. It should be noted, however, that the information is not *per se* irrelevant and could be used for impeachment and rebuttal purposes, should Feldman try to, for example, introduce evidence of his character for honesty and truthfulness in an attempt to establish that he did not engage in the OIP's alleged fraudulent conduct. Likewise, such material could be relevant in assessing any assurances Feldman might make against further anti-fraud violations, *see Steadman v. SEC*, 603 F.2d 1126, 1140 (5th Cir. 1979), *aff'd on other grounds*, 450 U.S. 91 (1981); *S.E.C. v. Manor Nursing Centers, Inc.*, 458 F.2d 1082, 1101 (2d Cir. 1972), as well as for the Court to consider when determining remedies in this matter. *See, e.g.*, *In the Matter of Philip A. Lehman*, File No. 3-11972, 2006 WL 3054584, at *9, n.4 (Oct. 27, 2006) (considering a respondent a recidivist even though the prior action against him was settled on a neither admit nor deny basis); *see also*, *In the Matter of Gary M. Kornman*, File No. 3-12717, 2009 WL 367653, at *7 (Feb. 13, 2009) (permitting consideration of prior charges); *In the Matter of Benjamin Levy Sec., Inc.*, 46 S.E.C. 1145, 1146-47 (1978) (administratively barring associated person based on conviction for making false statements in a loan application); *In the Matter of Ahmed Mohamed Soliman*, 52 S.E.C. 227, 230-31 (1995) (administratively revoking registration and imposing associational bars for submitting false documents to IRS).

V. CONCLUSION

For the foregoing reasons, Feldman's motion should be denied in its entirety.

Dated: June 18, 2012

Respectfully submitted,

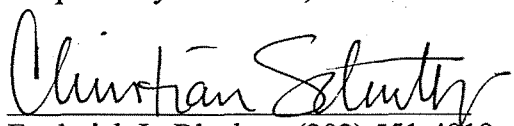

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EXHIBIT 1

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Equity Options Product Specifications

Unit of Trade

100 shares per option contract.

Premium Quotations

Stated in points and fractions. One point equals $100. Minimum tick for series trading below 3 is .05 ($5.00) and for all other series .10 ($10.00).

Strike Price Intervals

2-1/2 points for stocks trading below $25, 5 points for those trading from $25 to $200, and 10 points for those trading above $200.

Exercise Style

American. Option may be exercised on any business day prior to the expiration date.

Expiration Months

Two near-term months plus two additional months in the January, February or March quarterly cycle.

Expiration Dates

The Saturday immediately following the third Friday of the expiration month.

Position Limits

Limits vary according to the number of outstaing share and trading volume. The largest, most frequently traded stocks have an option position limit of 75,000 contracts; smaller capitalization stocks may offer position limits of 60,000, 31,500, 22,500 or 13,500 contracts. Customer hedge exemptions are available.

Minimum Customer Margin for Uncovered Writers

The dollar amount of the premium plus 20% of the underlying security value minus the amount by which the option is out of the money (if any) with a minimum of the premium plus 10% of the underlying security value.

Trading Hours

9:30 a.m. to 4:00 p.m. (Eastern Time).

Exercise Settlement Price

Strike price times $100.

Exercise Settlement Time

Exercise notices tendered on any business day will result in delivery of the underlying stock on the third (T+3) business day following exercise.

This web site discusses exchange-traded options issued by The Options Clearing Corporation. No statement in this web site is to be construed as a recommendation to purchase or sell a security, or to provide investment advice. Options involve risk and are not suitable for all investors. Prior to buying or selling an option, a person must receive a copy of Characteristics and Risks of Standardized Options (/about/publications/character-risks.jsp) . Copies of this document may be obtained from your broker, from any exchange on which options are traded or by contacting The Options Clearing Corporation, One North Wacker Dr., Suite 500, Chicago, IL 60606 (1-888-678-4667).

EXHIBIT 2

Products

Product Specifications

Equity Options

Exchange traded equity options are "physical delivery" options. This means that there is a physical delivery of the underlying stock to or from your brokerage account if the option is exercised. The owner of an equity option can exercise the contract at any time prior to the exercise deadline set by the investor's brokerage firm. Generally this deadline occurs on the option's last day of trading. The expiration date for equity options is the Saturday following the third Friday of the month. If the third Friday of the month is an Exchange holiday, the last trading day is the Thursday immediately preceding the holiday. After the option's expiration date, the equity option will cease to exist.

For additional information on equity options, visit the Equity Option Strategies section of the web site, or download the Understanding Stock Options brochure (Acrobat format).

Equity Options Product Specifications

Symbol:
For listed stock, the option symbols are the same as for the underlying stock. Symbols for options on qualified over-the-counter securities vary according to the vendor. Visit the CBOE Symbol Directory for specific symbols.

Underlying:
Generally, 100 shares of common stock or American Depository Receipts ("ADRs") of companies that are listed on securities exchanges or trade over-the-counter.

Strike Price Intervals:
Generally, 2 1/2 points when the strike price is between $5 and $25, 5 points when the strike price is between $25 and $200, and 10 points when the strike price is over $200. Strikes are adjusted for splits, re-capitalizations, etc.

Strike (Exercise) Prices:
In-, at- and out-of-the-money strike prices are initially listed. New series are generally added when the underlying trades through the highest or lowest strike price available.

Premium Quotation:
Stated in points and fractions. One point equals $100. Minimum tick for options trading below 3 is .05 and for all other series, .10.

Expiration Date:
Saturday immediately following the third Friday of the expiration month.

Expiration Months:
Two near-term months plus two additional months from the January, February or March quarterly cycles.

Exercise Style:
American - Equity options generally may be exercised on any business day before the expiration date.

Settlement of Option Exercise:
Exercise notices properly tendered on any business day will result in delivery of the underlying stock on the third business day following exercise.

Position and Exercise Limits:
Limits vary according to the number of outstanding shares and past six-month trading volume of the underlying stock. The largest in capitalization and most frequently traded stocks have an option position limit of 250,000 contracts (with adjustments for splits, re-capitalizations, etc.) on the same side of the market; smaller capitalization stocks have position limits of 200,000, 75,000, 50,000 or 25,000 contracts (with adjustments for splits, re-capitalizations, etc.) on the same side of the market. The number of contracts on the same side of the market that may be exercised within any five consecutive business days is equal to the position limit. Equity option positions must be aggregated with equity LEAPS positions on the same underlying for position and exercise limit purposes. Exemptions may be available for certain qualified hedging strategies.

Reporting Requirements:
Please refer to Exchange Rule 4.13 for information pertaining to reporting requirements for positions in excess of 200 contracts.

Margin:
Purchases of puts or calls with 9 months or less until expiration must be paid for in full. Writers of uncovered puts or calls must deposit / maintain 100% of the option proceeds* plus 20% of the aggregate contract value (current equity price x $100) minus the amount by which the option is out-of -the-money, if any, subject to a minimum for calls of option proceeds* plus 10% of the aggregate contract value and a minimum for puts of option proceeds* plus 10% of the aggregate exercise price amount. (*For calculating maintenance margin, use option current market value instead of option proceeds.) Additional margin may be required pursuant to Exchange Rule 12.10.

Last Trading Day:
Trading in equity options will ordinarily cease on the business day (usually a Friday) preceding the expiration date.

Trading Hours:
8:30 a.m. - 3:00 p.m. Central Time (Chicago time).

EXHIBIT 3

in cooperation with entities the Administration has considered appropriate, for example, industry trade associations, industry members, and energy efficiency organizations.

The Administration is making available the information and materials developed under the program to small business concerns, including smaller design, engineering, and construction firms, and other Federal programs for energy efficiency, such as the Energy Star for Small Business Program.

The Administration will develop a strategy to educate, encourage, and assist small business concerns in adopting energy efficient building fixtures and equipment.

Consideration of Comments

This is a direct final rule, and SBA will review all comments. SBA believes that this rule is routine and non-controversial, and SBA anticipates no significant adverse comments to this rulemaking. If SBA receives any significant adverse comments, it will publish a timely withdrawal of this direct final rule.

Compliance With Executive Orders 12866, 12988, and 13132, the Paperwork Reduction Act (44 U.S.C. Ch. 35), and the Regulatory Flexibility Act (5 U.S.C. 601–612)

Executive Order 12866

The Office of Management and Budget (OMB) has determined that this rule does not constitute a significant regulatory action under Executive Order 12866.

Executive Order 12988

This action meets applicable standards set forth in sections 3(a) and 3(b)(2) of Executive Order 12988, Civil Justice Reform, to minimize litigation, eliminate ambiguity, and reduce burden. The action does not have retroactive or preemptive effect.

Executive Order 13132

For purposes of E.O. 13132, the SBA has determined that the rule will not have substantial, direct effects on the States, on the relationship between the national government and the States, or on the distribution of power and responsibilities among the various levels of government. Therefore, for the purpose of Executive Order 13132, Federalism, SBA determines that this proposed rule has no federalism implications warranting preparation of a federalism assessment.

Paperwork Reduction Act, 44 U.S.C. Ch. 35

SBA has determined that this proposed rule does not impose additional reporting or recordkeeping requirements under the Paperwork Reduction Act, 44 U.S.C. Chapter 35.

Regulatory Flexibility Act, 5 U.S.C. 601–612

The Regulatory Flexibility Act (RFA) 5 U.S.C. 601, requires administrative agencies to consider the effect of their actions on small entities, small non-profit enterprises, and small local governments. Pursuant to the RFA, when an agency issues a rulemaking, the agency must prepare a regulatory flexibility analysis which describes the impact of the rule on small entities. However, section 605 of the RFA allows an agency to certify a rule, in lieu of preparing an analysis, if the rulemaking is not expected to have a significant economic impact on a substantial number of small entities. Within the meaning of RFA, SBA certifies that this rule will not have a significant economic impact on a substantial number of small entities.

List of Subjects in 13 CFR Part 101

Administrative practice and procedure, Authority delegations (Government agencies), Intergovernmental relations, Investigations, Organization and functions (Government agencies), Reporting and recordkeeping requirements.

■ For the reasons stated in the preamble, the Small Business Administration amends 13 CFR part 101 as follows:

PART 101–ADMINISTRATION

■ 1. The authority citation for part 101 is revised to read as follows:

Authority: 5 U.S.C. 552 and App. 3, secs. 2, 4(a), 6(a), and 9(a)(1)(T); 15 U.S.C. 633, 634, 687; 31 U.S.C. 6506; 44 U.S.C. 3512; 42 U.S.C. 6307(d); 15 U.S.C. 657h; E.O. 12372 (July 14, 1982), 47 FR 30959, 3 CFR, 1982 Comp., p. 197, as amended by E.O. 12416 (April 8, 1983), 48 FR 15887, 3 CFR, 1983 Comp., p. 186.

■ 2. Amend part 101 by adding Subpart E to read as follows:

Subpart E—Small Business Energy Efficiency

Sec.

101.500 Small Business Energy Efficiency Program.

§ 101.500 Small Business Energy Efficiency Program.

(a) The Administration has developed and coordinated a Government-wide program, which is located at *http://www.sba.gov/energy*, building on the Energy Star for Small Business Program, to assist small business concerns in becoming more energy efficient, understanding the cost savings from improved energy efficiency, and identifying financing options for energy efficiency upgrades.

(b) The Program has been developed and coordinated in consultation with the Secretary of the Department of Energy and the Administrator of the Environmental Protection Agency, and in cooperation with entities the Administrator has considered appropriate, for example, such as industry trade associations, industry members, and energy efficiency organizations. SBA's Office of Policy and Strategic Planning will be responsible for overseeing the program but will coordinate with the Department of Energy and EPA.

(c) The Administration is distributing and making available online, the information and materials developed under the program to small business concerns, including smaller design, engineering, and construction firms, and other Federal programs for energy efficiency, such as the Energy Star for Small Business Program.

(d) The Administration will develop a strategy to educate, encourage, and assist small business concerns in adopting energy efficient building fixtures and equipment.

Sandy K. Baruah,

Acting Administrator.

[FR Doc. E8–24599 Filed 10–16–08; 8:45 am]

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SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 240

[Release No. 34–58774; File No. S7–08–08]

RIN 3235–AK06

"Naked" Short Selling Antifraud Rule

AGENCY: Securities and Exchange Commission.

ACTION: Final rule.

SUMMARY: The Securities and Exchange Commission ("Commission") is adopting an antifraud rule under the Securities Exchange Act of 1934 ("Exchange Act") to address fails to deliver securities that have been associated with "naked" short selling. The rule will further evidence the liability of short sellers, including broker-dealers acting for their own

accounts, who deceive specified persons about their intention or ability to deliver securities in time for settlement (including persons that deceive their broker-dealer about their locate source or ownership of shares) and that fail to deliver securities by settlement date.

DATES: *Effective Date:* October 17, 2008.

FOR FURTHER INFORMATION CONTACT: James A. Brigagliano, Associate Director, Josephine J. Tao, Assistant Director, Victoria L. Crane, Branch Chief, Joan M. Collopy, Special Counsel, Christina M. Adams and Matthew Sparkes, Staff Attorneys, Office of Trading Practices and Processing, Division of Trading and Markets, at (202) 551–5720, at the Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549–6628.

SUPPLEMENTARY INFORMATION: We are adding Rule 10b–21 [17 CFR 242.10b–21] under the Exchange Act.

I. Introduction

We are adopting an antifraud rule, Rule 10b–21, aimed at short sellers, including broker-dealers acting for their own accounts, who deceive specified persons, such as a broker or dealer, about their intention or ability to deliver securities in time for settlement and that fail to deliver securities by settlement date. Among other things, Rule 10b–21 will target short sellers who deceive their broker-dealers about their source of borrowable shares for purposes of complying with Regulation SHO's "locate" requirement.[1] Rule 10b–21 will also apply to sellers who misrepresent to their broker-dealers that they own the shares being sold.

A seller misrepresenting its short sale locate source or ownership of shares may intend to fail to deliver securities in time for settlement and, therefore, engage in abusive "naked" short selling. Although abusive "naked" short selling is not defined in the federal securities laws, it refers generally to selling short without having stock available for delivery and intentionally failing to deliver stock within the standard three-day settlement cycle.[2]

Although abusive "naked" short selling as part of a manipulative scheme is always illegal under the general antifraud provisions of the federal securities laws, including Rule 10b–5 of the Exchange Act,[3] Rule 10b–21 will further evidence the liability of persons that deceive others about their intention or ability to deliver securities in time for settlement, including persons that deceive their broker-dealer about their locate source or ownership of shares.[4] We believe that a rule further evidencing the illegality of these activities will focus the attention of market participants on such activities. Rule 10b–21 will also further evidence that the Commission believes such deceptive activities are detrimental to the markets and will provide a measure of predictability for market participants.

All sellers of securities should promptly deliver, or arrange for delivery of, securities to the respective buyer and all buyers of securities have the right to expect prompt delivery of securities purchased. Thus, Rule 10b–21 takes direct aim at an activity that may create fails to deliver. Those fails can have a negative effect on shareholders, potentially depriving them of the benefits of ownership, such as voting and lending. They also may create a misleading impression of the market for an issuer's securities. Rule 10b–21 will also aid broker-dealers in complying with the locate requirement of Regulation SHO and, thereby, potentially reduce fails to deliver. In addition, Rule 10b–21 could help reduce manipulative schemes involving "naked" short selling.

II. Background

A. Regulation SHO

Short selling involves a sale of a security that the seller does not own or that is consummated by the delivery of a security borrowed by or on behalf of the seller.[5] In a "naked" short sale, a seller does not borrow or arrange to borrow securities in time to make delivery to the buyer within the standard three-day settlement period.[6] As a result, the seller fails to deliver securities to the buyer when delivery is due (known as a "fail" or "fail to deliver").[7] Sellers sometimes intentionally fail to deliver securities as part of a scheme to manipulate the price of a security,[8] or possibly to avoid borrowing costs associated with short sales.

Although the majority of trades settle within the standard three-day settlement period,[9] we adopted Regulation SHO [10] in part to address problems associated with persistent fails to deliver securities and potentially abusive "naked" short selling.[11] Rule

[1] *See* 17 CFR 242.203(b)(1).

[2] *See* Exchange Act Release No. 56212 (Aug. 7, 2007), 72 FR 45544 (Aug. 14, 2007) ("2007 Regulation SHO Final Amendments"); Exchange Act Release No. 54154 (July 14, 2006), 71 FR 41710 (July 21, 2006) ("2006 Regulation SHO Proposed Amendments").

[3] 17 CFR 240.10b–5.

[4] This conduct is also in violation of other provisions of the federal securities laws, including the antifraud provisions.

[5] 17 CFR 242.200(a).

[6] *See* Exchange Act Release No. 50103 (July 28, 2004), 69 FR 48008 (Aug. 6, 2004) ("2004 Regulation SHO Adopting Release") (stating that "naked" short selling generally refers to selling short without having borrowed the securities to make delivery).

[7] Generally, investors complete or settle their security transactions within three business days. This settlement cycle is known as T+3 (or "trade date plus three days"). T+3 means that when the investor purchases a security, the purchaser's payment generally is received by its brokerage firm no later than three business days after the trade is executed. When the investor sells a security, the seller generally delivers its securities, in certificated or electronic form, to its brokerage firm no later than three business days after the sale. The three-day settlement period applies to most security transactions, including stocks, bonds, municipal securities, mutual funds traded through a brokerage firm, and limited partnerships that trade on an exchange. Government securities and stock options settle on the next business day following the trade. In addition, Rule 15c6–1 prohibits broker-dealers from effecting or entering into a contract for the purchase or sale of a security that provides for payment of funds and delivery of securities later than the third business day after the date of the contract unless otherwise expressly agreed to by the parties at the time of the transaction. 17 CFR 240.15c6–1; Exchange Act Release No. 33023 (Oct. 7, 1993), 58 FR 52891 (Oct. 13, 1993). However, failure to deliver securities on T+3 does not violate Rule 15c6–1.

[8] In 2003, the Commission settled a case against certain parties relating to allegations of manipulative short selling in the stock of a corporation. The Commission alleged that the defendants profited from engaging in massive "naked" short selling that flooded the market with the stock, and depressed its price. *See Rhino Advisors, Inc. and Thomas Badian*, Lit. Rel. No. 18003 (Feb. 27, 2003); *see also SEC* v. *Rhino Advisors, Inc. and Thomas Badian*, Civ. Action No. 03–civ–1310 (RO) (S.D.N.Y) (Feb. 26, 2003); *see also* Securities Exchange Act Release No. 48709 (Oct. 28, 2003), 68 FR 62972, 62975 (Nov. 6, 2003) ("2003 Regulation SHO Proposing Release") (describing the alleged activity in the settled case involving stock of Sedona Corporation); 2004 Regulation SHO Adopting Release, 69 FR at 48016, n.76.

[9] According to the National Securities Clearing Corporation ("NSCC"), 99% (by dollar value) of all trades settle on time. Thus, on an average day, approximately 1% (by dollar value) of all trades, including equity, debt, and municipal securities fail to settle. The vast majority of these fails are closed out within five days after T+3. In addition, fails to deliver may arise from either short or long sales of securities. There may be legitimate reasons for a fail to deliver. For example, human or mechanical errors or processing delays can result from transferring securities in custodial or other form rather than book-entry form, thereby causing a fail to deliver on a long sale within the normal three-day settlement period. In addition, broker-dealers that make markets in a security ("market makers") and who sell short thinly-traded, illiquid stock in response to customer demand may encounter difficulty in obtaining securities when the time for delivery arrives. The Commission's Office of Economic Analysis ("OEA") estimates that, on an average day between May 1, 2007 and July 31, 2008 (*i.e.*, the time period that includes all full months after the Commission started receiving price data from NSCC), trades in "threshold securities," as defined in Rule 203(b)(c)(6) of Regulation SHO, that fail to settle within T+3 account for approximately 0.3% of dollar value of trading in all equity securities.

[10] 17 CFR 242.200. Regulation SHO became effective on January 3, 2005.

