

**UNITED STATES OF AMERICA**  
**Before the**  
**SECURITIES AND EXCHANGE COMMISSION**

**SECURITIES EXCHANGE ACT OF 1934**  
**Release No. 65941 / December 13, 2011**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-14660**

**In the Matter of**

**GARY S. BELL**

**Respondent.**

**ORDER INSTITUTING ADMINISTRATIVE  
AND CEASE-AND-DESIST PROCEEDINGS  
PURSUANT TO SECTIONS 15(b) AND 21C  
OF THE SECURITIES EXCHANGE ACT OF  
1934, MAKING FINDINGS, AND IMPOSING  
REMEDIAL SANCTIONS AND A CEASE-  
AND-DESIST ORDER**

**I.**

The Securities and Exchange Commission (“Commission”) deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 (“Exchange Act”) against Gary S. Bell (“Respondent”).

**II.**

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the “Offer”) which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission’s jurisdiction over him and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order (“Order”), as set forth below.

### III.

On the basis of this Order and Respondent's Offer, the Commission finds<sup>1</sup> that:

#### Summary

1. These proceedings arise out of violations of the locate and close-out requirements of Regulation SHO of the Securities Exchange Act of 1934 ("Reg. SHO") by Respondent Bell and his firm GAS I, LLC ("GAS") who, from December 2006 through April 2007 (as for Bell) and May and June 2007 (as for GAS), violated these requirements and caused large persistent fail to deliver positions in threshold securities.

2. Subject to certain exceptions, Reg. SHO requires market participants seeking to effect a short sale to borrow, arrange to borrow, or have reasonable grounds to believe that a security can be borrowed in time to make delivery when due prior to effecting the short sale. This is known as the "locate requirement." Market makers, who ensure liquidity in the market, are excepted from the locate requirement if they are engaged in bona fide market making activities in the security for which the exception is claimed. Reg. SHO also requires fail-to-deliver positions<sup>2</sup> in certain securities that have persisted for thirteen consecutive settlement days to be immediately closed out.<sup>3</sup> In contrast to the locate requirement, market makers are not excepted from Reg. SHO's close-out requirement.

3. In this case, Bell and GAS improperly relied on the market maker exception from Reg. SHO's locate requirement and engaged in certain transactions that violated the locate and close out requirements. The first type of transaction – known in the industry as a "reverse conversion" or "reversal" – involves selling a put option and buying a call option – a combination that creates what is known as a "synthetic" long position – while selling short the underlying stock. The counterparty on the components of the reverse conversion – which is engaging in a "conversion" – benefits from the transaction because it is able to acquire a long stock position that is perfectly hedged by the synthetic short options position. That party can then loan out the shares of stock and receive fees from the borrowers. Those fees can be quite significant when the stock is

---

<sup>1</sup> The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

<sup>2</sup> Fails to deliver occur when a seller fails to deliver securities to the buyer when delivery is due. Generally, investors complete or settle their security transactions within three settlement days. This settlement cycle is known as T+3 (or "trade date plus three days"). T+3 means that when a trade occurs, the participants to the trade deliver and pay for the security at a clearing agency three days after the trade is executed so the brokerage firm can exchange those funds for the securities on that third settlement day. The three-day settlement period applies to most securities 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 settlement day following the trade (or T+1).

<sup>3</sup> A "close out" of a fail position involves the purchase of shares of like kind and quantity in the amount of the fail-to-deliver position.

a threshold security, because threshold securities are hard-to-borrow and therefore command large fees in the stock loan market. Consequently, prime brokers created the demand for the reverse conversion to create inventory for stock loans on hard-to-borrow securities, and options market makers like Bell and GAS fed this demand.

4. The second type of transaction, referred to herein as a “reset,” is a transaction in which a market participant who has a “fail-to-deliver” position in a threshold security buys shares of that security while simultaneously selling short-term, deep in-the-money<sup>4</sup> call options to, or buying short-term, deep in-the-money put options from, the counterparty to the share purchase. The purchase of shares creates the illusion that the market participant has satisfied the close out obligation of Reg. SHO. However, the shares that are apparently purchased in the reset transactions are never actually delivered to the purchaser because on the day after executing the reset, the option is either exercised (if a call) or assigned (if a put), transferring the shares back to the party that apparently sold them the previous day. This paired transaction allows the market participant with the fail-to-deliver position to effectively borrow the stock for a day, in order to appear to have satisfied the close out requirement of Rule 203(b)(3).

