UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDINGS RULINGS
Release No. 710/ July 11, 2012

ADMINISTRATIVE PROCEEDING
File No. 3-14848

In the Matter of	:	
	:	ORDER ON MOTIONS
OPTIONSXPRESS, INC.,	:	
THOMAS E. STERN, and	:	
JONATHAN I. FELDMAN	:	

On April 16, 2012, the Securities and Exchange Commission (Commission) issued an Order Instituting Administrative and Cease-and-Desist Proceedings (OIP). The hearing is scheduled to begin on September 5, 2012. There are three pending motions.

Motions for a More Definite Statement

optionsXpress, Inc. (optionsXpress) and Thomas E. Stern (Stern)[1] filed Motions for a More Definite Statement (More Definite Statement Motion) on May 29, 2012, and June 1, 2012, respectively. In the More Definite Statement Motion, optionsXpress and Stern (collectively, Respondents) claim that certain areas of the OIP are "vague, ambiguous, or contradictory," and that they must have a coherent and complete description of the allegations to prepare a defense. More Definite Statement Motion at 2. Respondents contend that the Division of Enforcement (Division) must provide a more definite statement as to the frequency of the exercise and assignment of call options sold by customers, or, alternatively, more as to its theory of liability that "would be consistent with non-guaranteed assignment." Id. at 4.

In addition, Respondents fault the OIP for not providing a straightforward explanation for what it means by failing to "deliver" shares, and failing to state what the Division intends to prove. Id. at 4-5. Respondents complain that the OIP lacks specificity regarding accounts and transactions. Specifically, the OIP defines "customers" as six customers including Jonathan I. Feldman (Feldman); Respondents request the names and account numbers for the other five customers who engaged in reverse conversions and similar options trading strategies and a full list of the transactions referred to in paragraph 42 of the OIP. Id. at 5-6. Finally, Respondents

[1] In separate filings, Stern incorporated the grounds and the briefs submitted by optionsXpress.

claim that the OIP does not describe conduct that would establish Feldman's primary fraud violations or the fraud scheme that he allegedly employed, and utterly fails to describe optionsXpress's alleged aiding and abetting violations. Id. at 7-9.

In its Response (Division Response) filed on June 5, 2012, the Division characterizes most of Respondents' complaints as post-hearing arguments on the sufficiency of the Division's proof. Division Response at 3. The Division points Respondents to the Securities Exchange Act of 1934, Regulation (Exchange Act) SHO Rules 203, 204, 204T, and their releases for information about the concept of delivery.[2] Id. at 3-4. To move the process forward, the Division has provided Respondents with customer account numbers, noting that it strains credulity to believe Respondents do not have this information when they earlier received subpoenas for information concerning these customer accounts. Id. at 4. The Division maintains there is no need for a list of the 1,317 failures to deliver since the OIP identifies the 25 stocks and the dates on which the failures occurred. Id. Finally, the Division insists that the OIP is clear on Respondents' conduct that caused and aided and abetted the primary fraud violations and notes that the alleged primary violator, Feldman, did not personally seek clarification of the allegations against him. Id. at 4-5.

optionsXpress's Reply in Support of the More Definite Statement Motion (Reply) filed on June 11, 2012, acknowledges that the Division has provided a list of accounts for which it is challenging the trading activity. Reply at 1 n.1. optionsXpress complains that the OIP puts forward a "novel and heretofore untested interpretation of Regulation SHO," and that to prepare its defense Respondents need to know more than the OIP reveals, such as: (1) does the Division contend the assignments were guaranteed, and if it does not make such a claim, then under what legal theory does it allege that Regulation SHO was violated; (2) what "delivery" requirements were allegedly violated; (3) the identity of the 1,317 failures to deliver; and (4) clarification of the fraud allegations. Reply at 1-7.

Ruling on Motions for a More Definite Statement

The pleadings contain a great deal of argument and statements of legal position. More Definite Statement Motion at 3-4, 7-9. For example, at a minimum, optionsXpress wants confirmation of its speculation that the Division's theory is that "the 'delivery' of shares bought to satisfy a delivery obligation did not terminate a net fail because the 'buy' was supposedly 'illusory.'" Reply at 2-3. Respondents also argue that the OIP is inherently flawed in that optionsXpress allegedly aided and abetted Feldman in defrauding his broker, optionsXpress. Id. at 5.