[11] *See* 2007 Regulation SHO Final Amendments, 72 FR at 45544 (stating that "[a]mong other things,

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203 of Regulation SHO, in particular, contains a "locate" requirement that provides that, "[a] broker or dealer may not accept a short sale order in an equity security from another person, or effect a short sale in an equity security for its own account, unless the broker or dealer has: (i) Borrowed the security, or entered into a bona-fide arrangement to borrow the security; or (ii) Reasonable grounds to believe that the security can be borrowed so that it can be delivered on the date delivery is due; and (iii) Documented compliance with this paragraph (b)(1)." [12] In the 2004 Regulation SHO Adopting Release, the Commission explicitly permitted broker-dealers to rely on customer assurances that the customer has identified its own source of borrowable securities, provided it is reasonable for the broker-dealer to do so.[13] We are concerned, however, that some short sellers may have been deliberately misrepresenting to broker-dealers that they have obtained a legitimate locate source.[14]

In addition, we are concerned that some short sellers may have made misrepresentations to their broker-dealers about their ownership of shares as an end run around Regulation SHO's locate requirement.[15] Some sellers have also misrepresented that their sales are long sales in order to circumvent Rule 105 of Regulation M,[16] which prohibits certain short sellers from purchasing securities in a secondary or follow-on offering.[17] Under Rule 200(g)(1) of Regulation SHO, "[a]n order to sell shall be marked 'long' only if the seller is deemed to own the security being sold pursuant to paragraphs (a) through (f) of this section [18] and either: (i) The security to be delivered is in the physical possession or control of the broker or dealer; or (ii) it is reasonably expected that the security will be in the physical possession or control of the broker or dealer no later than the settlement of the transaction." [19]

Under Regulation SHO, the executing or introducing broker-dealer is responsible for determining whether there are reasonable grounds to believe that a security can be borrowed so that it can be delivered on the date delivery is due on a short sale, and whether a seller owns the security being sold and can reasonably expect that the security will be in the physical possession or control of the broker-dealer no later than settlement date for a long sale. However, a broker-dealer relying on a customer that makes misrepresentations about its locate source or ownership of shares may not receive shares when delivery is due. For example, sellers may be making misrepresentations to their broker-dealers about their locate sources or ownership of shares for securities that are very difficult or expensive to borrow. Such sellers may know that they cannot deliver securities by settlement date due to, for example, a limited number of shares being available to borrow or purchase, or they may not intend to obtain shares for timely delivery because the cost of borrowing or purchasing may be high. That result undermines the Commission's goal of addressing concerns related to "naked" short selling and extended fails to deliver.

B. Concerns About "Naked" Short Selling

We have been concerned about "naked" short selling and, in particular, abusive "naked" short selling, for some time. As discussed above, our concerns about potentially abusive "naked" short selling were an important reason for our adoption of Regulation SHO in 2004. In addition, due to our concerns about the potentially negative market impact of large and persistent fails to deliver, and the fact that we continued to observe a small number of threshold securities [20] with fail to deliver positions that were not being closed out under existing delivery and settlement requirements, in 2007 we eliminated the "grandfather" exception to Regulation SHO's close-out requirement [21] and today we adopted amendments to eliminate the options market maker exception to the close-out requirement.[22]

In addition to the actions we have taken aimed at reducing fails to deliver and addressing potentially abusive "naked" short selling in threshold securities, recently we took emergency action targeting "naked" short selling in some non-threshold securities. Specifically, on July 15, 2008, we published an emergency order under Section 12(k) of the Exchange Act (the "July Emergency Order") [23] that temporarily imposed enhanced requirements on short sales in the publicly traded securities of certain substantial financial firms.[24]

We issued the July Emergency Order because we were concerned that false rumors spread by short sellers regarding financial institutions of significance in the U.S. could continue to threaten significant market disruption. As we

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Regulation SHO imposes a close-out requirement to address persistent failures to deliver stock on trade settlement date and to target potentially abusive "naked" short selling in certain equity securities.").

[12] 17 CFR 242.203(b). Market makers engaged in bona fide market making in the security at the time they effect the short sale are excepted from this requirement.

[13] *See* 2004 Regulation SHO Adopting Release, 69 FR at 48014.

[14] *See, e.g., Sandell Asset Management Corp., Lars Eric Thomas Sandell, Patrick T. Burke and Richard F. Ecklord*, Securities Act Release No. 8857 (Oct. 10, 2007) (settled order).

[15] *See id.*

[16] 17 CFR 242.105.

[17] *See Goldman Sachs Execution and Clearing L.P.*, Exchange Act Release No. 55465 (Mar. 14, 2007) (settled order); *Weitz and Altman*, Lit. Release No. 18121 (April 30, 2003) (settled civil action).

[18] Rule 200(b) of Regulation SHO provides that a seller is deemed to own a security if, "(1) The person or his agent has title to it; or (2) The person has purchased, or has entered into an unconditional contract, binding on both parties thereto, to purchase it, but has not yet received it; or (3) The person owns a security convertible into or exchangeable for it and has tendered such security for conversion or exchange; or (4) The person has an option to purchase or acquire it and has exercised such option; or (5) The person has rights or warrants to subscribe to it and has exercised such rights or warrants; or (6) The person holds a security futures contract to purchase it and has received notice that the position will be physically settled and is irrevocably bound to receive the underlying security."

[19] 17 CFR 242.200(g)(1).

[20] A "threshold security" is defined in Rule 203(c)(6) as any equity security of an issuer that is registered pursuant to section 12 of the Exchange Act (15 U.S.C. 78l) or for which the issuer is required to file reports pursuant to section 15(d) of the Exchange Act (15 U.S.C. 78o(d)): (i) For which there is an aggregate fail to deliver position for five consecutive settlement days at a registered clearing agency of 10,000 shares or more, and that is equal to at least 0.5% of the issue's total shares outstanding; and (ii) that is included on a list disseminated to its members by a self-regulatory organization. 17 CFR 242.203(c)(6).

[21] *See* 2007 Regulation SHO Final Amendments, 72 FR 45544. The "grandfather" exception had provided that fails to deliver established prior to a security becoming a threshold security did not have to be closed out in accordance with Regulation SHO's close-out requirement. This amendment also contained a one-time phase-in period that provided that previously-grandfathered fails to deliver in a security that was a threshold security on the effective date of the amendment must be closed out within 35 consecutive settlement days from the effective date of the amendment. The phase-in period ended December 5, 2007.

[22] *See* Exchange Act Release No. 34–58775 (Oct. 14, 2008) ("2008 Regulation SHO Final Amendments"). The options market maker exception had excepted from the close-out requirement any fail to deliver position in a threshold security resulting from short sales effected by a registered options market maker to establish or maintain a hedge on options positions that were created before the underlying security became a threshold security.

[23] *See* Exchange Act Release No. 58166 (July 15, 2008).

[24] *See id.* The Emergency Order required that, in connection with transactions in the publicly traded securities of the substantial financial firms identified on Appendix A to the Emergency Order ("Appendix A Securities"), no person could effect a short sale in the Appendix A Securities using the means or instrumentalities of interstate commerce unless such person or its agent had borrowed or arranged to borrow the security or otherwise had the security available to borrow in its inventory prior to effecting such short sale and delivered the security on settlement date.

noted in the July Emergency Order, false rumors can lead to a loss of confidence in our markets. Such loss of confidence can lead to panic selling, which may be further exacerbated by "naked" short selling. As a result, the prices of securities may artificially and unnecessarily decline well below the price level that would have resulted from the normal price discovery process. If significant financial institutions are involved, this chain of events can threaten disruption of our markets.[25]

On July 29, 2008, we extended the July Emergency Order after carefully reevaluating the current state of the markets in consultation with officials of the Board of Governors of the Federal Reserve System, the Department of the Treasury, and the Federal Reserve Bank of New York. Due to our continued concerns about the ongoing threat of market disruption and effects on investor confidence, we determined that the standards of extension had been met.[26] Pursuant to the extension, the July Emergency Order terminated at 11:59 p.m. EDT on August 12, 2008.[27]

In addition to our adopting Rule 10b–21, as noted above, today we also adopted amendments to eliminate the options market maker exception to Regulation SHO's delivery requirement.[28] We also adopted today an interim final temporary rule that enhances the delivery requirements for sales of all equity securities ("2008 Interim Rule").[29]

The amendments to the options market maker exception and the 2008 Interim Rule that we adopted today both focus on the timely delivery of securities and are not aimed at pre-trade activity, such as compliance with Regulation SHO's locate requirement. Because we continue to be concerned about fails to deliver and potentially abusive "naked" short selling, in addition to our initiatives to strengthen Regulation SHO's delivery requirements, we are adopting Rule 10b–21 to also target sellers who deceive their broker-dealers or certain other persons about their source of borrowable shares and their share ownership.

As we stated in the Proposing Release,[30] we are concerned about persons that sell short securities and deceive specified persons about their intention or ability to deliver the securities in time for settlement, or deceive their broker-dealer about their locate source or ownership of shares. Commission enforcement actions have contributed to our concerns about the extent of misrepresentations by short sellers about their locate sources and ownership of shares, regardless of whether they result in fails to deliver. For example, the Commission recently announced a settled enforcement action against hedge fund adviser Sandell Asset Management Corp. ("SAM"), its chief executive officer, and two employees in connection with allegedly (i) improperly marking some short sale orders "long" and (ii) misrepresenting to executing brokers that SAM personnel had located sufficient stock to borrow for short sale orders.[31]

In addition, as we have stated on several prior occasions, we are concerned about the negative effect that fails to deliver may have on the markets and shareholders.[32] For example, fails to deliver may deprive shareholders of the benefits of ownership, such as voting and lending.[33] In addition, where a seller of securities fails to deliver securities on settlement date, in effect the seller unilaterally converts a securities contract (which is expected to settle within the standard three-day settlement period) into an undated futures-type contract, to which the buyer might not have agreed, or that might have been priced differently.[34]

In addition, commenters (including issuers and investors) have repeatedly expressed concerns about fails to deliver in connection with manipulative "naked" short selling. For example, in response to proposed amendments to Regulation SHO in 2006[35] designed to further reduce the number of persistent fails to deliver in certain equity securities by eliminating Regulation SHO's "grandfather" exception, and amending the options market maker exception, we received a number of comments that expressed concerns about "naked" short selling and extended delivery failures.[36] Commenters continued to express these concerns in response to proposed amendments to eliminate the options market maker exception to the close-out requirement of Regulation SHO in 2007[37] and in response to the Proposing Release.[38]

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[25] We delayed the effective date of the Emergency Order to July 21, 2008 to create the opportunity to address, and to allow sufficient time for market participants to make, adjustments to their operations to implement the enhanced requirements. Moreover, in addressing anticipated operational accommodations necessary for implementation of the Emergency Order, we issued an amendment to the Emergency Order on July 18, 2008. *See* Exchange Act Release No. 58190 (July 18, 2008) (excepting from the Emergency Order bona fide market makers, short sales in Appendix A Securities sold pursuant to Rule 144 of the Securities Act of 1933, and certain short sales by underwriters, or members of a syndicate or group participating in distributions of Appendix A Securities).

[26] *See* Exchange Act Release No. 58248 (July 29, 2008).

[27] In addition, on September 17, 2008, the Commission further addressed abusive "naked" short selling by issuing an Emergency Order that temporarily adopted amendments to Regulation SHO's close-out requirement, amendments to eliminate Regulation SHO's options market maker exception to the close-out requirement, and Rule 10b–21. *See* Exchange Act Release No. 58572 (Sept. 17, 2008). The Commission also issued emergency orders to require disclosure of short sales, Exchange Act Release 58591 (Sept. 18, 2008) and 58591A (Sept. 21, 2008), and temporarily halt short selling in financial stocks, Exchange Act Release 58592 (Sept. 18, 2008) and Exchange Act Release 58611 (Sept. 21, 2008).

[28] *See supra* note 22.

[29] *See* Exchange Act Release No. 58773 (Oct. 14, 2008).

[30] Exchange Act Release No. 57511 (Mar. 17, 2008), 73 FR 15376, 15377 (Mar. 21, 2008) ("Proposing Release").

[31] *See Sandell Asset Management Corp.*, Securities Act Release No. 8857; *see also Goldman Sachs Execution and Clearing L.P.*, Exchange Act Release No. 55465; *U.S. v. Naftalin*, 441 U.S. 768 (1979) (discussing a market manipulation scheme in which brokers suffered substantial losses when they had to purchase securities to replace securities they had borrowed to make delivery on short sale orders received from an individual investor who had falsely represented to the brokers that he owned the securities being sold).

[32] *See supra* note 22; 2007 Regulation SHO Final Amendments, 72 FR at 45544; 2006 Regulation SHO Proposed Amendments, 71 FR at 41712; 2007 Regulation SHO Proposed Amendments, 72 FR at 45558–45559; Proposing Release, 73 FR at 15378.

[33] *See id.*

[34] *See id.*

[35] See 2006 Regulation SHO Proposed Amendments, 71 FR 41710.

[36] See, *e.g.*, letter from Patrick M. Byrne, Chairman and Chief Executive Officer, Overstock.com, Inc., dated Sept. 11, 2006 ("Overstock"); letter from Daniel Behrendt, Chief Financial Officer, and Douglas Klint, General Counsel, TASER International, dated Sept. 18, 2006 ("TASER"); letter from John Royce, dated April 30, 2007 ("Royce"); letter from Michael Read, dated April 29, 2007 ("Read"); letter from Robert DeVivo, dated April 26, 2007 ("DeVivo"); letter from Ahmed Akhtar, dated April 26, 2007 ("Akhtar").

[37] See, *e.g.*, letter from Jack M. Wedam, dated Oct. 16, 2007; letter from Michael J. Ryan, Executive Director and Senior Vice President, Center for Capital Markets Competitiveness, U.S. Chamber of Commerce, dated Sept. 13, 2007 ("U.S. Chamber of Commerce"); letter from Robert W. Raybould, CEO Enteleke Capital Corp., dated Sept. 12, 2007; letter from Mary Helburn, Executive Director, National Coalition Against Naked Shorting, dated Sept. 11, 2007 ("NCANS 2007").

[38] *See, e.g.*, letter from Richard H. Baker, President and Chief Executive Officer, Managed Funds Association, dated May 21, 2008 ("MFA") (stating that "[m]arket manipulation, such as intentional and abusive naked short selling, undermines the integrity of the U.S. capital markets and threatens investor confidence, market liquidity and market efficiency"); letter from Kurt N. Schacht and Linda Rittenhouse, Centre for Financial Market Integrity, dated June 17, 2008 (stating that they "support efforts by the Commission to curtail naked short selling, for all the reasons noted in the [Proposing Release] relating to the detrimental effects on the marketplace. As noted [in the Proposing Release], this practice not only affects

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To the extent that fails to deliver might be part of manipulative "naked" short selling, which could be used as a tool to drive down a company's stock price,[39] such fails to deliver may undermine the confidence of investors.[40] These investors, in turn, may be reluctant to commit capital to an issuer they believe to be subject to such manipulative conduct.[41] In addition, issuers may believe that they have suffered unwarranted reputational damage due to investors' negative perceptions regarding fails to deliver in the issuer's security.[42] Unwarranted reputational damage caused by fails to deliver might have an adverse impact on the security's price.[43]

Strengthening rules that address "naked" short selling will provide increased confidence in the markets. Since the issuance of the July Emergency Order, members of the public have repeatedly expressed their concerns about a loss of confidence in the markets. For example, one commenter stated that "financial confidence is critically important" for companies to do business.[44] Another commenter stated that "existing laws should be enforced, but further steps should be taken to prevent any further erosion of the investing publics [sic] confidence."[45]

We are concerned about the ability of short sellers to use "naked" short selling as a tool to manipulate the prices of securities.[46] Thus, in conjunction with our other short selling initiatives aimed at further reducing fails to deliver and addressing abusive "naked" short selling, we have adopted Rule 10b–21 substantially as proposed.

Proposed Rule 10b–21 was narrowly tailored to specify that it is unlawful for any person to submit an order to sell a security if such person deceives a broker-dealer, participant of a registered clearing agency,[47] or purchaser regarding its intention or ability to deliver the security on the date delivery is due, and such person fails to deliver the security on or before the date delivery is due.[48] We received over 700 comment letters in response to the Proposing Release.

The comment letters were from numerous entities, including issuers, retail investors, broker-dealers, SROs, associations, members of Congress, and other elected officials.[49] Many commenters supported our goals of further addressing potentially abusive "naked" short selling and fails to deliver, while not necessarily agreeing with the Commission's approach. For example, some commenters argued for more stringent short sale regulation.[50] Others urged us to take stronger enforcement action against abusive "naked" short sellers under the current federal securities laws rather than, or in addition to, adopting Rule 10b–21.[51]

shareowners by depriving the[m] of the basic benefits of ownership, it also may detrimentally affect the issuer's reputation and subvert the appropriate workings of the market by avoiding certain restrictions applicable to those who deliver on time. All of these issues can ultimately undermine investor confidence."); letter from Wallace E. Boston, President and Chief Executive Officer, American Public Education, Inc., dated May 20, 2008 (noting that "[a]s the CEO of a recently public company, I am acutely aware of the impact that abusive short-selling can have on issuers and investors.").

[39] *See, e.g., Rhino Advisors, Inc. and Thomas Badian*, Lit. Rel. No. 18003 (Feb. 27, 2003); *see also SEC* v. *Rhino Advisors, Inc. and Thomas Badian*, Civ. Action No. 03 civ 1310 (RO) (S.D.N.Y) (Feb. 26, 2003) (settled case in which we alleged that the defendants profited from engaging in massive "naked" short selling that flooded the market with the company's stock, and depressed its price); *see also S.E.C.* v. *Gardiner*, 48 S.E.C. Docket 811, No. 91 Civ. 2091 (S.D.N.Y. 1991) (alleged manipulation by sales representative by directing or inducing customers to sell stock short in order to depress its price); *U.S.* v. *Russo*, 74 F.3d 1383, 1392 (2d Cir. 1996) (short sales were sufficiently connected to the manipulation scheme as to constitute a violation of Exchange Act Section 10(b) and Rule 10b–5).

[40] In response to the 2007 Regulation SHO Proposed Amendments, we received comment letters discussing the impact of fails to deliver on investor confidence. *See, e.g.*, letter from NCANS 2007. Commenters expressed similar concerns in response to the 2006 Regulation SHO Proposed Amendments. *See, e.g.*, letter from Mary Helburn, Executive Director, National Coalition Against Naked Shorting, dated Sept. 30, 2006 ("NCANS 2006"); letter from Richard Blumenthal, Attorney General, State of Connecticut, dated Sept. 19, 2006.

[41] In response to the 2007 Regulation SHO Proposed Amendments, we received comment letters expressing concern about the impact of potential "naked" short selling on capital formation, claiming that "naked" short selling causes a drop in an issuer's stock price and may limit the issuer's ability to access the capital markets. *See, e.g.*, letter from Robert K. Lifton, Chairman and CEO, Medis Technologies, Inc., dated Sept. 12, 2007; letter from NCANS 2007. Commenters expressed similar concerns in response to the 2006 Regulation SHO Proposed Amendments. *See, e.g.*, letter from Congressman Tom Feeney—Florida, U.S. House of Representatives, dated Sept. 25, 2006; *see also* letter from Zix Corporation, dated Sept. 19, 2006 (stating that "[m]any investors attribute the Company's frequent re-appearances on the Regulation SHO list to manipulative short selling and frequently demand that the Company "do something" about the perceived manipulative short selling. This perception that manipulative short selling of the Company's securities is continually occurring has undermined the confidence of many of the Company's investors in the integrity of the market for the Company's securities.").

[42] Due in part to such concerns, some issuers have taken actions to attempt to make transfer of their securities "custody only," thus preventing transfer of their stock to or from securities intermediaries such as the Depository Trust Company ("DTC") or broker-dealers. *See* 2003 Regulation SHO Proposing Release, 68 FR at 62975. Some issuers have attempted to withdraw their issued securities on deposit at DTC, which makes the securities ineligible for book-entry transfer at a securities depository. *See id.* Withdrawing securities from DTC or requiring custody-only transfers would undermine the goal of a national clearance and settlement system designed to reduce the physical movement of certificates in the trading markets. *See id.* We note, however, that in 2003 the Commission approved a DTC rule change clarifying that its rules provide that only its participants may withdraw securities from their accounts at DTC, and establishing a procedure to process issuer withdrawal requests. *See* Exchange Act Release No. 47978 (June 4, 2003), 68 FR 35037 (June 11, 2003).