5. By avoiding the cost of borrowing shares and engaging in these reverse conversion and reset transactions, Bell and GAS were able to earn profits while subject to minimal risk. Because Bell and GAS improperly failed to borrow or arrange to borrow securities to make delivery when delivery was due, the short sales were “naked” short sales<sup>5</sup> that violated Reg. SHO.

6. Specifically, from December 2006 through June 2007, Respondent Bell and his firm GAS, both purported options market makers, willfully violated Rule 203(b)(1) of Reg. SHO by improperly claiming the market maker exception to avoid locating shares before effecting short sale transactions in Reg. SHO threshold securities.<sup>6</sup> Bell and GAS also willfully violated Rule 203(b)(3) of Reg. SHO by engaging in a series of sham reset transactions that employed short-term, paired stock and option positions, which enabled both Bell and GAS to circumvent their close out obligations in Reg. SHO threshold securities. Bell and GAS also assisted other options market makers who were executing their own sham reset transactions by acting as a counterparty to the sham transactions and in doing so violated the locate requirement. Respondent Bell, the principal trader at GAS and a part owner of GAS, willfully aided and abetted and caused GAS’s violations of Rules 203(b)(1) and 203(b)(3) of Reg. SHO.

---

<sup>4</sup> An “in-the-money” option is an option that entitles its holder to either buy securities below the current market price for that security (in the case of a call option), or to sell securities above the market price (in the case of a put option). An option that is “deep in-the-money” has a strike price that is far below (in the case of a call option) or far above (in the case of a put) the market price for the given security.

<sup>5</sup> In a “naked” short sale, the seller does not borrow or arrange to borrow the securities in time to make delivery to the buyer within the standard three-day settlement period. As a result, the seller fails to deliver the securities to the buyer when delivery is due.

<sup>6</sup> A “threshold security” is a security for which there is an aggregate fail-to-deliver position exceeding the size criteria set forth in Rule 203(c)(6) of Regulation SHO for a period of five consecutive settlement days.

## **Respondent**

7. *Gary S. Bell*, age 51, is a resident of Naperville, Illinois. Bell, who holds no securities licenses, was a sole-proprietor during the periods January 1, 2005 through May 3, 2006 and from November 30, 2006 through May 1, 2007. Bell was a broker-dealer registered with the Commission pursuant to Section 15(b) of the Exchange Act (File No. 8-35762) until April 30, 2007. On May 1, 2007, Bell began trading through GAS I, L.L.C. During the period from November 30, 2006 through September 25, 2007, Bell was a member of the Chicago Board Options Exchange (“CBOE”). During the period from May 1, 2007 through September 25, 2007, Bell was a part owner of GAS I.

## **Other Relevant Entity**

8. *GAS I, L.L.C.*, was an Illinois limited liability company with an office in Chicago. GAS was a broker-dealer registered with the Commission pursuant to Section 15(b) of the Exchange Act (File No. 8-35762) from May 1, 2007 to June 20, 2008. Bell was the managing member and a part owner of GAS. From May 1, 2007 through September 25, 2007, GAS was a member of the CBOE registered to conduct market maker business. Effective September 25, 2007, GAS terminated its membership at the CBOE and on September 11, 2009, GAS was dissolved.

## **Background**

### **Bell and GAS Failed to Locate Shares Prior to Effecting Short Sales**

9. From December 2006 through June 2007, Bell and GAS engaged in reverse conversions with purchasers of Reg. SHO threshold securities.

10. In these reverse conversions, Bell and GAS sold short shares of Reg. SHO threshold securities while simultaneously creating a synthetic long position in those same securities by purchasing call options from, and selling put options to, the same counterparty to whom Bell and GAS were selling short the shares of the threshold securities. These call and put options had the same strike price and expiration date, and were options to buy (or sell) the same threshold securities that Bell and GAS sold short in the reverse conversion transactions. Through this set of transactions, Bell and GAS eliminated their market risk because the short position was used to hedge the synthetic long position that had been created by purchasing call options and selling put options.