The Commission's Rules of Practice require that the OIP state the nature of the hearing, the legal authority, "a short and plain statement of the matters of fact and law to be considered and determined," and the nature of any relief sought. 17 C.F.R. § 201.200(b). The issue here is

[2] In the Securities Act Handbook 2515 (Wolters Kluwer Law & Business, 2012), "Regulation SHO-Regulation of Short Sales," effective September 7, 2004, appears in a section headed "Market Regulations." It states, "See SEC Release 34-50103; July 28, 2004, which has been added to Part 241 as an Interpretative Release."

whether the OIP sufficiently informed Respondents of the charges against them so they can prepare a defense. It has long been established that a respondent is not entitled to disclosure of the evidence on which the Division intends to rely or to disclosure of the Division's theory of the case. Charles M. Weber, 35 S.E.C. 79, 80-81 (1953), J. Logan & Co., 38 S.E.C. 827, 829-30 (1959); M. J. Reiter Co., 39 S.E.C. 484, 486 (1959).

I DENY the More Definite Statement Motion because the OIP gives sufficient notice of the allegations. In addition, the Division has made available to Respondents the non-privileged portions of the investigative file that are the basis for the allegations; there have been numerous meetings between Respondents and the Division at which, presumably, information has been transmitted; and the Division, in pleadings in connection with the motions at issue here, has disclosed various of its positions. Division Response at 4. Finally, the More Definite Statement Motion consists mainly of legal arguments which are not a proper basis for this type of motion.

Feldman's Summary Disposition Motion

The OIP alleges that Feldman willfully violated Section 17(a) of the Securities Act of 1933 (Securities Act), Section 10(b) of the Exchange Act, and Exchange Act Rules 10b-5 and 10b-21 in connection with "a complex short selling scheme to profit by circumventing the delivery requirements of Regulation SHO of the Exchange Act." OIP at 2. I granted Feldman's request to file a motion for summary disposition at the May 15, 2012, prehearing conference.

Feldman filed a Motion for Summary Disposition and Memorandum in Support (Summary Disposition Motion) on June 4, 2012, with five exhibits: Motion Exhibit 1, Affidavit of Erik Sirri (Sirri) with attachment A; Motion Exhibit 2, Affidavit of Feldman with attachments A-E; Motion Exhibit 3, Division's letter to Gregory T. Lawrence, Oct. 28, 2010; Motion Exhibit 4, Affidavit of Gregory T. Lawrence with attachment A; and Motion Exhibit 5, Jonathan I. Feldman, Office of Thrift Supervision (OTS), Order of Assessment, Order No. DC 11-015 (Feb. 17, 2011). According to Feldman, the Summary Disposition Motion should be granted because: (1) delivery obligations under Regulation SHO fall on the broker-dealer; and (2) delivery under Exchange Act Rule 10b-21 is a distinct concept which applies only where a customer has made a representation that she will deliver securities. Summary Disposition Motion at 2, 13-17.

Feldman charges that the allegations against him fail because: (1) he had no obligation under Regulation SHO to deliver shares; (2) he did not assume an obligation to deliver shares; and (3) he had no control over the delivery of shares. Summary Disposition Motion at 11-12. Feldman argues that he had no obligation to deliver securities in fact and that, as a matter of law, optionsXpress's alleged failure to deliver securities under Regulation SHO cannot be the basis of a fraud charge against him. Id. at 2-3, 11-14.