[43] *See also* 2006 Regulation SHO Proposed Amendments, 71 FR at 41712; 2007 Regulation SHO Amendments, 72 FR at 45544; 2007 Regulation SHO Proposed Amendments, 72 FR at 45558–45559; Proposing Release, 73 FR at 15378 (providing additional discussion of the impact of fails to deliver on the market); *see also* 2003 Regulation SHO Proposing Release, 68 FR at 62975 (discussing the impact of "naked" short selling on the market).

[44] *See* Comment of Ron Heller (July 21, 2008) ("Heller") (commenting on the Emergency Order).

[45] *See* Comment of Ronald L. Rourk (July 21, 2008) ("Rourk") (commenting on the proposal to eliminate Regulation SHO's options market maker exception).

[46] *See, e.g.*, Commission press release, dated July 13, 2008, announcing that the Commission's Office of Compliance Inspections and Examinations, as well as FINRA and New York Stock Exchange Regulation, Inc., will immediately conduct examinations aimed at the prevention of the intentional spreading of false information intended to manipulate securities prices. *See http://www.sec.gov/news/press/2008/2008-140.htm.* In addition, in April of this year, the Commission charged Paul S. Berliner, a trader, with securities fraud and market manipulation for intentionally disseminating a false rumor concerning The Blackstone Group's acquisition of Alliance Data Systems Corp ("ADS"). The Commission alleged that this false rumor caused the price of ADS stock to plummet, and that Berliner profited by short selling ADS stock and covering those sales as the false rumor caused the price of ADS stock to fall. *See http://www.sec.gov/litigation/litreleases/2008/lr20537.htm.*

[47] The term "participant" has the same meaning as in section 3(a)(24) of the Exchange Act. *See* 15 U.S.C. 78c(a)(24). The term "registered clearing agency" means a clearing agency, as defined in section 3(a)(23) of the Exchange Act, that is registered as such pursuant to section 17A of the Exchange Act. *See* 15 U.S.C. 78c(a)(23)(A), 78q–1 and 15 U.S.C. 78q–1(b), respectively.

[48] *See* Proposed Rule 10b–21.

[49] The comment letters are available on the Commission's Internet Web Site at *http://www.sec.gov/comments/s7-08-08/s70808.shtml.*

[50] *See, e.g.*, letter from Arik B. Fetscher, Esq., dated April 2, 2008; letter from Fred Adams, Jr., Chairman and Chief Executive Officer, Cal-Maine Foods, Inc., dated May 19, 2008; letter from David T. Hirschman, President and Chief Executive Officer, Center for Capital Markets Competitiveness, United States Chamber of Commerce, dated May 20, 2008 ("Chamber of Commerce"); letter from Wallace E. Boston, Jr., President and Chief Executive Officer, American Public Education, Inc., dated May 20, 2008; letter from Kurt N. Schacht, Executive Director, and Linda L. Rittenhouse, Senior Policy Analyst, CFA Institute Centre for Financial Market Integrity, dated June 17, 2008; letter from Guillaume Cloutier, dated July 25, 2008; letter from Shunliang Wang, dated July 27, 2008; letter from Scott Bridgford, dated July 29, 2008; letter from Keith Kottwitz, dated Aug. 1, 2008.

[51] *See, e.g.*, letter from Tony J. Akin, Jr., Financial Advisor, dated March 31, 2008; letter from Gary D. Owens, CEO, OYO Geospace, dated April 22, 2008; letter from Daniel J. Popeo, Chairman & General Counsel, and Paul D. Kamenar, Senior Executive Counsel, Washington Legal Foundation, dated May

Some commenters asked that if we adopt Rule 10b–21 as proposed, we provide certain clarifications regarding the application of the rule.[52] We highlight in the discussion below some of the main issues, concerns, and suggestions raised in the comment letters.

III. Discussion of Rule 10b–21

A. Rule 10b–21

After careful consideration of the comments, we are adopting Rule 10b–21 substantially as proposed. Rule 10b–21 specifies that it is unlawful for any person to submit an order to sell an equity security if such person deceives a broker-dealer, participant of a registered clearing agency,[53] or purchaser regarding its intention or ability to deliver the security on the date delivery is due, and such person fails to deliver the security on or before the date delivery is due.[54] Scienter is a necessary element for a violation of the rule.[55] Some commenters questioned whether, similar to Regulation SHO, proposed Rule 10b–21 would apply only to equity securities.[56] In response to these comments, we clarify that as proposed and adopted, Rule 10b–21 applies only to equity securities.[57]

Rule 10b–21 will cover those situations where a seller deceives a broker-dealer, participant of a registered clearing agency, or a purchaser about its intention to deliver securities by settlement date, its locate source, or its share ownership, and the seller fails to deliver securities by settlement date.[58] Rule 10b–21 will prohibit the deception of persons participating in the transaction—broker-dealers, participants of registered clearing agencies, or purchasers. Further, because one of the principal goals of Rule 10b–21 is to reduce fails to deliver, violation of the rule will occur only if a fail to deliver results from the relevant transaction.

For purposes of Rule 10b–21, broker-dealers (including market makers) acting for their own accounts will be considered sellers. For example, a broker-dealer effecting short sales for its own account will be liable under the rule if it does not obtain a valid locate source and fails to deliver securities to the purchaser. Such broker-dealers defraud purchasers that may not receive delivery on time, in effect unilaterally forcing the purchaser into accepting an undated futures-type contract.[59]

As noted above, under Regulation SHO, the executing or introducing broker-dealer is responsible for determining whether there are reasonable grounds to believe that a security can be borrowed so that it can be delivered on the date delivery is due on a short sale.[60] In the 2004 Regulation SHO Adopting Release, the Commission explicitly permitted broker-dealers to rely on customer assurances that the customer has identified its own locate source, provided it is reasonable for the broker-dealer to do so.[61] If a seller elects to provide its own locate source to a broker-dealer, the seller is representing that it has contacted that source and reasonably believes that the source can or intends to deliver the full amount of the securities to be sold short by settlement date. In addition, if a seller enters a short sale order into a broker-dealer's direct market access or sponsored access system ("DMA") with any information purporting to identify a locate source obtained by the seller, the seller makes a representation to a broker-dealer for purposes of Rule 10b–21.[62]

If a seller deceives a broker-dealer about the validity of its locate source, the seller will be liable under Rule 10b–21 if the seller also fails to deliver securities by the date delivery is due. For example, a seller will be liable for a violation of Rule 10b–21 if it represented that it had identified a source of borrowable securities, but the seller never contacted the purported source to determine whether shares were available and could be delivered in time for settlement and the seller fails to deliver securities by settlement date. A seller will also be liable if it contacted the source and learned that the source did not have sufficient shares for timely delivery, but the seller misrepresented that the source had sufficient shares that it could deliver in time for settlement and the seller fails to deliver securities by settlement date; or, if the seller contacted the source and the source had sufficient shares that it could deliver in time for settlement, but the seller never instructed the source to deliver the shares in time for settlement and the seller otherwise refused to deliver shares on settlement date such that the sale results in a fail to deliver.

One commenter recommended that the rule focus on whether there is a fail to deliver in the Continuous Net Settlement ("CNS") system, rather than on a seller's failure to deliver the securities sold.[63] The majority of equity trades in the United States are cleared and settled through systems administered by clearing agencies registered with the Commission. The NSCC clears and settles the majority of equity securities trades conducted on the exchanges and in the over the counter market. NSCC clears and settles trades through the CNS system, which nets the securities delivery and payment obligations of all of its members. The majority of NSCC's members are broker-

20, 2008; letter from David Hughes, dated July 17, 2008; letter from Dave Morgan, dated July 25, 2008; letter from Seth Bradley, dated July 30, 2008; letter from Michael Kianka, dated Aug. 1, 2008.

[52] *See, e.g.*, letter from James J. Angel, Associate Professor of Finance, Georgetown University, dated May 17, 2008 ("Angel"); letter from Heather Traeger, Assistant Counsel, Investment Company Institute, dated May 20, 2008; letter from Dr. Robert J. Shapiro, Chairman, Sonecon, LLC, and former U.S. Under Secretary of Commerce, dated May 20, 2008 ("Shapiro"); letter from Ira D. Hammerman, Managing Director and General Counsel, Securities Industry and Financial Markets Association, dated May 22, 2008 ("SIFMA"); letter from Michael R. Trocchio, Bingham McCutchen LLP, dated July 14, 2008 ("Bingham"); letter from MFA.

[53] *See supra* note 47 (defining the terms "participant" and "registered clearing agency" for purposes of the rule).

[54] *See* Rule 10b–21.

[55] *Ernst & Ernst* v. *Hochfelder, et al.*, 425 U.S. 185 (1976). Scienter has been defined as "a mental state embracing the intent to deceive, manipulate or defraud." *Id.* at 193, n.12. While the Supreme Court has not decided the issue (*see Aaron* v. *SEC*, 446 U.S. 686 (1980); *Ernst & Ernst*, 425 at 193 n.12), federal appellate courts have concluded that scienter may be established by a showing of either knowing conduct or by "an 'extreme departure from the standards of ordinary care * * * which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it.'" *Dolphin & Bradbury* v. *SEC*, 512 F.3d 634 (D.C. Cir. Jan. 11, 2008) (quoting *Sundstrand Corp.* v. *Sun Chemical Corp.*, 553 F.2d 1033, 1045 (7th Cir. 1977)). Some commenters stated they believe that Rule 10b–21 should require a finding of "intentional deception" to best achieve our goals without deterring legitimate short selling. *See, e.g.*, letter from MFA; another commenter, however, requested that we confirm that the concept of scienter, for purposes of Rule 10b–21, is identical to established precedent under Section 10(b) of the Exchange Act and Rule 10b–5 thereunder. *See* letter from SIFMA. We intend the scienter requirement of Rule 10b–21 to be the same as that required under Rule 10b–5.

[56] *See, e.g.*, letter from MFA.

[57] *See, e.g.*, Proposing Release, 73 FR at 15380; *see also* Rule 10b–21.

[58] As proposed, the rule referenced "the date delivery is due." To provide specificity as to when delivery is due for purposes of the rule, we are modifying this language to "settlement date" and defining "settlement date" as "the business day on which delivery of a security and payment of money is to be made through the facilities of a registered clearing agency in connection with the sale of a security." *See* Rule 10b–21(b).

[59] *See supra* note 22; 2007 Regulation SHO Final Amendments, 72 FR at 45544; 2006 Regulation SHO Proposed Amendments, 71 FR at 41712; 2007 Regulation SHO Proposed Amendments, 72 FR at 45558–45559.

[60] *See* 17 CFR 242.203(b)(3)(1).

[61] *See* 2004 Regulation SHO Adopting Release, 69 FR at 48014.

[62] Broker-dealers offer DMA to some customers by providing them with electronic access to a market's execution system using the broker-dealer's market participant identifier. The broker-dealer, however, retains the ultimate responsibility for the trading activity of its customer.

[63] *See* letter from SIFMA.

dealers.[64] NSCC notifies its members of their securities delivery and payment obligations daily. In addition, NSCC guarantees the completion of all transactions and interposes itself as the contraparty to both sides of the transaction. This commenter noted that a seller's clearing broker generally bears the responsibility to meet the firm's CNS delivery requirement and that it is difficult for a broker-dealer to determine which customer transactions or accounts give rise to a fail to deliver in the CNS system. We note, however, that Rule 10b–21 as proposed was not based on whether a fail to deliver occurred in CNS. Rather, the rule as proposed was concerned with whether an individual seller delivered securities that it sold. Along those lines, another commenter stated that the proposed rule should require a failure to deliver by the seller.[65]

We have determined to adopt the rule as proposed. The rule targets the misconduct of sellers. As discussed above, sellers should promptly deliver the securities they have sold and purchasers have the right to the timely receipt of securities that they have purchased. 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. Because fails to deliver in the CNS system are netted with pending deliveries, some sellers may be able to postpone delivery if another customer's purchase is received the same day. Thus, a person engaging in abusive "naked" short selling may be able to avoid detection for a period of time. This would undermine our goal of addressing abusive "naked" short selling.

B. Seller's Reliance on a Broker-Dealer or "Easy to Borrow" Lists

Rule 10b–21 provides that it shall be unlawful for any person to submit an order to sell an equity security if such person deceives a broker-dealer, participant of a registered clearing agency, or purchaser regarding its intention or ability to deliver the security on the date delivery is due.[66] Thus, as we discussed in the Proposing Release,[67] 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. For example, a seller might be relying on its broker-dealer to borrow or arrange to borrow the security to make delivery by settlement date. Alternatively, a seller might be relying on a broker-dealer's "Easy to Borrow" list. If a seller in good faith relies on a broker-dealer's "Easy to Borrow" list to satisfy the locate requirement, the seller would not be deceiving the broker-dealer 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. In discussing the locate requirement of Regulation SHO, in the 2004 Regulation SHO Adopting Release, the Commission stated that "absent countervailing factors, 'Easy to Borrow' lists may provide 'reasonable grounds' for a broker-dealer to believe that the security sold short is available for borrowing without directly contacting the source of the borrowed securities."[68]

C. Bona Fide Market Makers

As we discussed in the Proposing Release,[69] a market maker engaged in bona fide market making activity would not be making a representation at the time it submits an order to sell short that it can or intends to deliver securities on the date delivery is due, because such market makers are excepted from the locate requirement of Regulation SHO. Regulation SHO excepts from the locate requirement market makers engaged in bona-fide market making activities because market makers need to facilitate customer orders in a fast moving market without possible delays associated with complying with the locate requirement.[70] Thus, at the time of submitting an order to sell short, market makers that have an exception from the locate requirement of Regulation SHO may know that they may not be able to deliver securities on the date delivery is due.

D. "Long" Sales

Under Rule 10b–21, a seller will be liable if it deceives a broker-dealer, participant of a registered clearing agency, or purchaser about its ownership of shares or the deliverable condition of owned shares and fails to deliver securities by settlement date.[71] As we discussed in the Proposing Release,[72] a seller will be liable for a violation of Rule 10b–21 for causing a broker-dealer to mark an order to sell a security "long" if the seller knows or recklessly disregards that it is not "deemed to own" the security being sold, as defined in Rules 200(a) through (f) of Regulation SHO[73] or if the seller knows or recklessly disregards that the security being sold is not, or cannot reasonably be expected to be, in the broker-dealer's physical possession or control by the date delivery is due, and the seller fails to deliver the security by settlement date.

Broker-dealers acting for their own accounts will also be liable under Rule 10b–21 for marking an order "long" if the broker-dealer knows or recklessly disregards that it is not "deemed to own" the security being sold or that the security being sold is not, or cannot reasonably be expected to be, in the broker-dealer's physical possession or control by the date delivery is due, and the broker-dealer fails to deliver the security by settlement date.[74]

However, a seller would not be making a representation 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 if the seller submits an order to sell securities that are held in a margin account but the broker-dealer has loaned out the shares pursuant to the margin agreement. Under such circumstances, it would be reasonable for the seller to expect that the securities will be in the broker-dealer's physical possession or control by settlement date.

E. Rule 10b–21 and Other Antifraud Provisions of the Federal Securities Laws

One commenter stated that it believes proposed Rule 10b–21 is unnecessary "because the Commission already has ample existing authority, under Section 10(b) of the Exchange Act and Rule 10b–5 thereunder, to prosecute manipulative and/or fraudulent activity, including the type of activity that proposed Rule 10b–21 seeks to address."[75] Other commenters urged us to use less formal means than rulemaking to address our concerns regarding misrepresentations in the order entry process.[76] For

[64] As of July 31, 2008 approximately 91% of members of the NSCC were registered as broker-dealers.

[65] *See* letter from Bingham.

[66] *See* Rule 10b–21.

[67] *See* Proposing Release, 73 FR at 15379.

[68] 2004 Regulation SHO Adopting Release, 69 FR at 48014.

[69] *See* Proposing Release, 73 FR at 15379.

[70] *See* 2004 Regulation SHO Adopting Release, 69 FR at 48015, n. 67; *see also* 2008 Regulation SHO Final Amendments, *supra* note 22 (providing interpretive guidance regarding bona fide market making activities for purposes of Regulation SHO).

[71] *See* Rule 10b–21.

[72] *See* Proposing Release, 73 FR at 15379.

[73] 17 CFR 242.200(a)–(f).

[74] Such broker-dealers will also be liable under Regulation SHO Rule 203(a).

[75] *See* letter from SIFMA; *see* also letter from Bingham (stating that "[t]he Firms agree that the illicit conduct the Commission seeks to address through [proposed Rule 10b–21] is already illegal"); letter from MFA.

[76] *See, e.g.*, letter from Bingham; letter from MFA; *but, c.f.*, letter from Chamber of Commerce (noting

instance, these commenters suggested that the Commission or its staff could convey this message through FAQs, staff bulletins, and speeches.[77] We have determined, however, that the negative effects of abusive "naked" short selling on market confidence warrant formal Commission action.

While "naked" short selling as part of a manipulative scheme is already illegal under the general antifraud provisions of the federal securities laws, we believe that a rule further evidencing the illegality of these activities will focus the attention of market participants on such activities. Rule 10b–21 will also further evidence that the Commission believes such deceptive activities are detrimental to the markets and will provide a measure of predictability for market participants.

Some commenters sought clarification as to how this rule was different from Rule 10b–5.[78] We note that the set of factors that will serve as the basis for a violation of Rule 10b–21 as adopted are not determinative of a person's obligations under the general antifraud provisions of the federal securities laws. Accordingly, and in order to clarify the continued applicability of the general antifraud provisions outside of the strict context of Rule 10b–21, we have added a preliminary note to the rule as adopted, which states: "This rule is not intended to limit, or restrict, the applicability of the general antifraud provisions of the federal securities laws, such as section 10(b) of the Act and rule 10b–5 thereunder." We added this preliminary note because we believe it is important to underscore that Rule 10b–21 is not meant, in any way, to limit the general antifraud provisions of the federal securities laws. Additionally, this preliminary note provides much needed public clarity in answer to the confusion voiced by many commenters.

Similarly, we are modifying the proposed rule text slightly to add the word "also," as follows: "It shall *also* constitute a 'manipulative or deceptive device or contrivance' as used in section 10(b) of this Act for any person to submit an order to sell an equity security if such person deceives a broker or dealer, a participant of a registered clearing agency, or a purchaser about its intention or ability to deliver the security on or before the settlement date, and such person fails to deliver the security on or before the settlement date."

We believe the adding the word "also" in the rule text further clarifies that Rule 10b–21 does not affect the operation of Rule 10b–5 or other antifraud rules, but is instead intended to supplement the existing antifraud rules.

Commenters also raised questions whether there would be a private right of action for a violation of proposed Rule 10b–21.[79] We note that the courts have held that a private right of action exists with respect to Rule 10b–5 provided the essential elements constituting a violation of the rule are met.[80] Thus, a private plaintiff able to prove all those elements in a situation covered by Rule 10b–21 would be able to assert a claim under Section 10(b) of the Exchange Act and Rule 10b–5 thereunder.

F. Aiding and Abetting Liability

In the Proposing Release, we stated that "[a]lthough the proposed rule is primarily aimed at sellers that deceive specified persons about their intention or ability to deliver shares or about their locate source and ownership of shares, as with any rule, broker-dealers could be liable for aiding and abetting a customer's fraud under the proposed rule."[81] One commenter stated that broker-dealers should not be held responsible for policing their customer's compliance with their own legal requirements.[82] Another commenter urged us to specifically state that reliance by a broker-dealer on a customer representation regarding long/short status or receipt of a locate does not rise to the level of scienter required for aiding and abetting liability.[83] This commenter also asked us to make clear that broker-dealers who merely offer DMA or sponsored access to a customer who violates the new rule would not be liable for aiding and abetting such violation.[84]

Rule 10b–21 as adopted does not impose any additional liability or requirements on any person, including broker-dealers, beyond those of any existing Exchange Act rule. As we stated in the Proposing Release, broker-dealers would remain subject to liability under Regulation SHO and the general antifraud provisions of the federal securities laws.[85]

G. Administrative Law Matters

The Administrative Procedure Act also generally requires that an agency publish an adopted rule in the **Federal Register** 30 days before it becomes effective.[86] This requirement, however, does not apply if the agency finds good cause for making the rule effective sooner.[87] The Commission has determined that the rule should be effective in fewer than 30 days because it addresses illegal conduct that can cause market disruption. In addition, because the rule further evidences conduct that is manipulative and deceptive under existing general antifraud rules, market participants should not need time to adjust systems or procedures to comply with the rule. Therefore, the Commission finds good cause to make the rule effective on October 17, 2008.