11. The reverse conversion transactions in Reg. SHO securities were profitable for Bell and GAS because the prices of the three separate components of the transactions – the short sale, the sale of the put options, and the purchase of the call options – were interdependent, and were set at levels that created an agreed-upon net profit per share for Bell and GAS. That per-share net profit was the effective price of the conversion, a price that Bell’s and GAS’s counterparties were willing to pay in order to obtain shares of hard-to-borrow Reg. SHO threshold securities for the

length of time between the original execution of the conversion and the expiration of the option components of the conversion.

12. In executing these reverse conversions, Bell and GAS claimed the market maker exception in Rule 203(b)(1) of Reg. SHO and did not locate shares of the security in question prior to effecting the short sale. This failure to locate shares was improper, however, because Bell and GAS were not engaged in bona fide market making activity in connection with effecting the short sale transactions.

### **Bell and GAS Failed to Close Out Fail-to-Deliver Positions in Reg. SHO Threshold Securities**

13. Bell's and GAS's short sales resulted in a fail-to-deliver position in the threshold security on the books and records of their clearing firm – i.e. Bell and GAS had not delivered the shares they sold short to their clearing firm so that the clearing firm could settle the trade.

14. Rule 203(b)(3) of Reg. SHO requires clearing firms immediately to close out any fail-to-deliver position in a threshold security that persists for thirteen consecutive settlement days by purchasing securities of a like kind and quantity. Specifically, Rule 203(b)(3) 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 Continuous Net Settlement system that has persisted for thirteen consecutive settlement days. However, pursuant to Rule 203(b)(3)(vi) of Reg. SHO, a clearing firm is permitted reasonably to allocate a fail-to-deliver position to a broker or dealer whose short sale resulted in the position. Once the clearing firm has allocated the fail-to-deliver position to another broker or dealer, the obligation for complying with the close out requirement shifts to that broker or dealer.

15. On numerous occasions from December 2006 through June 2007, Bell's and GAS's clearing firm notified them that the clearing firm had allocated to Bell and GAS the obligation to close out fail-to-deliver positions in threshold securities. These notifications informed Bell and GAS that if they did not purchase shares sufficient to satisfy their fail-to-deliver positions, the clearing firm would purchase (or "buy-in") those shares for the Bell and GAS accounts.

16. Bell and GAS did not want their fail-to-deliver positions, which resulted from the short sale portion of the reverse conversion, to be bought-in by the clearing firm because this would result in the clearing firm making large purchases of Reg. SHO threshold securities, at the expense of Bell and GAS, at a price determined by the market. Additionally, the buy-in would have exposed Bell and GAS to market risk on its reverse conversion transaction because it would have eliminated the short position that had been used to hedge the synthetic long position created by the options component of the reverse conversion.

17. To avoid a forced buy-in, Bell, in his own name and later through GAS, entered into a series of sham reset transactions that circumvented his and GAS's obligation under Reg. SHO to close out its fail-to-deliver position. These complex sham transactions gave the appearance that Bell and GAS were closing out their fail-to-deliver positions by purchasing securities of like kind and quantity.

18. Specifically, on numerous occasions, Bell effected short-term in-the-money option transactions in conjunction with stock purchases to circumvent the Reg. SHO close out requirements. Bell “purchased” stock in the Reg. SHO threshold security from another market maker and simultaneously purchased a short-term put option from (or sold a short-term call option to) the same market maker. These combined stock and option transactions were either “married puts” (the purchase of stock in conjunction with the purchase of a put option on the same security) or “buy-writes” (the purchase of stock in conjunction with the sale (or “writing”) of call options on the same security).

19. Although married puts and buy-writes can be created using standard options, the option component of the reset transactions used by Bell and GAS were usually established using “FLEX” options. FLEX options are exchange traded options for which the parties can customize certain terms of the options, including the strike price, expiration date, and exercise type (*i.e.*, American or European). Bell and GAS used these FLEX options because they did not intend to actually purchase the shares required to satisfy their close out obligations. Rather, they simply wanted to appear to have satisfied that obligation through a purported purchase of shares. Thus, Bell and GAS structured the reset transactions so that the options component of the transaction would expire very soon after the purported “purchase” of shares had been reflected in Bell’s and GAS’s account at their clearing firm. Indeed, most of the FLEX options were customized to expire one day after they were purchased.