Feldman claims that the OIP does not allege that he made an express representation to deliver securities, and he argues that the Division implicitly and wrongly asserts that retail customers make a representation regarding delivery when submitting an order to sell a security. Id. at 2, 17. Feldman asserts that, "[e]ven if representations concerning delivery were made by simply placing a trade (which is not the case), members of the marketplace would view those putative representations as being made by optionsXpress." Id. at 18. Feldman reads the

Adopting Release for Exchange Act Rule 10b-21 to state that an individual retail customer is relieved of liability if the customer lacks control over delivery and relies on his or her broker. Id. at 18-19. In support of these positions, the Summary Disposition Motion explains the "mechanics of call options," based largely on the affidavit of Sirri. Id. at 6-8; Motion Exhibit 1. The Summary Disposition Motion claims: (1) Feldman never assumed an obligation to deliver securities citing Feldman's affidavit; (2) optionsXpress did not rely on Feldman for delivery by citing the terms and conditions of the optionsXpress User/Customer Agreement and e-mails between optionsXpress and Feldman; and (3) optionsXpress told Feldman it was compliant with the rules and regulations. Id. at 8-10; Motion Exhibit 2, attachments A-D.

Feldman argues that any Division argument that he deceived purchasers and participants of registered clearing agencies by submitting an order to sell or buy fails as a matter of law, citing United States v. Finnerty, 533 F.3d 143 (2d Cir. 2008). Id. at 20-23. He contends that the industry and marketplace understand that brokers, not individual customers, have the obligation to locate, borrow and deliver securities. Id. at 22-23.

Feldman asserts that Exchange Act Rule 10b-21 is an offshoot of Regulation SHO that does not apply to writing calls, the conduct he was charged with, because the language of the rule speaks of "an order to sell," and the result of writing a call is an option to buy. Id. at 26. Feldman claims that the antifraud charges fail for the same reason that the Exchange Act Rule 10b-21 charges fail: Feldman made no representation concerning his intention or ability to deliver. Id. at 23. He asserts that he was attempting "to make a profit off of a pre-existing arbitrage opportunity," using standard American-style options sold on the open market, and the only improper conduct alleged relates to regulation SHO: that assignments prevented delivery. Id. at 25.

Feldman also argues that the proceeding was initiated in violation of the 180-day deadline mandated by Section 929U of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank), 15 U.S.C. § 78d-5(a)(1).[3] Id. at 10-11, 27-30; Motion Exhibits 3-4. The Wells Notice was issued on October 28, 2010, and the OIP was issued on April 16, 2012.[4] Feldman contends that: (1) the Commission authorized filing the action within the second 180-day period which ended October 24, 2011, and the staff was required to file the action by that date; and (2) the third extension of 180 days was invalid because a determination to file the OIP had already been made. Summary Disposition Motion at 27-30.

[3] Section 929U of the statute requires that the Commission staff shall either file an action or provide notice to the Division Director of its intent not to file an action, not later than 180 days after the date on which the Commission staff provides a written Wells notice to any person. Section 4E(a)(2) provides for extensions of the 180-day limit. Summary Disposition Motion at 27-28.

[4] According to Feldman, the Wells notice was issued on October 28, 2010, the initial 180-day period expired on April 26, 2011, an additional extension period expired on October 24, 2011, and before October 24, 2011, the Commission authorized filing the action. Id. at 27.

Finally, Feldman charges that the OIP falsely alleges he was "fined" by OTS "for making material misrepresentations and/or concealing material facts as part of a scheme to defraud a federally-insured financial institution." Id. at 11. Feldman represents that he settled administrative charges on a non-fraud, non-scienter basis. Id.; Motion Exhibit 5. Feldman would have this statement stricken from the OIP, citing Federal Rule of Civil Procedure 12(f), and he wants the OTS matter to be inadmissible. Id. at 11, 30-31.

The Division filed its Response to the Motion for Summary Disposition with ten exhibits on June 18, 2012 (Opposition).[5] The Division claims that Feldman engaged in a stock-kiting scheme characterized by deceptive and manipulative conduct and that Feldman's arguments lack merit, in particular that he did not have a delivery obligation. Opposition at 1-2. The Division notes that when Rule 250 of the Commission's Rules of Practice was adopted in its present form the comment stated that summary disposition would be granted rarely, citing 60 Fed. Reg. 32738, 32767-68 (June 23, 1995). Id. at 2. The Division argues further that the Summary Disposition Motion is inappropriate at this juncture because the OIP and investigative evidence contradict statements in the Feldman and Sirri Affidavits presented as "uncontested facts." [6] Id. at 5-7.