IV. Paperwork Reduction Act

Rule 10b–21 does not contain a "collection of information" requirement within the meaning of the Paperwork Reduction Act of 1995.[88]

V. Cost-Benefit Analysis

We are sensitive to the costs and benefits of our rules and we have considered the costs and benefits of Rule 10b–21. In order to assist us in evaluating the costs and benefits, in the Proposing Release, we encouraged commenters to discuss any costs or benefits that the rule would impose. In particular, we requested comment on the potential costs for any modification to both computer systems and surveillance mechanisms and for information gathering, management, and recordkeeping systems or procedures, as well as any potential benefits resulting from the rule for issuers, investors, brokers or dealers, other securities industry professionals, regulators, and other market participants. Commenters were encouraged to provide analysis and data to support their views on the costs and benefits associated with the rule.

A. Benefits

Rule 10b–21 is intended to address abusive "naked" short selling and fails

that although the activity covered by proposed Rule 10b–21 is already a violation of the antifraud provisions of the federal securities laws, "[e]mphasizing that such deceit violates these laws may deter some of this activity in the future").

[77] *See, e.g.*, letter from Bingham.

[78] *See, e.g.*, letter from MFA; *see also* letter from SIFMA (seeking clarification as to whether the level of scienter in the proposed rule differs from that of Rule 10b–5).

[79] *See, e.g.*, letter from SIFMA. Another commenter stated that "[t]he Commission should make explicitly clear that the adoption of Proposed Rule 10b–21 does not create a private right of action for violations of the rule. * * *" *See* letter from Bingham.

[80] *See, e.g., Superintendent of Insurance* v. *Bankers Life & Cas. Co.*, 404 U.S. 6, 13, n. 9 (1971); *Ernst & Ernst*, 425 at 196 (citing prior cases).

[81] *See* Proposing Release, 72 FR at 15379.

[82] *See* letter from SIFMA.

[83] *See* letter from Bingham.

[84] *See id.*

[85] *See* Proposing Release, 72 FR at 15380.

[86] *See* 5 U.S.C. § 553(d).

[87] *Id.*

[88] 44 U.S.C. 3501 *et seq.*

to deliver. The rule is aimed at short sellers, including broker-dealers acting for their own accounts, who deceive broker-dealers, participants of a registered clearing agency, or purchasers about their intention or ability to deliver securities in time for settlement and that fail to deliver securities by settlement date. Among other things, Rule 10b–21 targets short sellers who deceive their broker-dealers about their source of borrowable shares for purposes of complying with Regulation SHO's "locate" requirement.[89] The rule also applies to sellers who misrepresent to their broker-dealers that they own the shares being sold.[90]

A seller misrepresenting its short sale locate source or ownership of shares may intend to fail to deliver securities in time for settlement and, therefore, engage in abusive "naked" short selling. As noted above, although abusive "naked" short selling is not defined in the federal securities laws, it refers generally to selling short without having stock available for delivery and intentionally failing to deliver stock within the standard three-day settlement cycle.[91] Such short selling may or may not be part of a scheme to manipulate the price of a security. Although "naked" short selling as part of a manipulative scheme is always illegal under the general antifraud provisions of the federal securities laws, including Rule 10b–5 under the Exchange Act,[92] Rule 10b–21 will further evidence the specific liability of persons that deceive specified persons about their intention or ability to deliver securities in time for settlement, including persons that deceive their broker-dealer about their locate source or ownership of shares and that fail to deliver securities by settlement date. We believe that a rule specifying the illegality of these activities will focus the attention of market participants on such activities. The rule will also further evidence that the Commission believes such deceptive activities are detrimental to the markets and will provide a measure of predictability for market participants.

All sellers of securities should promptly deliver, or arrange for delivery of, securities to the respective buyer and all buyers of securities have a right to expect prompt delivery of securities purchased. Thus, the rule takes direct aim at an activity that may create fails to deliver. Those fails can have a negative effect on shareholders, potentially depriving them of the benefits of ownership, such as voting and lending. They also may create a misleading impression of the market for an issuer's securities. As noted above, issuers and investors have expressed concerns about fails to deliver in connection with "naked" short selling. For example, in response to the 2006 Regulation SHO Proposed Amendments, we received a number of comments that expressed concerns about "naked" short selling and extended delivery failures.[93] Commenters continued to express these concerns in response to the 2007 Regulation SHO Proposed Amendments,[94] and in response to the Proposing Release.[95]

To the extent that fails to deliver might be indicative of manipulative "naked" short selling, which could be used as a tool to drive down a company's stock price,[96] such fails to deliver may undermine the confidence of investors.[97] These investors, in turn, may be reluctant to commit capital to an issuer they believe to be subject to such manipulative conduct.[98] In addition, issuers may believe that they have suffered unwarranted reputational damage due to investors' negative perceptions regarding fails to deliver in the issuer's security.[99] Any unwarranted reputational damage caused by fails to deliver might have an adverse impact on the security's price.[100]

Thus, to the extent that fails to deliver might create a misleading impression of the market for an issuer's securities, the rule will benefit investors and issuers by taking direct aim at an activity that may create fails to deliver. In addition, to the extent that "naked" short selling and fails to deliver result in an unwarranted decline in investor confidence about a security, the rule will improve investor confidence about the security. In addition, the rule will lead to greater certainty in the settlement of securities which should strengthen investor confidence in that process.

We believe the rule will result in broker-dealers having greater confidence that their customers have obtained a valid locate source and, therefore, that shares are available for delivery on settlement date. Thus, the rule will aid broker-dealers in complying with the locate requirement of Regulation SHO and, thereby, potentially reduce fails to deliver. In addition, to the extent that the rule results in fewer sales of threshold securities resulting in fails to deliver, the rule will reduce costs to broker-dealers because such broker-dealers will have to close-out a lesser amount of fails to deliver under Regulation SHO's close-out requirement.[101] The rule should also help reduce manipulative schemes involving "naked" short selling.

In the Proposing Release, we solicited comment on any additional benefits that could be realized with the proposed rule, including both short-term and long-term benefits. We also solicited comment regarding benefits to market efficiency, pricing efficiency, market stability, market integrity and investor protection. In response, one commenter stated that the "rule will have a positive impact on liquidity and market quality in securities traded." [102] Another commenter stated that "the liquidity of the market and the market quality of securities traded can be threatened or damaged if investors perceive that naked short sales may artificially distort the price of securities, in ways and instances unknown to honest investors, * * * in this regard, the strict application of the rule * * * should enhance liquidity and the market quality of securities traded." [103] This commenter also noted that, "[b]y increasing the liability of naked short sellers, the proposed rule should reduce the incidence of naked short sales and thereby reduce the likelihood of short squeezes." [104]

B. Costs

Rule 10b–21 is intended to address abusive "naked" short selling by further evidencing the liability of persons that deceive specified persons about their intention or ability to deliver securities

[89] *See* 17 CFR 242.203(b)(1).

[90] *See* Rule 10b–21.

[91] *See supra* note 2.

[92] 17 CFR 240.10b–5.

[93] *See supra* note 36.

[94] *See supra* note 37.

[95] *See supra* note 38.

[96] *See supra* note 39.

[97] *See supra* note 40.

[98] *See supra* note 41.

[99] *See supra* note 42 (discussing the fact that due to such concerns some issuers have taken actions to attempt to make transfer of their securities "custody only," thus preventing transfer of their stock to or from securities intermediaries such as the DTC or broker-dealers).

[100] *See supra* note 43.

[101] Rule 203(b)(3)(iii) of Regulation SHO contains a close-out requirement that applies only to broker-dealers for securities in which a substantial amount of fails to deliver have occurred, also known as "threshold securities." Specifically, Rule 203(b)(3)'s close-out requirement requires a participant of a clearing agency registered with the Commission to take immediate action to close out a fail to deliver position in a threshold security in the CNS system that has persisted for 13 consecutive settlement days by purchasing securities of like kind and quantity; *see also* 2008 Interim Rule, *supra* note 29 (temporarily enhancing Regulation SHO's delivery requirements for sales of all equity securities).

[102] *See* letter from Susanne Trimbath, PhD., CEO and Chief Economist, STP Advisory Services, LLC, dated May 30, 2008 ("Trimbath") (noting also a tax benefit to investors from enforcing delivery on settlement date).

[103] *See* letter from Shapiro.

[104] *See id.*

in time for settlement, including persons that deceive their broker-dealer about their locate source or ownership of shares and that fail to deliver securities by settlement date. In the Proposing Release, we sought data supporting any potential costs associated with the rule, and specific comment on any systems changes to computer hardware and software, or surveillance costs that might be necessary to implement the rule. One commenter stated that "the rule will have a positive impact on liquidity and market quality in securities traded * * * [w]ithout strict rules against settlement failures, a systemic crisis could occur where investors are reluctant to engage in trades in U.S. markets because settlement finality is in question. The markets and investors need the assurance of Rule 10b–21 that securities transactions will be settled." [105] Another commenter stated that "the liquidity of the market and the market quality of securities traded can be threatened or damaged if investors perceive that naked short sales may artificially distort the price of securities, in ways and instances unknown to honest investors, * * * in this regard, the strict application of the rule * * * should enhance liquidity and the market quality of securities traded." [106] This commenter also noted that, "[b]y increasing the liability of naked short sellers, the proposed rule should reduce the incidence of naked short sales and thereby reduce the likelihood of short squeezes. The prospect of short squeezes is increased by the moral hazard that occurs when short sellers believe there is little or no cost to carrying out abusive naked short sales, and therefore rules that impose such costs reduce this prospect." [107] The commenter also noted that any costs associated with purchasing or borrowing securities to deliver on a sale instead of allowing the fail to deliver position to remain open "would not represent an additional cost, since a legitimate short sale involves borrowing the security for delivery at the cost of such borrowing. Therefore, it would reflect only the cost of complying with the rules and laws that apply to all investors." [108] This commenter also noted that "[s]trict liability for failing to deliver securities in short sales is needed to offset the implicit savings of violating the law and rules, and getting away with it." [109]

We recognize, however, that Rule 10b–21 may result in increased costs to broker-dealers to the extent that the rule encourages or results in broker-dealers limiting the extent to which they rely on customer assurances in complying with the locate requirement of Regulation SHO. In addition, the rule may result in increased costs to sellers who inadvertently fail to deliver securities because such sellers, in an attempt to avoid liability under the rule, might purchase or borrow securities to deliver on a sale at a time when, but for the rule, the seller would have allowed the fail to deliver position to remain open.

One commenter stated that, "unless Proposed Rule 10b–21 were modified to eliminate aiding and abetting liability and allow reliance upon customer assurances, the price discovery and liquidity provided through short sales may be constrained." [110] Although broker-dealer concerns regarding aiding and abetting liability under Rule 10b–21 may potentially impact liquidity and efficiency in the markets, we believe that such an impact, if any, will be minimal. Rule 10b–21 as adopted does not impose any additional liability or requirements on any person, including broker-dealers, beyond those of any existing Exchange Act rule. Aiding and abetting liability is a question of fact, determined on a case-by-case basis. In addition, as we stated in the Proposing Release, broker-dealers would remain subject to liability under Regulation SHO and the general antifraud provisions of the federal securities laws. [111]

VI. Consideration of Burden on Competition and Promotion of Efficiency, Competition, and Capital Formation

Section 3(f) of the Exchange Act requires the Commission, whenever it engages in rulemaking and whenever it is required to consider or determine if an action is necessary or appropriate in the public interest, to consider whether the action would promote efficiency, competition, and capital formation. [112] In addition, Section 23(a)(2) of the Exchange Act requires the Commission, when adopting rules under the Exchange Act, to consider the impact such rules would have on competition. [113] Exchange Act Section 23(a)(2) prohibits the Commission from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.

Rule 10b–21 is intended to address abusive "naked" short selling and fails to deliver. The rule is aimed at short sellers, including broker-dealers acting for their own accounts, who deceive specified persons, such as a broker-dealer, about their intention or ability to deliver securities in time for settlement and fail to deliver securities by settlement date. Among other things, Rule 10b–21 targets short sellers who deceive their broker-dealers about their source of borrowable shares for purposes of complying with Regulation SHO's "locate" requirement. [114] The rule also applies to sellers who misrepresent to their broker-dealers that they own the shares being sold. [115]

Although "naked" short selling as part of a manipulative scheme is always illegal under the general antifraud provisions of the federal securities laws, including Rule 10b–5 under the Exchange Act, [116] Rule 10b–21 will further evidence the liability of persons that deceive specified persons about their intention or ability to deliver securities in time for settlement, including persons that deceive their broker-dealer about their locate source or ownership of shares and that fail to deliver securities by settlement date. We believe that a rule further evidencing the illegality of these activities will focus the attention of market participants on such activities. The rule will also provide a measure of predictability for market participants. We believe Rule 10b–21 will have minimal impact on the promotion of price efficiency.

In the Proposing Release, we sought comment regarding whether Rule 10b–21 will adversely impact liquidity, disrupt markets, or unnecessarily increase risks or costs to customers. In response, one commenter noted that, "the liquidity of the market and the market quality of securities traded can be threatened or damaged if investors perceive that naked short sales may artificially distort the price of securities, in ways and instances unknown to honest investors, * * * in this regard, the strict application of the rule * * * should enhance liquidity and the market quality of securities traded." [117] This commenter also noted that, "[b]y increasing the liability of naked short sellers, the proposed rule should reduce the incidence of naked short sales and

[105] *See* letter from Trimbath.
[106] *See* letter from Shapiro.
[107] *See id.*
[108] *See id.*
[109] *See id.*
[110] *See* letter from Bingham.
[111] *See* Proposing Release, 72 FR at 15377.
[112] 15 U.S.C. 78c(f).
[113] 15 U.S.C. 78w(a)(2).
[114] *See* 17 CFR 242.203(b)(1).
[115] *See* Rule 10b–21.
[116] 17 CFR 240.10b–5.
[117] *See* letter from Shapiro.

thereby reduce the likelihood of short squeezes. * * *"[118]

Another commenter stated that, "unless Proposed Rule 10b–21 were modified to eliminate aiding and abetting liability and allow reliance upon customer assurances, the price discovery and liquidity provided through short sales may be constrained."[119] Although broker-dealer concerns regarding aiding and abetting liability under Rule 10b–21 may potentially impact liquidity and efficiency in the markets, we believe that such an impact, if any, will be minimal. Rule 10b–21 as adopted does not impose any additional liability or requirements on any person, including broker-dealers, beyond those of any existing Exchange Act rule. Aiding and abetting liability is a question of fact, determined on a case-by-case basis. In addition, as we stated in the Proposing Release, broker-dealers would remain subject to liability under Regulation SHO and the general antifraud provisions of the federal securities laws.[120]

In addition, we believe that the rule will have minimal impact on the promotion of capital formation. The perception that abusive "naked" short selling is occurring in certain securities can undermine the confidence of investors. These investors, in turn, may be reluctant to commit capital to an issuer they believe to be subject to such manipulative conduct. For example, in response to the Proposing Release, one commenter noted that, "[c]onfidence in the securities markets is diminished when investors and others cannot rely on the receipt of securities in trades."[121] Thus, we believe that strengthening our rules against "naked" short selling by targeting sellers who deceive their broker-dealers about their source of borrowable shares and their share ownership will provide increased confidence in the markets.

In addition, we note that we have previously sought comment regarding the impact on capital formation of other proposed amendments aimed at reducing fails to deliver and addressing potentially abusive "naked" short selling, including whether the proposed increased short sale restrictions would affect investors' decisions to invest in certain equity securities.[122] In response, commenters expressed concern about the potential impact of "naked" short selling on capital formation claiming that "naked" short selling causes a drop in an issuer's stock price that may limit the issuer's ability to access the capital markets.[123] Thus, to the extent that "naked" short selling and fails to deliver result in an unwarranted decline in investor confidence about a security, the rule is expected to improve investor confidence about the security. We note, however, that persistent fails to deliver exist in only a small number of securities and may be a signal of overvaluation rather than undervaluation of a security's price.[124] In addition, we believe that the rule will lead to greater certainty in the settlement of securities, which is expected to strengthen investor confidence in the settlement process.

We also believe that Rule 10b–21 will not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act. By specifying that abusive "naked" short selling is a fraud, the Commission believes the rule will promote competition by providing the industry with guidance regarding the liability of sellers that deceive specified persons about their intention or ability to deliver securities in time for settlement, including persons that deceive their broker-dealer about their locate sources or share ownership and that fail to deliver securities by settlement date.

VII. Final Regulatory Flexibility Analysis

The Commission has prepared a Final Regulatory Flexibility Analysis ("FRFA"), in accordance with the provisions of the Regulatory Flexibility Act ("RFA"),[125] regarding Rule 10b–21 under the Exchange Act. An Initial Regulatory Flexibility Analysis ("IRFA") was prepared in accordance with the RFA and was included in the Proposing Release. We solicited comments on the IRFA.

A. Reasons for the Rule

Rule 10b–21 is intended to address fails to deliver associated with abusive "naked" short selling. While "naked" short selling as part of a manipulative scheme is already illegal under the general antifraud provisions of the federal securities laws, Rule 10b–21 specifies that it is unlawful for any person to submit an order to sell an equity security if such person deceives a broker-dealer, participant of a registered clearing agency, or purchaser about its intention or ability to deliver securities on the date delivery is due, and such person fails to deliver the security on or before the date delivery is due. Thus, Rule 10b–21 will further evidence the liability of persons that deceive specified persons about their intention or ability to deliver securities in time for settlement, including persons that deceive their broker-dealer about their locate source or ownership of shares.

B. Objectives

Rule 10b–21 is aimed at short sellers, including broker-dealers acting for their own accounts, that deceive specified persons, such as a broker or dealer, about their intention or ability to deliver securities in time for settlement and that fail to deliver securities by settlement date. We believe that a rule further evidencing the illegality of these activities will focus the attention of market participants on such activities. The rule will also underscore that the Commission believes such deceptive activities are detrimental to the markets and will provide a measure of predictability for market participants.

All sellers of securities should promptly deliver, or arrange for delivery of, securities to the respective buyer and all buyers of securities have a right to expect prompt delivery of securities purchased. Thus, Rule 10b–21 takes direct aim at an activity that may create fails to deliver. Those fails can have a negative effect on shareholders, potentially depriving them of the benefits of ownership, such as voting and lending. They also may create a misleading impression of the market for an issuer's securities. Rule 10b–21 will also aid broker-dealers in complying with the locate requirement of Regulation SHO and, thereby, potentially reduce fails to deliver. In addition, the rule is expected to help reduce manipulative schemes involving "naked" short selling.

C. Significant Issues Raised By Public Comment

The IRFA appeared in the Proposing Release. We requested comment on any aspect of the IRFA. In particular, we requested comment on: (i) The number of small entities that would be affected by the rule; and (ii) the existence or nature of the potential impact of the rule on small entities. We requested that the

[118] *See id.*

[119] *See* letter from Bingham.

[120] *See* Proposing Release, 72 FR at 15377.

[121] *See* letter from Trimbath.

[122] *See* 2006 Regulation SHO Proposed Amendments, 71 FR 41710; 2007 Regulation SHO Proposed Amendments, 72 FR 45558.

[123] *See, e.g., supra* note 41 (citing to comment letters expressing concern regarding the impact of potential "naked" short selling on capital formation).

[124] Persistent fails to deliver may be symptomatic of an inadequate supply of shares in the equity lending market. If short sellers are unable to short sell due to their inability to borrow shares, their opinions about the fundamental value of the security may not be fully reflected in a security's price, which may lead to overvaluation.