20. By entering into these reset transactions, Bell and GAS created the false impression that they had satisfied their Reg. SHO close out obligation. Bell and GAS, however, knew that the following day, or shortly thereafter, Bell or GAS would exercise the right to sell the stock back to its counterparty. (In the case of a call option, the option would expire in-the-money, causing the market maker that had purchased that call option to assign an exercise notice to Bell or GAS for Bell or GAS to sell the stock).

21. Moreover, Bell and GAS never actually received the stock they “purchased” from the other market maker because that market maker was selling short the stock without actually having any shares to sell or any intention to borrow shares in time for delivery when due.<sup>7</sup> Accordingly, Bell and GAS never received any shares and so never in fact closed out the “fail-to-deliver” position, as required by Reg. SHO, that was initially established during the reverse conversion transaction. Bell and GAS knew, or had reason to know that the combination of the purchase of shares and the sale of the FLEX option would result in maintenance of the “fail-to-deliver” position.

22. The clearing firm used by Bell and GAS, however, reset Bell’s and GAS’s Reg. SHO close out obligation to day one, thus giving Bell and GAS another thirteen settlement days in which to close out the short position, based on Bell’s and GAS’s purported “purchase” of shares and exercise of the option.

---

<sup>7</sup> These market makers were themselves improperly relying on Reg. SHO’s locate exception related to bona fide market making activity because they were not engaged in bona fide market making activity in connection with these short sales.

23. After receiving subsequent buy-in notices from their clearing firm, Bell and GAS continued to engage in these types of transactions until the initial options positions (call options purchase/put options sale) expired or were assigned, thus closing out the short position and eliminating the synthetic long position that the short position had hedged. By engaging in this course of conduct, Bell, in his own name and later through GAS, impermissibly maintained fail-to-deliver positions in numerous Reg. SHO threshold securities for longer than thirteen settlement days. Indeed, on numerous occasions, Bell's repeated use of reset transactions allowed him and GAS to maintain a large fail-to-deliver position in a threshold security for several months.

24. During the relevant period, Bell and GAS engaged in a large number of reverse conversions and reset transactions in numerous threshold securities including, but not limited to: NYSE Group; Chipotle Mexican Grill, Inc.; Novastar Financial, Inc.; and AtheroGenics, Inc. In addition, on numerous occasions, Bell and GAS assisted other purported market makers in evading their close out obligations by acting as the counterparty to reset transactions. Specifically, Bell and GAS sold short shares of Reg. SHO threshold securities so that other market makers could "purchase" the securities to close out their own fail-to-deliver positions, and simultaneously sold deep in-the-money put options or bought deep in-the-money call options, the combination of which allowed the other market makers to circumvent their own Reg. SHO close out obligations. Neither Bell nor GAS located the shares of these threshold securities prior to entering into the short sale component of these reset transactions.

25. As a result of Bell's and GAS's violations of Reg. SHO's locate and close out requirements, they received ill-gotten gains of at least \$1.5 million.

### **Violations**

#### **Bell Willfully Violated Rule 203(b)(1) of Reg. SHO and Willfully Aided and Abetted and Caused GAS's Violation**

26. Pursuant to the locate requirement of Rule 203(b)(1) of Reg. SHO, a broker or dealer may not effect a short sale in an equity security unless, prior to accepting a short sale order in an equity security from another person, or effecting a short sale in an equity security for its own account, it has "(i) [b]orrowed the security, or entered into a bona-fide arrangement to borrow the security; or (ii) [r]easonable grounds to believe that the security can be borrowed so that it can be delivered on the date delivery is due; and (iii) [d]ocumented compliance with [these requirements]."

27. Rule 203(b)(2)(iii) contains an exception to this locate requirement for short sales effected "by a market maker in connection with bona-fide market making activities in the security for which this exception is claimed."

28. At the time Bell, in his own name and later through GAS, placed orders to sell short certain Reg. SHO threshold securities as part of the reverse conversion transactions and reset transactions described above, he failed to locate the securities, claiming the market maker

exception to the locate requirement. The market maker exception was not available to either Bell or GAS, however, because they were not engaging in bona-fide market making activities in these securities.

29. As a result of the conduct described above, Bell willfully violated, and willfully aided and abetted and caused GAS's violations of, Rule 203(b)(1) of Reg. SHO.