The Opposition goes on at length as to how Feldman violated Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act, and Exchange Act Rules 10b-5 and 10b-21, and that Feldman acted with scienter. Id. at 8-24. The Division maintains that Feldman's conduct falls within the anti-fraud provisions that oblige sellers of securities to deliver securities they sell. Id. at 15. The Division disputes Feldman's position that his conduct was not covered by Rule 10b-21, and notes that Rule 10b-21 was adopted to address abusive naked short selling and failures to deliver by sellers, among other things. Id. at 16. The Division argues that Rule 10b-21 applies to deep-in-the-money call options that Feldman sold. Id. at 23-24.

[5] Opposition Exhibit 1, The Options Clearing Corporation's Equity Options Product Specifications; Opposition Exhibit 2, the Chicago Board Options Exchange's Equity Options Product Specifications; Opposition Exhibit 3, 73 Fed. Reg., 61666-78; Opposition Exhibit 4, Penson Financial Services, Inc. (Penson) Customer Account Forms; Opposition Exhibit 5, optionsXpress February 12, 2010, letter to Financial Industry Regulatory Authority; Opposition Exhibit 6, November 18, 2009, e-mails between persons at Penson; Opposition Exhibit 7, November 30, 2009, e-mails between persons at Penson; Opposition Exhibit 8, Declaration of Deborah A. Tarasevich in support of the Division's Opposition; Opposition Exhibit 9, Jonathan I. Feldman, OTS Docket No. 08183, Adjudicatory Proceeding No. AP-10-04, Notice of Intention to Remove and Prohibit and Notice of Charges and Hearing and Notice of Assessment of a Civil Money Penalty (June 25, 2010); Opposition Exhibit 10, Jonathan I. Feldman, OTS Docket No. 08183, Order No. DC 11-015, Stipulation and Consent to the Issuance of an Order of Assessment of a Civil Money Penalty (Feb. 17, 2011).

[6] Commission Rule of Practice 250(a) provides that the facts of the pleadings of the party against whom the motion is made shall be taken as true. Opposition at 5.

The Division insists that it did not violate the 180-day rule. The Division maintains that the issuance of the OIP on April 16, 2012, was done in compliance with Dodd-Frank, but even noncompliance would not bar this action because it was brought within the statute of limitations. Id. at 24-25. According to the Division, the Commission decided on October 13, 2011, to approve the Division Director's request to further extend the deadline to April 17, 2012.[7] Id. at 24. The Division dismisses as supposition Feldman's argument that the Commission's decision to grant authority to institute the action one week after approving the Division Director's request for extension means the Division Director made a determination to file the action before the extension. Id.

Finally, the Division opposes Feldman's request to strike statements in the OIP that reference an OTS action against Feldman, because the statements cite a public document, the OTS Notice of Action against Feldman. Id. at 25; Opposition Exhibit 9.

Feldman filed a Reply to the Division's Opposition (Reply) on June 25, 2012, with one Exhibit (Reply Exhibit 1).[8] Feldman insists he had no duty to deliver securities because optionsXpress accepted his buy-writes as full performance of any delivery obligation. Reply at 1. The Reply faults the Division for: (1) failing to acknowledge or address the delivery obligations among the National Securities Clearing Corporation's Continuous Net Settlement (CNS) system, optionsXpress, and Feldman; (2) failing to show that the Division Director had not determined to file the action before he or the Commission approved a third 180-day period; and (3) not acknowledging a false allegation in the OIP concerning Feldman's OTS fine. Id. at 2.

Feldman argues that the Division has not shown that material issues of fact exist and that it has not presented evidence to dispute the affidavits that were part of the Summary Disposition Motion, in particular the description of the mechanics of delivery set out by Sirri and the characteristics of Feldman's trading set out by Feldman. Id. at 2-5. Feldman argues that the Division's theory of liability is invalid because the submission of an order to buy or sell securities alone is not deceptive, and the argument that the agreement between Feldman and optionsXpress required Feldman to deliver securities is unsupported and irrelevant. Id. at 7-9. The Reply disputes the Division's definition of "physical delivery" by noting that The Options Clearing Corporation is the issuer of exchange traded equity options and the way in which it uses the term "physical delivery" in its Put and Call Options Prospectus should govern. Id. at 9-10, Reply Exhibit 1.