[125] 5 U.S.C. 603.

comments specify costs of compliance with the rule, and suggest alternatives that would accomplish the objectives of the rule. We did not receive any comments that responded specifically to this request.

D. Small Entities Subject to the Rule

The entities covered by Rule 10b–21 will include small broker-dealers, small businesses, and any investor who effects a short sale that qualifies as a small entity. Although it is impossible to quantify every type of small entity that may be able to effect a short sale in a security, paragraph (c)(1) of Rule 0–10 under the Exchange Act [126] states that the term "small business" or "small organization," when referring to a broker-dealer, means a broker or dealer that had total capital (net worth plus subordinated liabilities) of less than $500,000 on the date in the prior fiscal year as of which its audited financial statements were prepared pursuant to § 240.17a–5(d); and is not affiliated with any person (other than a natural person) that is not a small business or small organization. As of 2007, the Commission estimates that there were approximately 896 broker-dealers that qualified as small entities as defined above.[127]

Any business, however, regardless of industry, could be subject to the rule if it effects a short or long sale. The Commission believes that, except for the broker-dealers discussed above, an estimate of the number of small entities that fall under the rule is not feasible.

E. Reporting, Recordkeeping, and Other Compliance Requirements

Rule 10b–21 is intended to address abusive "naked" short selling by further evidencing the liability of persons that deceive specified persons about their intention or ability to deliver securities in time for settlement, including persons that deceive their broker-dealer about their locate source or ownership of shares and that fail to deliver securities by settlement date. The Commission believes that the rule may impose new or additional compliance costs on any affected party, including broker-dealers, that are small entities. To comply with Regulation SHO, small broker-dealers needed to modify their systems and surveillance mechanisms to comply with Regulation SHO's locate, marking and delivery requirements. Thus, any systems and surveillance mechanisms necessary for broker-dealers to comply with the rule should already be in place. We believe that any necessary additional systems and surveillance changes, in particular changes by sellers who are not broker-dealers, will be similar to the changes incurred by broker-dealers when Regulation SHO was implemented.

F. Agency Action To Minimize Effect on Small Entities

The RFA directs the Commission to consider significant alternatives that would accomplish the stated objective, while minimizing any significant adverse impact on small entities. Pursuant to Section 3(a) of the RFA,[128] the Commission must consider the following types of alternatives: (a) The establishment of differing compliance or reporting requirements or timetables that take into account the resources available to small entities; (b) the clarification, consolidation, or simplification of compliance and reporting requirements under the rule for small entities; (c) the use of performance rather than design standards; and (d) an exemption from coverage of the rule, or any part thereof, for small entities.

A primary goal of Rule 10b–21 is to address abusive "naked" short selling. While "naked" short selling as part of a manipulative scheme is always illegal under the general antifraud provisions of the federal securities laws, Rule 10b–21 specifies that it is a fraud for any person to submit an order to sell an equity security if such person deceives a broker-dealer, participant of a registered clearing agency, or purchaser about its intention or ability to deliver the security on the date delivery is due and such person fails to deliver the security on or before the date delivery is due. Rule 10b–21 is aimed at short sellers, including broker-dealers acting for their own accounts, who deceive specified persons, such as a broker or dealer, about their intention or ability to deliver securities in time for settlement and who do not deliver securities by settlement date. Among other things, Rule 10b–21 targets short sellers who deceive their broker-dealers about their source of borrowable shares for purposes of complying with Regulation SHO's "locate" requirement.[129] The rule also applies to sellers who misrepresent to their broker-dealers that they own the shares being sold.

We believe that imposing different compliance requirements, and possibly a different timetable for implementing compliance requirements, for small entities would undermine the Commission's goal of addressing abusive "naked" short selling and fails to deliver. In addition, we have concluded similarly that it is not consistent with the primary goal of the rule to further clarify, consolidate, or simplify the rule for small entities. Finally, the rule imposes performance standards rather than design standards.

VIII. Statutory Authority

Pursuant to the Exchange Act and, particularly, Sections 2, 3(b), 6, 9(h), 10, 11A, 15, 15A, 17, 17A, 19 and 23(a) thereof, 15 U.S.C. 78b, 78c(b), 78f, 78i(h), 78j, 78k–1, 78o, 78o–3, 78q, 78q–1, 78s and 78w(a), the Commission is adopting a new antifraud rule, Rule 10b–21, to address abusive "naked" short selling.

List of Subjects in 17 CFR Part 240

Brokers, Fraud, Reporting and recordkeeping requirements, Securities.

■ For the reasons set out in the preamble, Title 17, Chapter II, of the Code of Federal Regulations is amended as follows.

PART 240—GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

■ 1. The authority citation for part 240 continues to read, in part, as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z–2, 77z–3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78e, 78f, 78g, 78i, 78j, 78j–1, 78k, 78k–*1*, 78l, 78m, 78n, 78o, 78p, 78q, 78s, 78u–5, 78w, 78x, 78–*ll*, 78mm, 80a–20, 80a–23, 80a–29, 80a–37, 80b–3, 80b–4, 80b–11, and 7201 *et seq.;* and 18 U.S.C. 1350, unless otherwise noted.

■ 2. Add § 240.10b–21 to read as follows:

§ 240.10b–21 Deception in connection with a seller's ability or intent to deliver securities on the date delivery is due.

Preliminary Note to § 240.10b–21: This rule is not intended to limit, or restrict, the applicability of the general antifraud provisions of the federal securities laws, such as section 10(b) of the Act and rule 10b–5 thereunder.

(a) It shall also constitute a "manipulative or deceptive device or contrivance" as used in section 10(b) of this Act for any person to submit an order to sell an equity security if such person deceives a broker or dealer, a participant of a registered clearing agency, or a purchaser about its intention or ability to deliver the security on or before the settlement date, and such person fails to deliver the

[126] 17 CFR 240.0–10(c)(1).

[127] These numbers are based on OEA's review of 2007 FOCUS Report filings reflecting registered broker-dealers. This number does not include broker-dealers that are delinquent on FOCUS Report filings.

[128] 5 U.S.C. 603(c).

[129] *See* 17 CFR 242.203(b)(1).

security on or before the settlement date.

(b) For purposes of this rule, the term *settlement date* shall mean the business day on which delivery of a security and payment of money is to be made through the facilities of a registered clearing agency in connection with the sale of a security.

By the Commission.

Dated: October 14, 2008.

Florence E. Harmon,

Acting Secretary.

[FR Doc. E8-24714 Filed 10-16-08; 8:45 am]

BILLING CODE 8011-01-P

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 240 and 249

[Release No. 34-58785; File No. S7-31-08; October 15, 2008]

RIN 3235-AK23

Disclosure of Short Sales and Short Positions by Institutional Investment Managers

AGENCY: Securities and Exchange Commission.

ACTION: Interim final temporary rule; Request for comments.

SUMMARY: The Commission is adopting an interim final temporary rule requiring certain institutional investment managers to file information on Form SH concerning their short sales and positions of section 13(f) securities, other than options. The new rule extends the reporting requirements established by our Emergency Orders dated September 18, 2008, September 21, 2008 and October 2, 2008, with some modifications. The extension will be effective until August 1, 2009. Consistent with the Orders, the rule requires an institutional investment manager that exercises investment discretion with respect to accounts holding section 13(f) securities having an aggregate fair market value of at least $100 million to file Form SH with the Commission following a calendar week in which it effected a short sale in a section 13(f) security, with some exceptions.

DATES: *Effective Date:* §§ 240.10a-3T, 249.326T and temporary Form SH are effective from October 18, 2008 until August 1, 2009.

Compliance Dates: An institutional investment manager that is required to file a Form SH report on October 24, 2008 or October 31, 2008, must comply with Rule 10a-3T, except that it:

- May exclude disclosure of short positions reflecting short sales before September 22, 2008 from the Form SH report filed on either or both of those dates. An institutional investment manager choosing to exclude these short sales effected before September 22 is not required to report short positions otherwise reportable if the short position in the section 13(f) security constitutes less than one-quarter of one percent of that class of the issuer's securities issued and outstanding as reported on the issuer's most recent annual or quarterly report, and any current report subsequent thereto, filed with the Commission pursuant to the Securities Exchange Act of 1934, unless the manager knows or has reason to believe that the information contained therein is inaccurate, and the fair market value of the short position in the section 13(f) security is less than $1,000,000; and
- Does not have to file Form SH in XML format in accordance with the special filing instructions posted on the Commission's Web site. Instead, the institutional investment manager may file Form SH on EDGAR in the same manner as the form was filed pursuant to the Emergency Orders dated September 18, 2008, September 21, 2008 and October 2, 2008.

Comment Date: Comments on the interim final temporary rule should be received on or before December 16, 2008.

ADDRESSES: Comments may be submitted by any of the following methods:

Electronic Comments

- Use the Commission's Internet comment form (*http://www.sec.gov/rules/final.shtml*); or
- Send an e-mail to *rule-comments@sec.gov*. Please include File Number S7-31-08 on the subject line; or
- Use the Federal Rulemaking Portal (*http://www.regulations.gov*). Follow the instructions for submitting comments.

Paper Comments

- Send paper comments in triplicate to Florence E. Harmon, Acting Secretary, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549-1090.

All submissions should refer to File Number S7-31-08. This file number should be included on the subject line if e-mail is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (*http://www.sec.gov/rules/final.shtml*). Comments are also available for public inspection and copying in the Commission's Public Reference Room, 100 F Street, NE., Washington, DC 20549. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make publicly available.

FOR FURTHER INFORMATION CONTACT: Steven Hearne, at (202) 551-3430, in the Division of Corporation Finance, Marlon Paz, at (202) 551-5756, in the Division of Trading and Markets, or Stephan N. Packs, at (202) 551-6865, in the Division of Investment Management, U.S. Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549-3010.

SUPPLEMENTARY INFORMATION: The Commission is adopting temporary Rule 10a-3T and Temporary Form SH (Form SH) under the Securities Exchange Act of 1934 [1] as an interim temporary final rule. We are soliciting comments on all aspects of the interim temporary final rule and Form SH. We will carefully consider the comments that we receive and intend to address them in a subsequent release.

I. Background

Recently, we have become concerned that there is a substantial threat of sudden and excessive fluctuations of securities prices and disruption in the functioning of the securities markets that could threaten fair and orderly markets. These concerns are evidenced by our recent publication of Emergency Orders under section 12(k) of the Exchange Act in July [2] and September of this year.[3] In these Orders, we noted our concerns about the possible unnecessary or artificial price movements that may be based on unfounded rumors and may be exacerbated by short selling.

Short selling involves a sale of a security that the seller does not own or a sale which is consummated by the delivery of a security borrowed by, or for the account of, the seller.[4] Short sales normally are settled by the

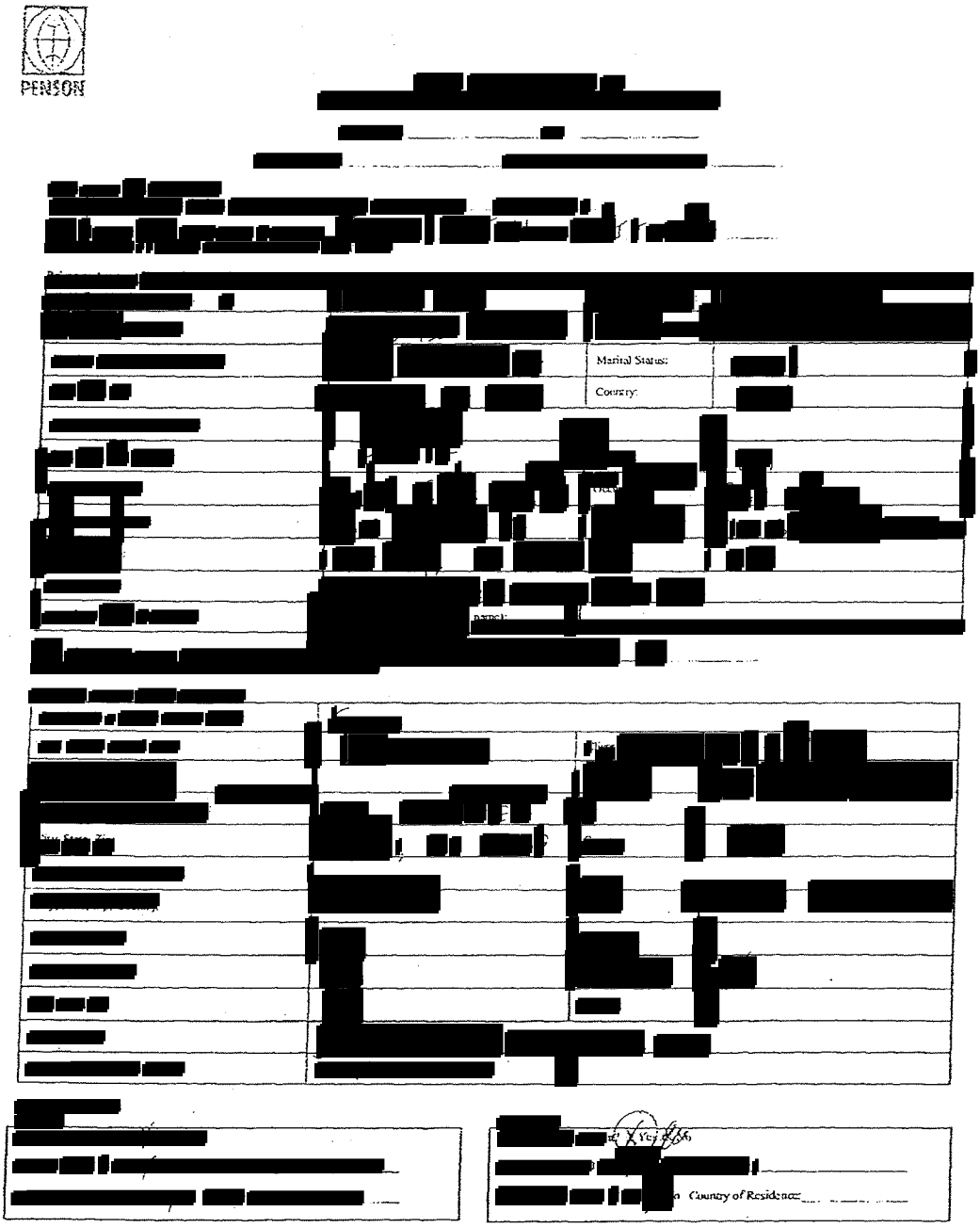
[1] 15 U.S.C. 78 *et seq.*

[2] Release No. 34-58166 (July 15, 2008) [73 FR 42379] (imposing borrowing and delivery requirements on short sales of the equity securities of certain financial institutions).

[3] Release Nos. 34-58592 (Sept. 18, 2008) [73 FR 55169] (temporarily prohibiting short selling in the publicly traded securities of certain financial institutions), 34-58591 (Sept. 18, 2008) [73 FR 55175] (requiring institutional investment managers to report short sales activities) and 34-58572 (Sept. 17, 2008) [73 FR 54875] (imposing enhanced delivery requirements on sales of all equity securities).

[4] 17 CFR 242.200(a).

EXHIBIT 4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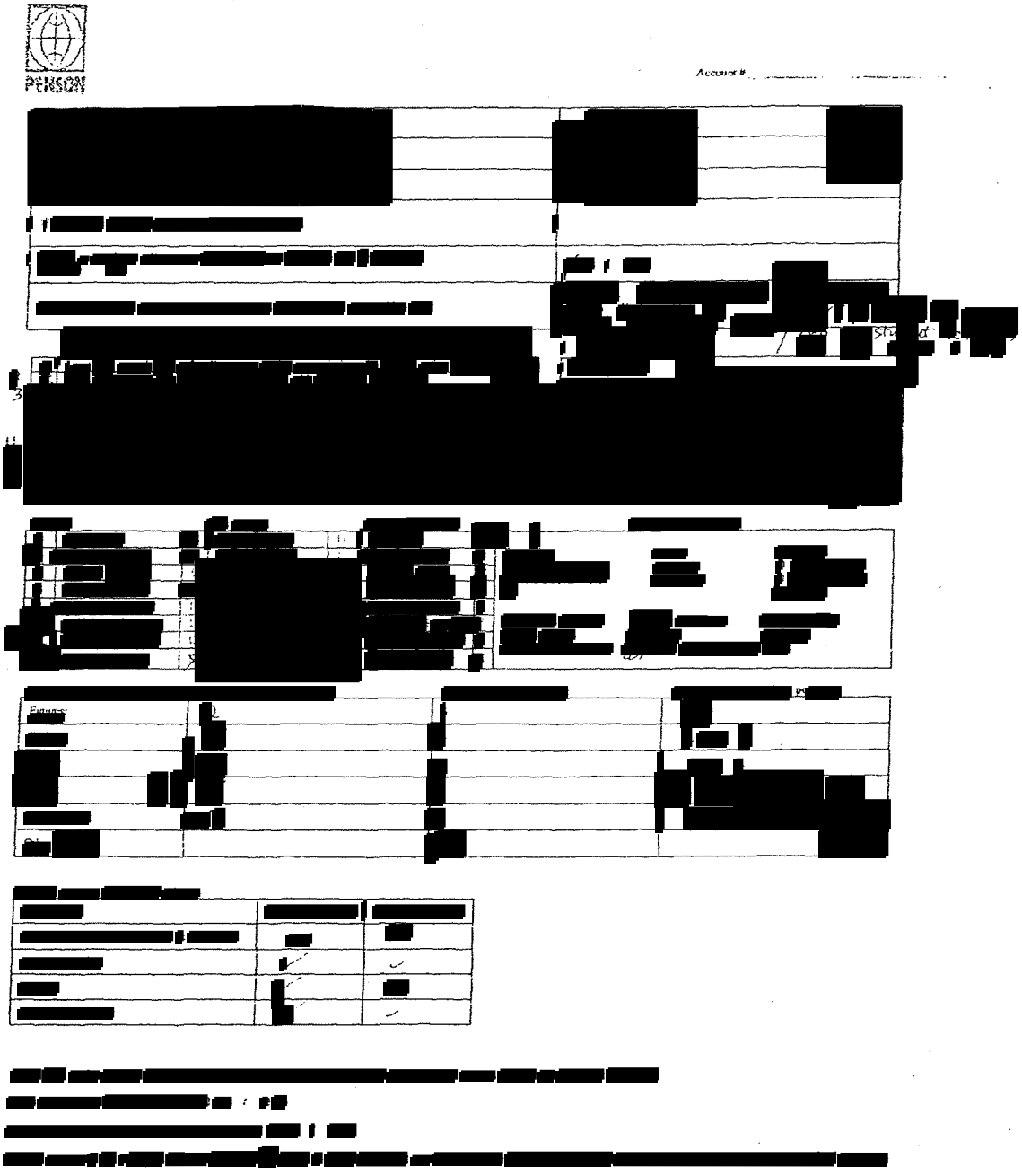