### **Bell Willfully Violated Rule 203(b)(3) of Reg. SHO and Willfully Aided and Abetted and Caused GAS's Violation**

30. Rule 203(b)(3) imposes an obligation on clearing firms immediately to close out any fail-to-deliver positions in a threshold security that last for thirteen consecutive settlement days<sup>8</sup> by purchasing securities of like kind and quantity. Pursuant to Rule 203(b)(3)(vi), however, a clearing firm is permitted reasonably to allocate a fail-to-deliver position to a broker or dealer for which it clears trades or for which it is responsible for settlement, based on such broker or dealer's short position. Once the clearing firm has allocated the fail-to-deliver position to another broker or dealer, the obligation to comply with the mandatory close out requirement shifts to that broker or dealer.

31. Once the fail-to-deliver position is allocated to the broker or dealer, that broker or dealer, in order to satisfy the close out requirement of Rule 203(b)(3) of Reg. SHO, must purchase securities of like kind and quantity. Borrowing securities, or otherwise entering into an arrangement that merely creates the appearance of a purchase, does not satisfy the close out requirement under Rule 203(b)(3) of Reg. SHO.

32. In addition, Rule 203 of Reg. SHO specifically prohibits firms from satisfying their close out obligations through sham transactions that merely give the appearance of closing out a fail-to-deliver position. Specifically, Rule 203(b)(3)(vii) provides that a clearing firm will be deemed not to have satisfied the close out obligation if it enters into an agreement with another person to purchase securities and the clearing firm knows, or has reason to know, that the other person will not deliver securities in settlement of the purchase. Once the clearing firm has allocated the fail-to-deliver position to another broker or dealer, the sham transactions provision of Rule 203(b) applies to that broker or dealer.

33. By selling (or purchasing) deep in-the-money FLEX call (or put) options while simultaneously purporting to "purchase" stock, Bell and GAS engaged in sham transactions that gave the appearance that they were closing out its fail-to-deliver position when, in fact, Bell and GAS knew, or had reason to know that these transactions would result in a fail-to-deliver position.

---

<sup>8</sup> In October 2008, the Commission adopted Rule 204T (which was made permanent as Rule 204 effective July 31, 2009). Under Rule 204, clearing firms must close out fails-to-deliver on all equity securities (not just threshold securities) and must do so earlier than under Rule 203(b)(3). Clearing firms must now close out fails-to-deliver by either borrowing or purchasing securities of like kind and quantity no later than the beginning of regular trading hours on the first settlement day after the settlement date. Fails resulting from long sales or attributable to bona fide market making activity have two additional settlement days before they must be closed out.

34. As a result of the conduct described above, Bell willfully violated and willfully aided and abetted and caused GAS's violations of, Rule 203(b)(3) of Reg. SHO.

### **Undertaking**

35. Bell has undertaken to provide to the Commission, within thirty (30) days after the end of the nine (9) month suspension period described below, an affidavit that he has complied fully with the sanctions described in Section IV below.

### **IV.**

In view of the foregoing, the Commission deems it appropriate, in the public interest, to impose the sanctions agreed to in Respondent Bell's Offer.

Accordingly, pursuant to Sections 15(b) and 21C of the Exchange Act, it is hereby ORDERED that:

A. Respondent cease and desist from committing or causing any violations and any future violations of Exchange Act Rules 203(b)(1) and 203(b)(3).

B. Respondent be, and hereby is, suspended from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization for a period of nine (9) months, effective on the second Monday following the entry of this Order.

C. Respondent shall, within ten (10) days of the entry of this Order, pay disgorgement of \$1,500,000 and prejudgment interest of \$336,094 and a civil money penalty in the amount of \$250,000 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600 and pursuant to 31 U.S.C. 3717. Payment shall be: (A) made by wire transfer, United States postal money order, certified check, bank cashier's check or bank money order; (B) made payable to the Securities and Exchange Commission; (C) hand-delivered or mailed to the Securities and Exchange Commission, Office of Financial Management, 100 F St., NE, Stop 6042, Washington, DC 20549; and (D) submitted under cover letter that identifies Gary S. Bell as a Respondent in these proceedings, the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Andrew M. Calamari, Division of Enforcement, Securities and Exchange Commission, Three World Financial Center, Suite 400, New York, NY 10281.

D. Respondent shall comply with the undertaking enumerated in Section III, paragraph 35 above.

By the Commission.

Elizabeth M. Murphy  
Secretary