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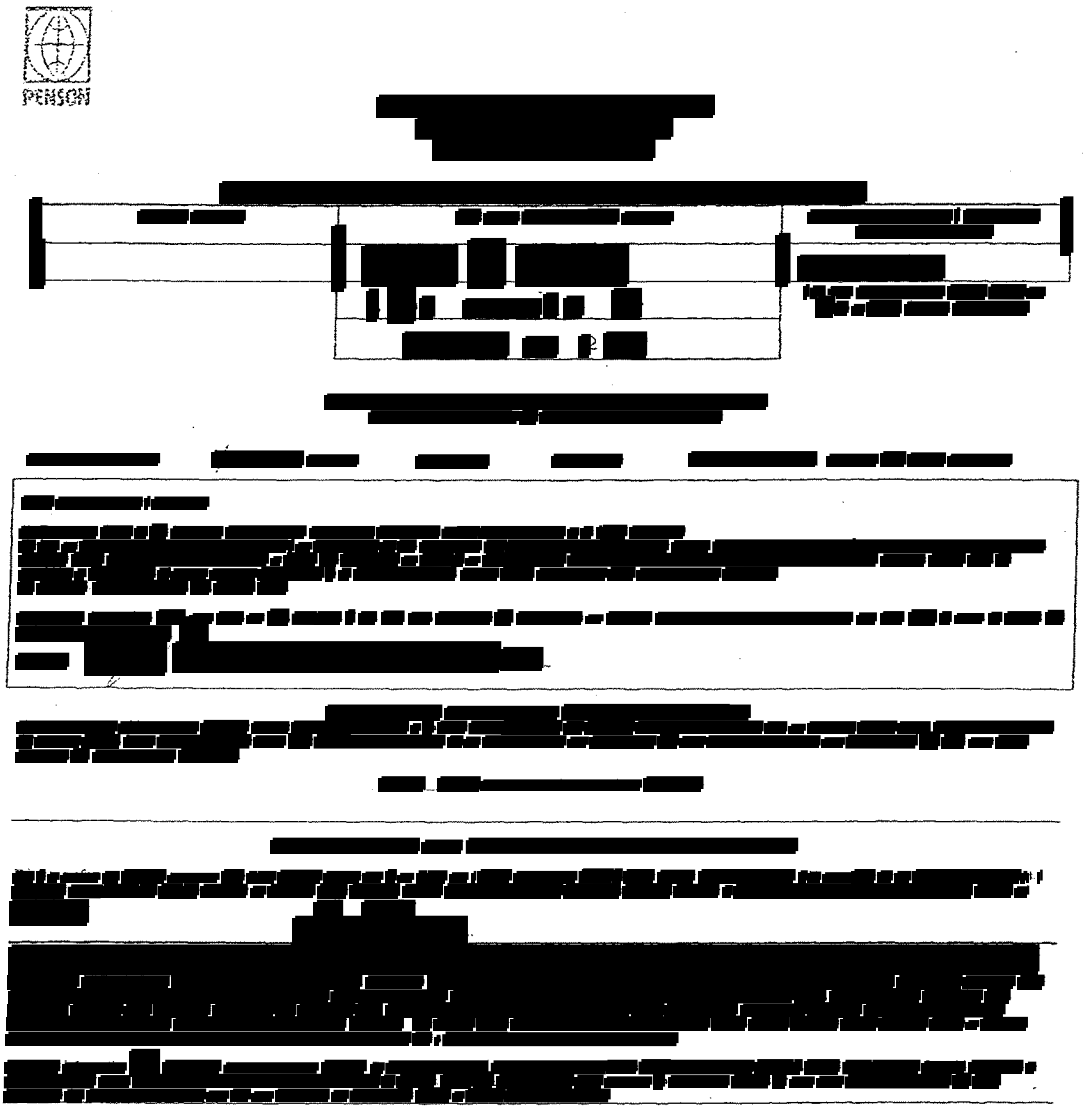

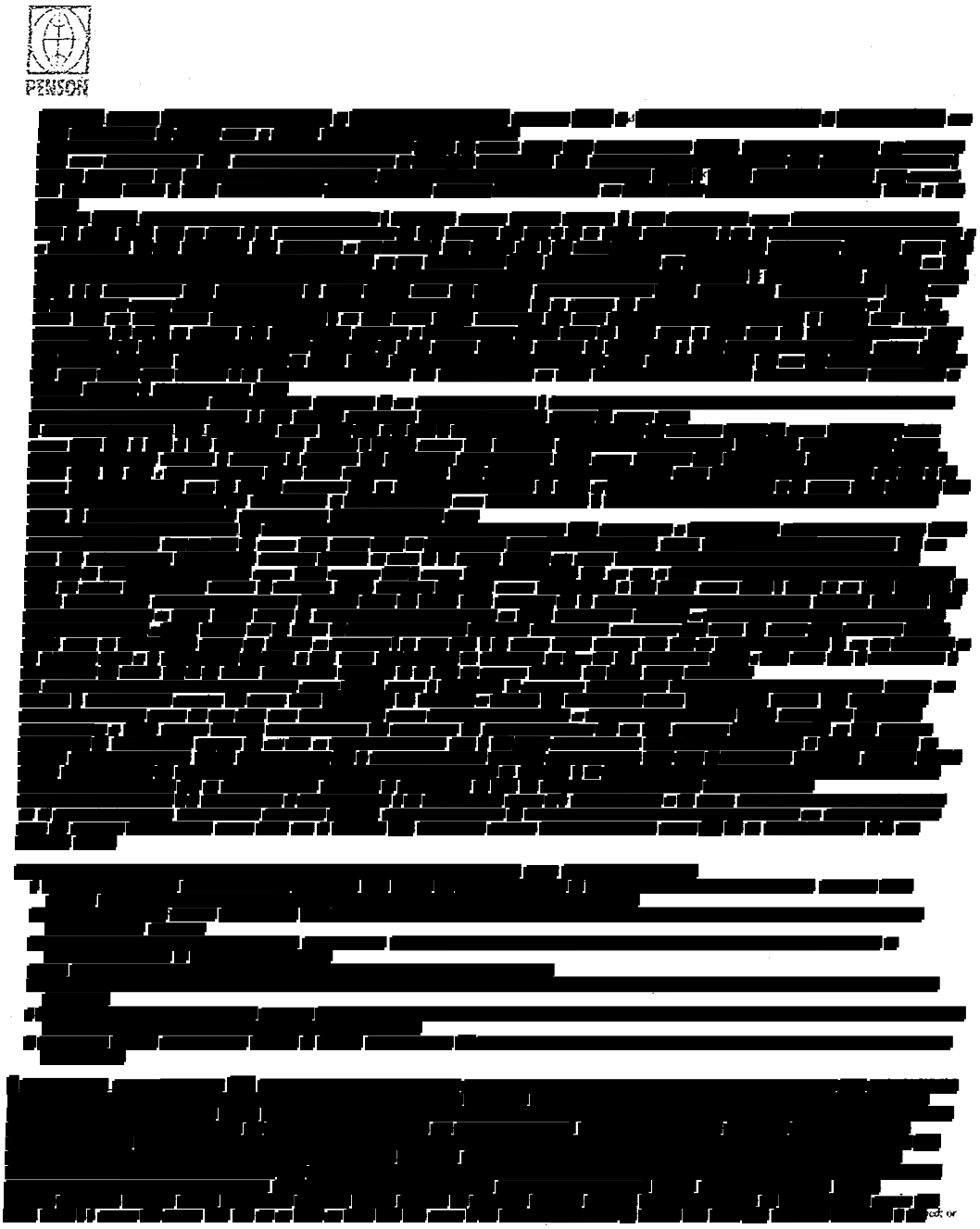

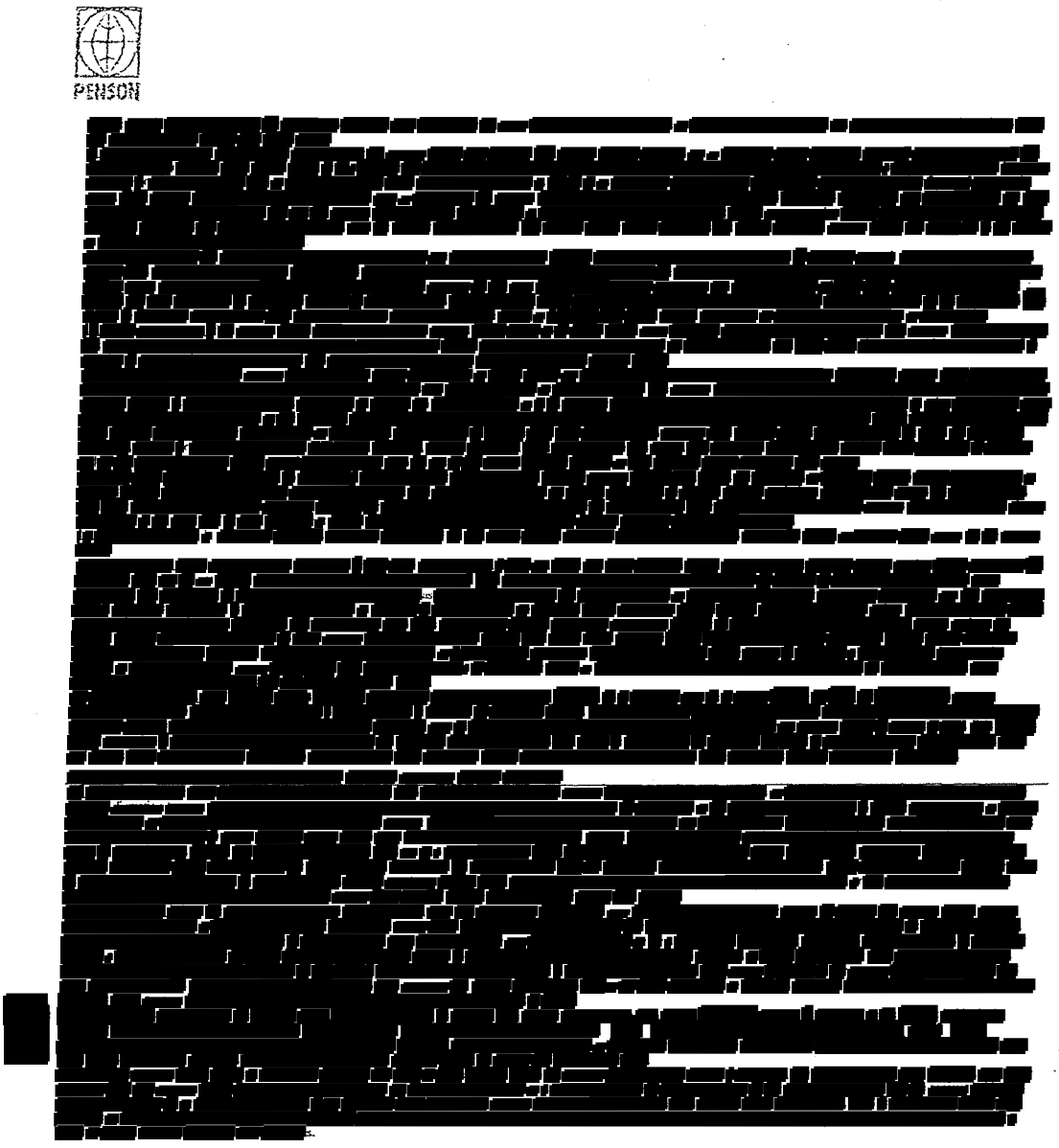

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MARGIN DISCLOSURE STATEMENT

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EXHIBIT 5

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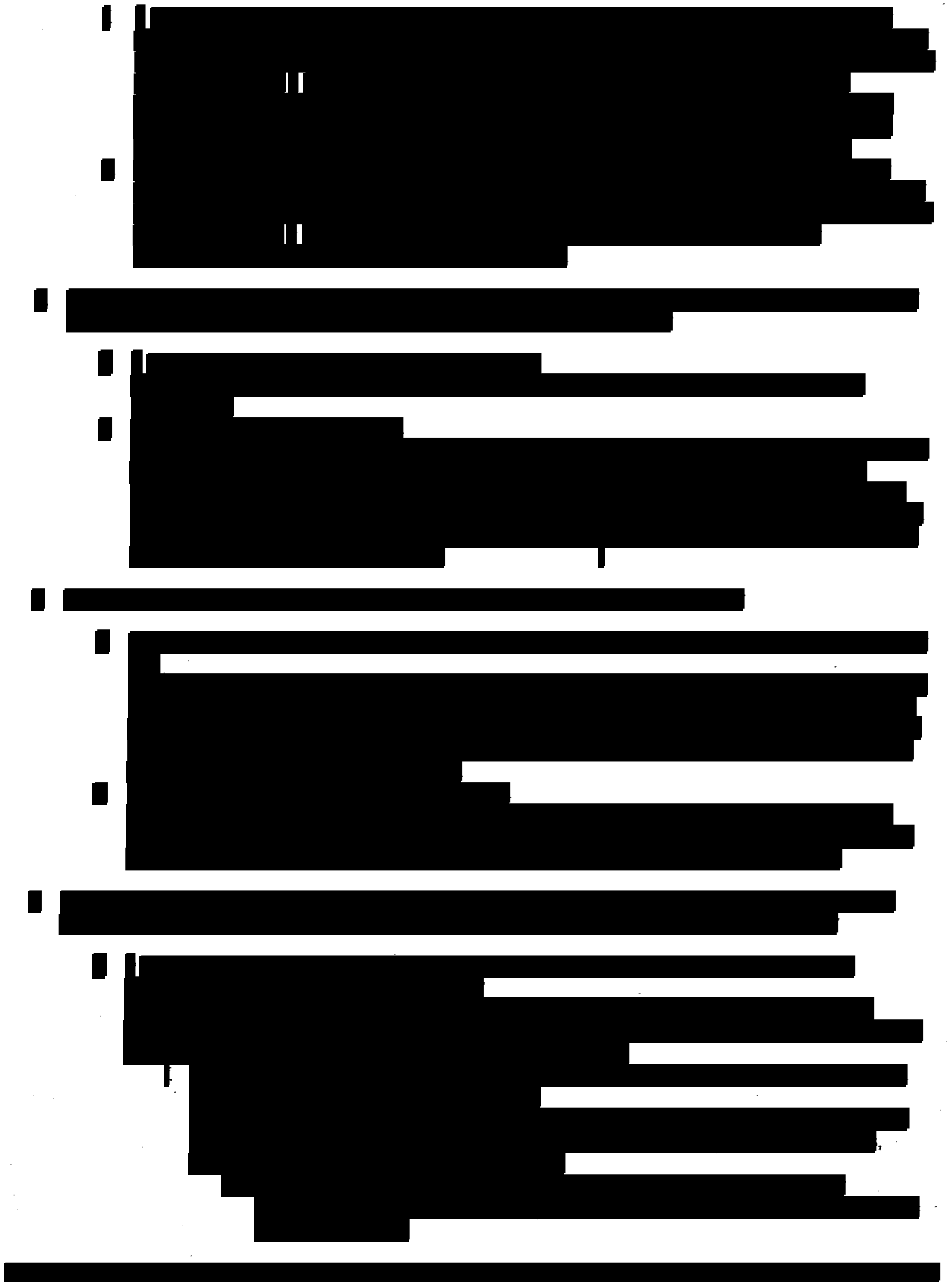

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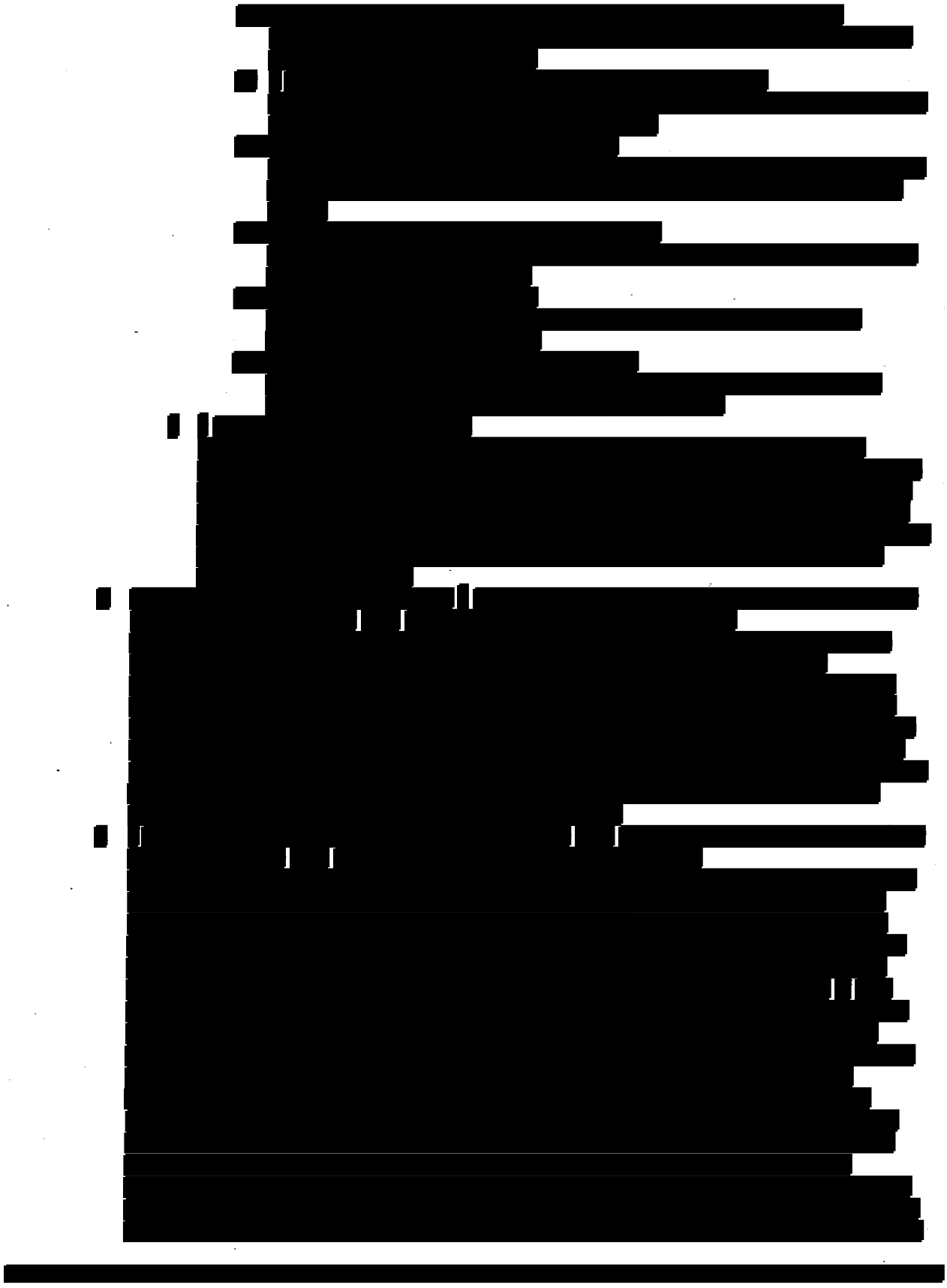

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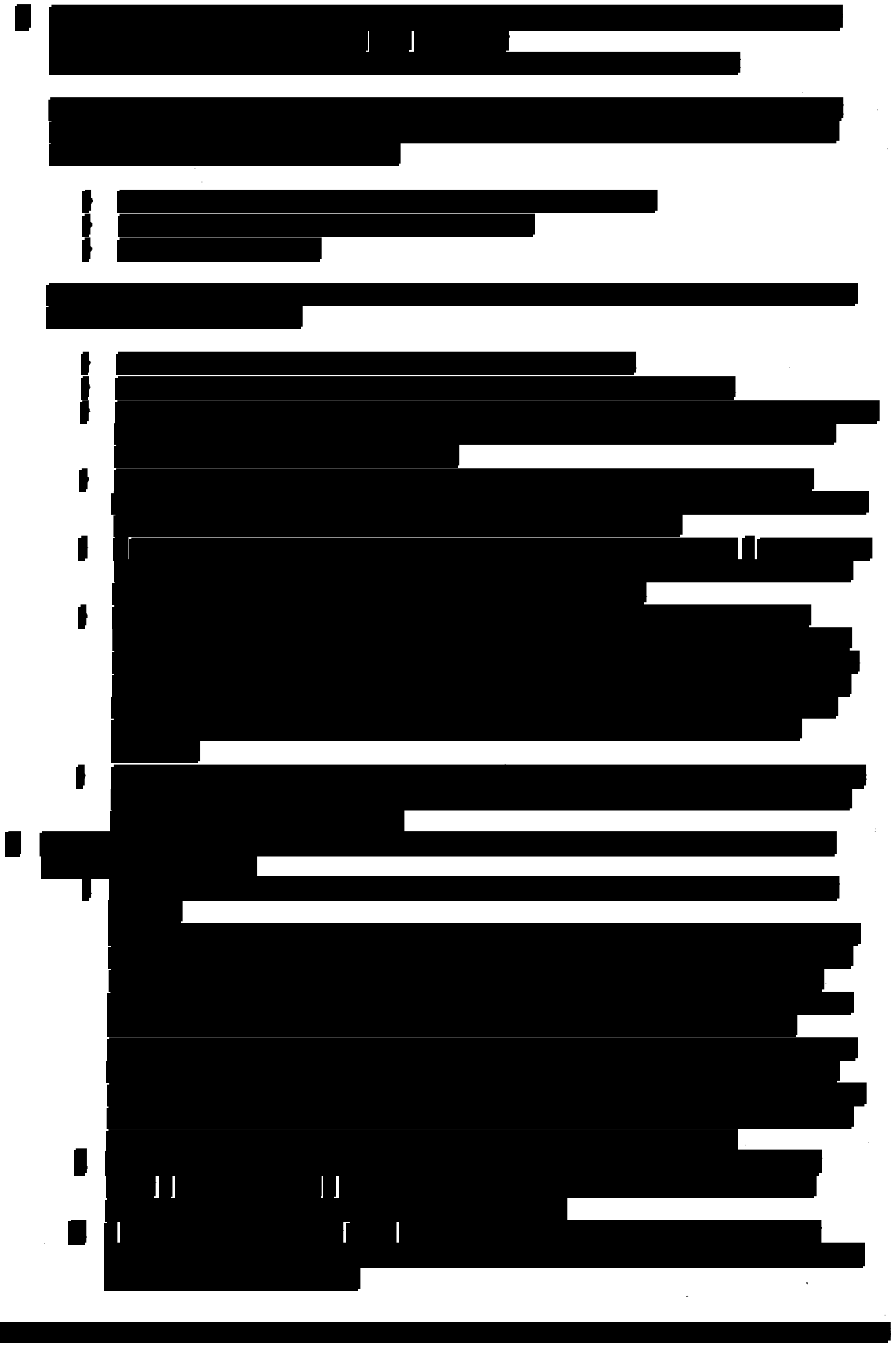

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Cadena, and the Operations – Non-Clearing department individual was supervised by Scott Johnson.

[redacted]

iv. documentation relating to the Firm's response to Items 13(b)(i) through 13(b)(ii), above.

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

EXHIBIT 6

From: Robert Crain <RCrain@PENSON.COM>
Sent: Wednesday, November 18, 2009 2:31 PM (GMT)
To: John Kenny <JKenny@PENSON.COM>
Subject: FW: OPTIONS 11.18.2009

John,

Terra Nova customer account [redacted] was assigned again last night, this time for 703,000 shares of SHLD. This position is carrying a requirement of $50.9M to settle on 11/20. We are reviewing the account now and will be calling the broker this morning.

Thanks,

Robert

From: Josh Pendleton
Sent: Wednesday, November 18, 2009 8:06 AM
To: Robert Crain; Bart McCain; Bill Yancey; Brian Bowman; Brian Hall; David Henkel; David Rafteseth; Felisha Howard; John Kenny; Jonathan Anderson; Kevin McAleer; Lora Chavez; Nicholas Brown; Phil Pendergraft; Ray Carli; Rocky Engemoen; Rudy De La Sierra; Stephen Worcester; Jay Hanville; LaShuniqual Meshack; Steven Potamis; Scott Borden; Paul Duckworth; Sylvia Meza; Cindy Vu; Penson - Dallas - Options; Kalin Nonchev; Helen Buck; Brandon Troster; Gayle Pruett; Sean Madden; Kenny Worcester; Evan Black; Josh Pendleton
Subject: OPTIONS 11.18.2009

OCC 234C

OCC 111C Portfolio Margin Account

OCC 513C

Cash Collateral

0.00

Cash Collateral

0.00

Cash Collateral

0.00

Gov. Treasury Collateral

610,419,910.70

Gov. Treasury Collateral

21,706,924.23

Gov. Treasury Collateral

0.00

Valued Securities

0.00

Valued Securities

0.00

Valued Securities

0.00

Total Margin Deposit

610,419,910.70

Total Margin Deposit

21,706,924.23

Total Margin Deposit

0.00

Margin Requirement

650,302,460.00

Margin Requirement

20,306,348.00

Margin Requirement

0.00

Margin Deficit

(39,882,549.30)

Margin Excess

1,400,576.23

Margin Excess

0.00

Trade Premium - Collect

46,259,683.66

Trade Premium - Collect

212,329.00

Trade Premium - Pay

0.00

Net Settlement Credit

46,259,683.66

Net Settlement Credit

212,329.00

Net Settlement Debit

0.00

Prior Day LIQ NAV

233,310,086.00

Prior Day LIQ NAV

Prior Day LIQ NAV

Current LIQ NAV

265,409,139.00

Current LIQ NAV

Current LIQ NAV

Change in Market Risk

32,099,053.00

Change in Market Risk

Change in Market Risk

Change in Residual ES Risk

7,783,496.30

Change in Residual ES Risk

Change in Residual ES Risk

OCC 234F Stock Loan

OCC 111F JBO Account

OCC 513F Proprietary Account

Cash Collateral

0.00

Cash Collateral

0.00

Cash Collateral

0.00

Gov. Treasury Collateral

8,043,981.00

Gov. Treasury Collateral

0.00

Gov. Treasury Collateral

5,452,320.25

Valued Securities

0.00

Valued Securities

0.00

Valued Securities

0.00

Total Margin Deposit

8,043,981.00

Total Margin Deposit

0.00

Total Margin Deposit

5,452,320.25

Margin Requirement

11,415,590.00

Margin Requirement

0.00

Margin Requirement

5,564,319.00

Margin Deficit

(3,371,609.00)

Margin Excess

0.00

Margin Deficit

(111,998.75)

Stock Loan Credit

728,400.00

Trade Premium - Collect

0.00

Trade Premium - Collect

16,475.00

Net Settlement Debit

(2,643,209.00)

Net Settlement Credit

0.00

Net Settlement Debit

(95,523.75)

Prior Day LIQ NAV

Prior Day LIQ NAV

0.00

Prior Day LIQ NAV

1,044,064.00

Current LIQ NAV

Current LIQ NAV

0.00

Current LIQ NAV

1,007,859.00

Change in Market Risk

Change in Market Risk

0.00

Change in Market Risk

-36,205.00

Change in Residual ES Risk

Change in Residual ES Risk

0.00

Change in Residual ES Risk

148,203.75

logo-for-signature-2

Joshua Pendleton | NEW YORK WINDOW ANALYST

Penson Financial Services, Inc.

1700 Pacific Avenue, Suite 1400 | Dallas, TX 75201

P: 214.765.1214 | F: 214.217.5055

www.penson.com <http://www.penson.com>

Building the Best Clearing and Execution Services Firm in the World

EXHIBIT 7

From: John Kenny <JKenny@PENSON.COM>
Sent: Monday, November 30, 2009 2:32 PM (GMT)
To: Ryan Dill <RDill@PENSON.COM>
Subject: Re: Feldman MJN.xlsx

Ryan,

They can't roll the positions and have to cover. We will have to cover the positions if they don't, assignment or not

John Kenny

Penson Financial Services, Inc.

The Flexible Choice in Global Financial Services

From: Ryan Dill
To: John Kenny
Sent: Mon Nov 30 06:50:36 2009
Subject: Re: Feldman MJN.xlsx

John
So how do we but this person in if he has already bought himself in? I know that the problem is that he will get assigned again later today. So are we going tell him that he has to go long?

Ryan Dill

On Nov 27, 2009, at 1:55 PM, "John Kenny" <JKenny@PENSON.COM> wrote:

Can we borrow? Give the customer the choice (cost of borrow vs risk of market impact of large buy in. They need to make a decision today!

Can you set up a call to discuss with them ?

John Kenny

Penson Financial Services, Inc.

The Flexible Choice in Global Financial Services

From: Ryan Dill
To: David Rafteseth; Summer Poldrack; Gary Wiedman; Ryan Thomason
Cc: Jerry Reilly; John Kenny; Robert Crain
Sent: Fri Nov 27 13:01:19 2009
Subject: RE: Feldman MJN.xlsx

John,

We have this CNS delivery obligation because this guys strategy is to get assigned every day. So, he gets assigned and then covers the following day. He has done what we asked them to do, but we still have a CNS delivery due.

How are we going to handle this? This buy in is for about 20 million.

<image002.jpg>

Ryan Dill | Relationship Manager

Penson Financial Services, Inc.

1700 Pacific Avenue, Suite 1400 | Dallas, TX 75201

P: 214.765.1126 | F: 214.217.4979

www.penson.com

From: David Rafteseth
Sent: Friday, November 27, 2009 11:57 AM
To: Ryan Dill; Summer Poldrack; Gary Wiedman; Ryan Thomason
Cc: Jerry Reilly; John Kenny; Robert Crain
Subject: RE: Feldman MJN.xlsx

We have a CNS delivery obligation regardless of what was agreed upon with the customer. Buyins remain open and we will check the account on Monday.

<image003.png>

David Rafteseth | Vice President, Internal Controls

Penson Financial Services, Inc.

1700 Pacific Avenue, Suite 1400 | Dallas, TX 75201

P: 214.765.1093 | F: 214.217.5011

www.penson.com

Building the Best Clearing and Execution Services Firm in the World

From: Ryan Dill
Sent: Friday, November 27, 2009 11:48 AM
To: Summer Poldrack; David Rafteseth; Gary Wiedman; Ryan Thomason
Cc: Jerry Reilly; John Kenny; Robert Crain
Subject: Feldman MJN.xlsx

They are covering this the day that they get their assignment report so they are processing these as we agreed.

The attached spreadsheet show this, so we should not truly need to borrow or buyin.

Robert: It looks like they have added this new symbol. We may need to talk to them about this and that they need to give us a heads up when they do add new symbols.

EXHIBIT 8

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-14848

In the Matter of

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

Respondents.

DECLARATION OF DEBORAH A. TARASEVICH IN SUPPORT OF THE DIVISION OF ENFORCEMENT'S RESPONSE TO RESPONDENT JONATHAN I. FELDMAN'S MOTION FOR SUMMARY DISPOSITION

Deborah A. Tarasevich, pursuant to 28 U.S.C. § 1746, declares:

1. I am an Assistant Director with the Division of Enforcement ("Division") of the Securities and Exchange Commission ("Commission"). I submit this Declaration in support of the Division's Response to Respondent Jonathan I. Feldman's ("Feldman") Motion for Summary Disposition.

2. On October 28, 2010, the Division issued a written Wells notice to Feldman for violations of Section 17(a) of the Securities Act of 1933 ("Securities Act") and Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Rules 10b-5 and 10b-21 thereunder.

3. On October 28, 2010, the Division issued written Wells notices to: (a) optionsXpress, Inc. ("optionsXpress") for violations of Rules 204 and 204T of Regulation SHO of the Exchange Act ("Reg. SHO") and causing and willfully aiding and abetting Feldman's violations; (b) Thomas E. Stern ("Stern"), optionsXpress' Chief

Financial Officer, for causing and willfully aiding and abetting Feldman's and optionsXpress' violations; and (c) Peter J. Bottini ("Bottini"), Phillip J. Hoeh ("Hoeh"), and Kevin E. Strine ("Strine"), officers of optionsXpress, for causing and willfully aiding and abetting Feldman's and optionsXpress' violations.

4. On April 8, 2011, the Division's Director, pursuant to Section 929U of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"), as codified in Section 4E of the Exchange Act, extended the filing deadline to October 21, 2011 as to the Wells notices issued to Feldman, optionsXpress, Stern, Bottini, Hoeh, and Strine after determining that the staff's investigation was "sufficiently complex" under Section 929U.

5. On October 13, 2011, the Division's Director received approval from the Commission, pursuant to Section 929U of the Dodd-Frank Act, to extend the filing deadline to April 17, 2012, as to the Wells notices issued to Feldman, optionsXpress, Stern, Bottini, Hoeh, and Strine after determining that the staff's investigation was "sufficiently complex" under Section 929U.

6. On October 20, 2011, the Commission authorized the institution of litigated administrative proceedings against Feldman, optionsXpress, Stern, Bottini, Hoeh, and Strine for the violations mentioned above in paragraphs 2 and 3.

7. On October 25, 2011, I informed Feldman's counsel that the Division staff had procured an additional 180-day extension under the Dodd-Frank Act as to Feldman's Wells notice. I also informed Feldman's counsel that the staff had obtained Commission authorization to institute litigated administrative proceedings against Feldman.

8. On [redacted], the Commission authorized the institution of settled administrative proceedings against Bottini, Hoeh, and Strine for causing optionsXpress' violations of Rules 204 and 204T of Reg. SHO. The Commission also authorized the institution of litigated administrative proceedings against only the remaining, non-settling Respondents Feldman, optionsXpress, and Stern for the violations mentioned above in paragraphs 2 and 3.

9. On April 16, 2012, the Commission instituted the authorized settled administrative proceedings against Bottini, Hoeh, and Strine for causing optionsXpress' violations of Rules 204 and 204T of Reg. SHO. The Commission also instituted the authorized litigated administrative proceedings against the remaining, non-settling Respondents Feldman, optionsXpress, and Stern for the violations mentioned above in paragraphs 2 and 3.

I declare under penalty of perjury that the foregoing is true and correct.

Executed on June 13, 2012.

Deborah A. Tarasevich

EXHIBIT 9

UNITED STATES OF AMERICA
Before The
OFFICE OF THRIFT SUPERVISION
DEPARTMENT OF THE TREASURY

In the Matter of:	)	Adjudicatory Proceeding
Jonathan I. Feldman,	)	No.: AP-10-04
Senior Vice President and Institution Affiliated Party of	)	Effective Date: June 25, 2010
Eastern Savings Bank Hunt Valley, Maryland OTS Docket No. 08183	)	

NOTICE OF INTENTION TO REMOVE AND PROHIBIT AND NOTICE OF CHARGES AND HEARING AND NOTICE OF ASSESSMENT OF A CIVIL MONEY PENALTY

I. PRELIMINARY STATEMENT

1. The Director of the Office of Thrift Supervision (OTS), pursuant to Sections 8(e) and 8(i)(2)(B) of the Federal Deposit Insurance Act (FDIA), 12 U.S.C. §§ 1818(e) and (i)(2)(B), issues this Notice of Charges and Hearing for Removal and Prohibition and Notice of Assessment of a Civil Money Penalty (Notice). By issuing this Notice, the OTS commences administrative adjudicatory proceedings and assesses civil money penalties against Jonathan I. Feldman (Respondent or Feldman) a Senior Vice President and institution-affiliated party (IAP) of Eastern Savings Bank, Hunt Valley, Maryland, a Federally chartered savings association (Eastern).

2. OTS charges that Respondent, in his capacity as a member of The Townhomes at Ivy Ridge, LLC (Ivy Ridge), materially altered loan documents related to four loans totaling $3.25 million, of which Respondent was a guarantor, made by ESSA Bank & Trust (ESSA) to Ivy

Ridge. Respondent made the alterations to the loan documents without ESSA's knowledge or agreement, and concealed the alterations from ESSA, in an improper attempt to secure a release of Respondent's guarantor liability.

3. OTS charges that Respondent engaged in violations of law and/or regulation and unsafe or unsound practices.

4. OTS charges that by reason of Respondent's misconduct, ESSA has suffered or will probably suffer financial loss or other damage and/or Respondent received financial gain and/or other benefit.

5. OTS charges that Respondent's misconduct involved personal dishonesty on his part and/or a willful disregard for the safety and soundness of ESSA.

6. OTS charges that grounds exist to:

(a) remove Respondent from Eastern and prohibit him from further participation in the affairs of Eastern and other insured depository institutions pursuant to Section 8(e) of the FDIA, 12 U.S.C. § 1818(e); and

(b) assess civil money penalties against Respondent, pursuant to section 8(i)(2)(B) of the FDIA, 12 U.S.C. § 1818(i)(2)(B).

II. JURISDICTION

7. Eastern, at all times relevant to this action, has been a federal savings bank with a charter issued under the Home Owners' Loan Act (the HOLA). *See* 12 U.S.C. §§ 1461 *et seq.*

8. Eastern, at all times relevant to this action, has been subject to examination, supervision, and regulation by the OTS. *See* 12 U.S.C. §§ 1463 and 1464.

9. Respondent, at all times relevant to this action, has served as the Senior Vice President of Eastern and is an "institution-affiliated party" of Eastern. *See*, 12 U.S.C. § 1813(u)(1).

10. ESSA, at all times relevant to this action, has been a federal savings bank with a charter issued under the Home Owners' Loan Act (the HOLA), *see*, 12 U.S.C. §§ 1461 *et seq.*, and subject to examination, supervision, and regulation by the OTS, *see*, 12 U.S.C. §§ 1463 and 1464. In addition ESSA is a "business institution" within the meaning of that term as used in Section 8 of the FDIA. *See*, § 8(e)(1)(A)(ii), (B)(i), (C)(ii) of the FDIA; 12 U.S.C. § 1818(e)(1)(A)(ii), (B)(i), (C)(ii). ESSA is also an insured depository institution within the meaning of that term in Section 8(e)(1) of the FDIA, 12 U.S.C. § 1818(e)(1), and Section 8(i)(B)(i)(II) of the FDIA, 12 U.S.C. § 1818(i)(B)(i)(II).

11. The Director of the OTS is the "appropriate Federal banking agency" with jurisdiction to initiate and maintain removal and prohibition and civil money penalty proceedings against an IAP. *See* 12 U.S.C. §§ 1818(e) and (i)(2); 1813(q)(4) and 1464(d)(1)(A).

12. Because Respondent is, and at all relevant times, has been an IAP, he is subject to the authority of the OTS to initiate and maintain these administrative proceedings against him pursuant to the provisions of Section 8 of the FDIA, 12 U.S.C. § 1818.

13. Although Respondent is an IAP of Eastern, the misconduct that is the basis for this action relates to Respondent's conduct, as a member of Ivy Ridge, with ESSA. The fact that this action does not relate to Respondent's conduct at the depository institution in which he serves as an IAP does not affect OTS's jurisdiction to bring the instant action. The IAP misconduct that serves as a basis for a removal and prohibition action under Section 8(e)(1) of the FDIA can be in connection with any insured depository institution or business institution. *See* § 8(e)(1)(A), (B), (C) of the FDIA; 12 U.S.C. § 1818(e)(1)(A), (B), (C). Further, OTS may bring a civil money penalty action under Section 8(i)(2)(B) of the FDIA, 12 U.S.C. § 1818(i)(2)(B), for violation of "any law or regulation" that "results in pecuniary gain or other benefit" to a party. *See* § 8(i)(2)(B)(i)(II) and (ii)(III) of the FDIA, 12 U.S.C. § 1818(i)(2)(B)(i)(II) and (ii)(III) (i)(2)(B).

III. FACTUAL ALLEGATIONS AND CHARGES

14. Ivy Ridge is a Pennsylvania limited liability company formed in 2005. Respondent was one of four members of Ivy Ridge.

15. In 2006, Ivy Ridge planned to acquire 8.55 acres of land located in Smithfield Township, Monroe County, Pennsylvania for the purpose of developing and constructing townhomes.

16. In order to obtain financing for this development project, Ivy Ridge applied for a loan from ESSA. On or about March 20, 2006, ESSA made four commercial loans totaling $3,249,632.60 to Ivy Ridge to finance the development project (Loans). The maturity date of the Loans was March 20, 2008.

17. As a condition of making the Loans, ESSA required the Respondent and the other three members of Ivy Ridge each to execute personal guaranties for repayment of the Loans. Each member, including Respondent, executed separate documents titled "Commercial Guaranty Agreement" whereby each member personally guaranteed repayment of the Loans (Guaranty).

18. Prior to the March 20, 2008 maturity date of the loans, Ivy Ridge applied for an extension for the Loans. As a condition of the extension, ESSA required that Respondent and the other three members of Ivy Ridge execute a "Restated Commercial Guaranty" (Restated Guaranty) to renew and extend their personal guaranties on the Loans. The purpose of ESSA's requirement for the Restated Guaranty was to ensure that Respondent and the other members of Ivy Ridge remained guarantors of the Loans after the extension.

19. Without the knowledge or consent of ESSA, and contrary to the intention of ESSA, Respondent altered his Restated Guaranty so that instead of restating his personal guaranty of the Loans, the altered Restated Guaranty *released* Respondent from all personal liability for the Loans.

20. Respondent concealed the changes he made to his altered Restated Guaranty by having the changes typed in an identical type size and font as the original Restated Guaranty. In order to conceal the changes further, Respondent duplicated ESSA's internal document management system authentication and identification mark in the original Restated Guaranty in Respondent's retyped altered Restated Guaranty.

21. Respondent made the modifications to his Restated Guaranty without the knowledge, authorization, or approval of ESSA.

22. Respondent returned his altered Restated Guaranty to ESSA without disclosing that he had made modifications to the document that materially changed the legal effect of his Restated Guaranty.

23. With the belief that it had obtained unaltered executed Restated Guaranty documents from each of the members of Ivy Ridge, ESSA approved an extension on the maturity date of the Loans.

24. On or about August 7, 2008, Ivy Ridge defaulted on the Loans.

25. ESSA contacted Respondent to obtain payment on the defaulted Loans pursuant to his Restated Guaranty. For the first time, Respondent disclosed to ESSA the modifications he made to his Restated Guaranty, and informed ESSA that he would not make any payment on the defaulted Loans because his Restated Guaranty, as modified, released him as a guarantor of the Loans.

26. Through his undisclosed, unilateral, and unnegotiated modifications of his Restated Guaranty, and by concealing the modifications, Respondent effectuated a scheme to release himself of any personal liability as a guarantor on the Loans. As a result, Respondent received a financial gain or benefit from his misconduct by avoiding any personal liability for repayment on the defaulted Loans.

27. As a result of Ivy Ridge's default on the Loans, and ESSA's inability to obtain payment from Respondent as a guarantor of the Loans, ESSA's loss on the Loans will be between $1.0 million to $1.5 million dollars.

IV. STATUTORY CHARGES UNDER 12 U.S.C. § 1818(e)

Respondent has Engaged in Actions that Satisfy the Grounds for an Order of Removal and Prohibition Under Section 8(e) of the FDIA.

28. OTS realleges paragraphs 14 through 27 above.

29. By the actions described above, Respondent has directly or indirectly violated laws and regulations, *see* § 8(e)(1)(A)(i)(I) of the FDIA, 12 U.S.C. § 1818(e)(1)(A)(i)(I), as follows:

a. Respondent violated 18 U.S.C. § 1014 by knowingly making false statements as to material facts to a federally-insured depository institution for the purpose of influencing the institution's actions on a loan; and

b. Respondent violated 18 U.S.C. § 1344 by knowingly making material misrepresentations and/or concealing material facts as part of a scheme or attempted scheme to defraud a federally-insured depository institution.

30. In addition, Respondent engaged or participated in unsafe or unsound practices in connection with an insured depository institution or business institution. *See* § 8(e)(1)(A)(ii) of the FDIA, 12 U.S.C. § 1818(e)(1)(A)(ii).

31. By reason of Respondent's violation of law and regulation and/or his unsafe or unsound practices, an insured depository institution or business institution has suffered or will probably suffer financial loss or other damage; the interests of the insured depository institution's depositors have been or could be prejudiced; and/or Respondent received financial gain or other benefit. *See* § 8(e)(1)(B) of the FDIA, 12 U.S.C. § 1818(e)(1)(B).

32. Further, Respondent's violation of laws and regulations and/or unsafe and unsound practices involved personal dishonesty on his part and/or a willful or continuing disregard for the safety and soundness of an insured depository institution or business institution. *See* §8(e)(1)(C)(i) and (ii) of the FDIA, 12 U.S.C. § 1818(e)(1)(C)(i) and (ii).

V. REQUESTED RELIEF AND NOTICE OF HEARING

33. Notice is hereby given that a hearing will be held in Baltimore, Maryland for the purpose of taking evidence on the charges specified above in order to determine whether an appropriate order of removal and prohibition should be issued under Section 8(e) of the FDIA, 12 U.S.C. § 1818(e), to remove and prohibit the future participation by Respondent in the affairs of, *inter alia*, any insured depository institution, or any holding company thereof.

VI. STATUTORY CHARGES UNDER SECTION 8(i)(2) of the FDIA

Respondent Has Engaged in Actions that Satisfy the Grounds for Assessment of Second-Tier Civil Money Penalties Against Respondent Under Section 8(i)(2)(B) of the FDIA.

34. OTS realleges paragraphs 14 through 27 above.

35. Respondent has engaged in violations of law or regulation, as recited in paragraph 29 *supra*. *See* §8(i)(2)(B)(i)(I) of the FDIA, 12 U.S.C. § 1818(i)(2)(B)(i)(I).

36. Respondent's violation of law and regulation has resulted in pecuniary gain or other benefit to Respondent. *See* §8(i)(2)(B)(ii)(III) of the FDIA, 12 U.S.C. § 1818(i)(2)(B)(ii)(III).

Aggregate Amount of Assessed Civil Penalties

37. Based on the foregoing, the grounds exist, pursuant to 12 U.S.C. § 1818(i)(2)(B), to assess a second-tier civil penalty against Respondent. After taking into account the size of Respondent's financial resources, good faith considerations, the gravity of the violations, the history of previous violations, and such other matters as justice may require, the OTS hereby assesses a civil money penalty of $125,000 against Respondent.

Civil Penalty Payment Directions and Procedural Matters

38. It is hereby ordered that Respondent shall forfeit and pay the civil money penalty of $125,000.

39. The civil money penalties set forth in this Notice are assessed by the OTS pursuant to sections 8(i)(2) of the FDIA, 12 U.S.C. § 1818(i)(2). Except as the OTS may otherwise order in writing, remittance of the payment of the penalties set forth herein shall be made by delivering to the OTS Financial Operations at 1700 G Street, N.W., Washington, D.C. 20552 a cashier's check or official bank check in the amount of $125,000 payable to the order of the Treasury of the United States.

40. Notice is given, pursuant to section 8(i)(2)(H) of the FDIA, 12 U.S.C. § 1818(i)(2), that Respondent is afforded an opportunity for a formal hearing, if requested, concerning the above assessment of civil money penalties. A hearing will be held with respect to the assessment against Respondent, provided that within twenty (20) days after issuance and service of this Notice, Respondent files a written request for a hearing concerning the assessment. Any request for such a hearing must be filed with the Office of Financial Institution Adjudication (OFIA), 3501 North Fairfax Drive, Suite D8116, Arlington, VA 22226, and with the OTS, c/o Sandra Evans, Secretary for Adjudicatory Proceedings, (sandra.evans@ots.treas.gov), 1700 G Street, N.W., Washington, D.C. 20552, within twenty (20) days after issuance and service of this Notice on Respondent. **Respondent is encouraged to file any request for a hearing electronically with the Office of Financial Institution Adjudication at** ofia@fdic.gov. Respondent shall also serve a copy of any such request upon Susan L. Chomicz, Deputy Chief Counsel – Enforcement, (susan.chomicz@ots.treas.gov), Office of Thrift Supervision, 1700 G St., N.W., Washington, D.C. 20552; upon Alan H. Faircloth, Regional Enforcement Counsel, (alan.faircloth@ots.treas.gov), Office of Thrift Supervision, 1475 Peachtree St., NE, Atlanta, Georgia 30309; and upon V. Scott

Bailey, Senior Attorney, Office of Thrift Supervision, 1700 G Street, N.W., Washington, DC 20552 (vernon.bailey@ots.treas.gov).

41. Any hearing held concerning the civil money penalty assessments, as described above, shall be combined with the hearing of the other matters set forth in the foregoing Notice, including those concerning the issuance of a removal and prohibition order.

42. If Respondent fails to file a request for a hearing within the aforementioned twenty-day (20-day) period, the above assessment of civil money penalties in the aggregate amount of $125,000 shall constitute a final and unappealable assessment order of the OTS against Respondent as provided by 12 U.S.C. § 1818(i)(2)(E). *See also* 12 C.F.R. § 509.19(c)(2). Any final and unappealable assessment order may be referred to the United States Department of Justice for collection against the subject of the assessment order.

VII. PROCEDURES GENERALLY

43. The OTS hereby appoints Administrative Law Judge C. Richard Miserendino (ALJ) of OFIA to preside over any hearing held regarding the subject of this Notice. Unless otherwise set by the ALJ or by agreement of the parties, the hearing should commence on or before sixty days following service of this Notice. The exact time of day and any change in location will be announced at a later time by the ALJ. The hearing will be conducted before the ALJ in accordance with the provisions of the Administrative Procedure Act, 5 U.S.C. §§ 554-557, as made applicable by 12 U.S.C. § 1818(h) and 12 C.F.R. Part 509.

44. Respondent is directed to file an Answer to this Notice within twenty (20) days with OFIA, Attn: Honorable C. Richard Miserendino, ALJ, 3501 N. Fairfax Drive, Suite VS-D8116, Arlington, VA 22226-3500, with the Secretary for Adjudicatory Proceedings, Office of the Chief Counsel, OTS, 1700 G. Street, N.W. Washington, D.C. 20552, and with the attorneys whose names appear on the accompanying certificate of service, within twenty days from the date of

service of this Notice of Charges, in accordance with 12 C.F.R. § 519.19. Respondent is encouraged to file any answer electronically with the Office of Financial Institution Adjudication at ofia@fdic.gov. Failure to answer within this time period shall constitute a waiver of the right to appear and contest the allegations contained in this Notice and shall, upon the OTS's motion, cause the ALJ or the OTS to find the facts in this Notice to be as alleged and to issue an appropriate order.

45. Section 509.10 of the OTS rules, 12 C.F.R. § 509.10, governs the filing of papers in this proceeding. Except as otherwise provided by that rule, any papers required to be filed shall be filed with the Office of Financial Institution Adjudication, 3501 N. Fairfax Drive, Suite VS-D8 1 13, Arlington, VA 22226-3500.

46. Respondent also shall serve a copy of each and every of filing on: OTS, c/o Sandra Evans, Secretary for Adjudicatory Proceedings, (sandra.evans@ots.treas.gov), 1700 G St., N.W., Washington, D.C. 20552; Susan L. Chomicz, Deputy Chief Counsel – Enforcement, (susan.chomicz@ots.treas.gov), Office of Thrift Supervision, 1700 G. Street, N.W. Washington, D.C. 20552; Alan H. Faircloth, Regional Enforcement Counsel, (alan.faircloth@ots.treas.gov), Office of Thrift Supervision, 1475 Peachtree St., NE, Atlanta, Georgia 30309; and V. Scott Bailey, Senior Attorney, Office of Thrift Supervision, 1700 G Street, N.W., Washington, DC 20552 (vernon.bailey@ots.treas.gov).

47. Within twenty (20) days after service of this Notice, Respondent may file a written request for a private hearing. Section 509.23 of the OTS rules, 12 C.F.R. § 509.33, sets out the requirements for any such request and any replies thereto. The evidentiary hearing of this matter before the presiding ALJ will be open to the public, unless the Director of the OTS, in his sole discretion, determines that an open hearing will be contrary to the public interest. *See* 12 U.S.C. § 1818(u)(2). The Director (or a duly authorized representative) will rule on any request filed under

Section 509.33(a), and copies of any such request should be sent to the Director of OTS, c/o Ms. Sandra Evans, Secretary for Adjudicatory Proceedings, Office of Thrift Supervision, 1700 G Street, N.W. – Fifth Floor, M2, Washington, D.C. 20552.

The Office of Thrift Supervision, by its Director (or his duly authorized designee), issues this Notice on this 25 day of June, 2010.

OFFICE OF THRIFT SUPERVISION

By:
Name: Thomas A. Barnes
Title: Deputy Director Examinations, Supervision and Consumer Protection

(Pursuant to delegated authority)

EXHIBIT 10

UNITED STATES OF AMERICA
Before The
OFFICE OF THRIFT SUPERVISION

In the Matter of:	
JONATHAN I. FELDMAN,	Order No.: DC 11-015
Senior Vice President and Institution Affiliated Party of	Effective Date: February 17, 2011
Eastern Savings Bank Hunt Valley, Maryland OTS Docket No. 08183	

ORDER OF ASSESSMENT OF A CIVIL MONEY PENALTY

WHEREAS, Jonathan I. Feldman (Respondent) has executed a Stipulation and Consent to the Issuance of an Order of Assessment of a Civil Money Penalty (Stipulation); and

WHEREAS, Respondent, by executing the Stipulation, has consented and agreed to the issuance of this Order of Assessment of Civil Money Penalty (Order) by the Office of Thrift Supervision (OTS), pursuant to 12 U.S.C. § 1818(i); and

WHEREAS, pursuant to delegated authority, the Deputy Director of Examinations, Supervision and Consumer Protection is authorized to issue Orders of Assessment of a Civil Money Penalty where an institution-affiliated party has consented to the issuance of an Order;

NOW, THEREFORE, IT IS ORDERED that:

Payment of Civil Money Penalty.

1. Effective immediately, Respondent is ordered to pay the sum of One-Hundred, Twenty-Five Thousand Dollars ($125,000) by tendering a certified check or bank draft made payable to the order of the Treasury of the United States.

Indemnification Prohibited.

2. Respondent shall pay such civil money penalty himself and is prohibited from seeking or accepting indemnification for such payment from any third-party.

Effective Date, Incorporation of Stipulation.

3. This Order is effective on the Effective Date as shown on the first page. The Stipulation is made a part hereof and is incorporated herein by this reference.

IT IS SO ORDERED.

OFFICE OF THRIFT SUPERVISION

By: /s/
Thomas A. Barnes
Deputy Director, Examinations, Supervision and Consumer Protection

Date: See Effective Date on page 1

UNITED STATES OF AMERICA
Before The
OFFICE OF THRIFT SUPERVISION

In the Matter of	Order No.: DC 11-015
JONATHAN I. FELDMAN	Effective Date: February 17, 2011
Senior Vice President and Institution-Affiliated Party of	
Eastern Savings Bank Hunt Valley, Maryland OTS Docket No. 08183	

STIPULATION AND CONSENT TO THE ISSUANCE OF AN ORDER OF ASSESSMENT OF A CIVIL MONEY PENALTY

WHEREAS, the Office of Thrift Supervision (OTS), acting by and through its Deputy Director of Examinations, Supervision and Consumer Protection (Deputy Director), and based upon information derived from the exercise of its regulatory and supervisory responsibilities, has informed Jonathan I. Feldman (Feldman), Senior Vice President and institution-affiliated party of Eastern Savings Bank, Hunt Valley, Maryland, OTS Docket No. 08183 (Eastern Savings Bank), that grounds exist to initiate a civil money penalty assessment proceeding against him pursuant to 12 U.S.C. § 1818(i); and

WHEREAS, the Deputy Director, pursuant to delegated authority, is authorized to issue Orders of Assessment of a Civil Money Penalty where an institution-affiliated party has consented to the issuance of an order; and

WHEREAS, Feldman desires to cooperate with the OTS to avoid the time and expense of an administrative civil money penalty proceeding by entering into this Stipulation and Consent to the Issuance of an Order of Assessment of a Civil Money Penalty (Stipulation), without admitting or denying that such grounds exist, but only admitting the statements and conclusions in Paragraphs 1, 2, 3, and 4 below concerning Jurisdiction, hereby stipulates and agrees as follows:

Jurisdiction.

1. Eastern Savings Bank is a "savings association" within the meaning of 12 U.S.C. § 1813(b) and 12 U.S.C. § 1462(4). Accordingly, Eastern Savings Bank is an "insured depository institution" as that term is defined in 12 U.S.C. § 1813(c).

2. Feldman is a Senior Vice President of Eastern Savings Bank, and is an "institution-affiliated party" of Eastern Savings Bank, as that term is defined in 12 U.S.C. § 1813(u), and served in such capacity within six (6) years of the Effective Date as shown on the first page (*see* 12 U.S.C. § 1818(i)(3)).

3. ESSA Bank & Trust, Stroudsburg, Pennsylvania, OTS Docket No. 01254, (ESSA), is a "savings association" within the meaning of 12 U.S.C. § 1813(b) and 12 U.S.C. § 1462(4). Accordingly, ESSA is an "insured depository institution" as that term is defined in 12 U.S.C. § 1813(c).

4. Pursuant to 12 U.S.C. § 1813(q), the Director of the OTS is the "appropriate Federal banking agency" to initiate and maintain a civil money penalty proceeding against Feldman pursuant to 12 U.S.C. § 1818(i).

OTS Findings of Fact.

5. Feldman has been employed as a Senior Vice President at the Hunt Valley office of Eastern Savings Bank at all times pertinent to the events described herein. The OTS finds that Feldman, in his business dealings with ESSA, materially altered a loan document without the knowledge or consent of ESSA, such that the loan document no longer reflected the agreement of the parties, in the course of obtaining an extension of loans from ESSA.

6. Accordingly, pursuant to 12 U.S.C. § 1818(i), Feldman has violated a law or regulation and/or recklessly engaged in unsafe or unsound practices in conducting the affairs of ESSA, an insured depository institution, which has caused or is likely to cause more than a minimal loss to an insured depository institution and/or has resulted in pecuniary gain or other benefit to Feldman.

Consent.

7. Feldman consents to the issuance by the OTS of the accompanying Order of Assessment of a Civil Money Penalty (Order). Feldman further agrees to comply with the terms of the Order upon the Effective Date of the Order and stipulates that the Order complies with all requirements of law.

Finality.

8. This Order is issued by the OTS under the authority of 12 U.S.C. § 1818(i). Upon the Effective Date, it shall be a final order, effective and fully enforceable by the OTS under the provisions of 12 U.S.C. § 1818(i).

Waivers.

9. Feldman waives the following:

(a) the right to an administrative hearing including, without limitation, any such right

provided by 12 U.S.C. §§ 1818(h) or 1818(i);

(b) the right to seek judicial review of the Order, including, without limitation, any such right provided by 12 U.S.C. §§ 1818(h) or 1818(i), or otherwise to challenge the validity of the Order;

(c) any and all claims against the OTS, including its employees and agents, and any other governmental entity for the award of fees, costs, or expenses related to this OTS enforcement matter and/or the Order, whether arising under common law, federal statutes, or otherwise; and

(d) the right to assert this proceeding, this consent to the issuance of the Order, and/or the issuance of the Order, the payment of any monies, or the provision of any other financial relief as contemplated by the Order, as the basis for a claim of double jeopardy in any pending or future proceeding brought by the United States Department of Justice or any other governmental entity.

OTS Authority Not Affected.

10. Nothing in this Stipulation or accompanying Order shall inhibit, estop, bar or otherwise prevent the OTS from taking any other action affecting Feldman if at any time the OTS deems it appropriate to do so to fulfill the responsibilities placed upon the OTS by law. The OTS agrees not to institute further proceedings against Feldman for the specific acts, omissions, or violations in the Findings of Fact set forth in Paragraph 5 above to the extent known to the OTS as of the Effective Date of the accompanying Order, unless such acts, omissions, or violations reoccur.

Other Governmental Actions Not Affected.

11. Feldman acknowledges and agrees that his consent to the issuance of the Order is solely for the purpose of resolving the matters addressed herein, consistent with Paragraph 10 above, and does not otherwise release, discharge, compromise, settle, dismiss, resolve, or in any way affect any actions, charges against, or liability of Feldman that arise pursuant to this action or otherwise, and that may be or have been brought by any governmental entity other than the OTS.

Miscellaneous.

12. The laws of the United States of America shall govern the construction and validity of this Stipulation and the Order.

13. If any provision of this Stipulation and/or the Order is ruled to be invalid, illegal, or unenforceable by the decision of any Court of competent jurisdiction, the validity, legality, and enforceability of the remaining provisions hereof shall not in any way be affected or impaired thereby, unless the Deputy Director in his or her sole discretion determines otherwise.

14. All references to the OTS in this Stipulation and the Order shall also mean any of the OTS's predecessors, successors, and assigns.

15. The section and paragraph headings in this Stipulation and the Order are for convenience only and shall not affect the interpretation of this Stipulation or the Order.

16. The terms of this Stipulation and the Order represent the final agreement of the parties with respect to the subject matters hereof and constitute the sole agreement of the parties with respect to such subject matters.

WHEREFORE, Feldman executes this Stipulation.

JONATHAN I. FELDMAN

By: /s/
Jonathan I. Feldman

OFFICE OF THRIFT SUPERVISION

By: /s/
Thomas A. Barnes
Deputy Director, Examinations, Supervision and Consumer Protection

Date: See Effective Date on page 1