---

[7] The Division states that the Commission approved extending the filing deadline for 180 days on October 13, 2011, and authorized institution of administrative proceedings against Feldman and others on October 20, 2011. It conveyed this information to Feldman's counsel on October 25, 2011. On April 12, 2012, the Commission authorized institution of settled administrative proceedings against several respondents, and litigated administrative proceedings against Feldman, Stern, and optionsXpress. Opposition Exhibit 8.

[8] The Reply Exhibit 1 is The Options Clearing Corporation, Put and Call Options Prospectus (Apr. 12, 2002).

The Reply argues that a determination of whether Feldman acted with scienter is not required to decide the Summary Disposition Motion, and Feldman did not assume the delivery obligation that by default and industry practice is assumed by optionsXpress. Id. at 11. Also, the Reply maintains that Feldman could not commit a primary anti-fraud violation because he did not control the allegedly deceptive conduct, and that the Division's position that language in the Adopting Release to Rule 10b-21 does not apply because it refers to Rule 203 and not Rule 204 is absurd. Id. at 11-12. According to the Reply, Feldman could not effect delivery at CNS, citing the Sirri Affidavit. Id. at 12.

Feldman argues that the filing of the OIP was outside the Dodd-Frank deadline because the Division has not shown by affidavit that the Division Director's decision to file an action was not made prior to October 13, 2011, and Feldman disagrees with the Division's authority as to why noncompliance with Dodd-Frank would nevertheless permit this proceeding. Id. at 13-14. Finally, Feldman insists that paragraph ten of the OIP should be modified because he was not fined by the OTS, but settled the allegations on a non-fraud basis and consented to a fine. Id. at 14-15.

Ruling on Summary Disposition Motion

Rule 250 of the Commission's Rules of Practice states that a motion for summary disposition may be granted if there is no genuine issue with regard to any material fact and the maker of the motion is entitled to summary disposition as a matter of law.[9] 17 C.F.R. § 201.250(b). It is obvious from the above four-page summary of the positions of Feldman and the Division that many material facts are in dispute. At this stage of the proceeding, I cannot determine whether Feldman's legal arguments are correct because resolving them requires facts and the record only contains assertions in materials that have not been admitted into evidence and are not subject to official notice. There are too many factual disputes to enumerate, but two prominent examples are assertions in the Affidavits of Sirri and Feldman. Summary Disposition Motion, Motion Exhibits 1-2. See John P. Flannery, Administrative Proceedings Rulings Release No. 662, 100 SEC Docket 36870 (Jan. 10, 2011).

I reject Feldman's argument that the Commission was compelled to institute the action by October 21, 2011, even though on October 13, 2011, the Division received Commission approval for an extension, until April 17, 2012, to file the action. The language of Section 4E(a)(2) of the Exchange Act that provides for additional extensions in "complex actions," notes that it is "Notwithstanding paragraph (1)," which is relied on by Feldman. The Declaration of a Division Assistant Director states the Director determined that the staff's investigation was "sufficiently complex," which appears obvious from the pleadings at issue in this Order. Opposition Exhibit 8 at 2.

Paragraph 10 of the OIP states that the OTS fined Feldman for "making material misrepresentations and/or concealing material facts as part of a scheme to defraud a federally-

[9] Rule 56 of the Federal Rules of Civil Procedure is identical.

insured financial institution." OIP at 3. That language appears almost verbatim in Jonathan I. Feldman, OTS Docket No. 08183, Adjudicatory Proceeding No. AP-10-04, Notice of Intention to Remove and Prohibit and Notice of Charges and Hearing and Notice of Assessment of a Civil Money Penalty (June 25, 2010). Opposition Exhibit 9. On February 17, 2011, to avoid the time and expense of an administrative civil money penalty proceeding, Feldman entered a Stipulation and Consent to the Issuance of an Order of Assessment of a Civil Money Penalty with OTS that states as a matter of fact that:

> 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.

Opposition Exhibit 10 at 3.

If the allegations are proven, a person's regulatory record is a valid consideration in determining sanctions to be assessed in the public interest. For all the reasons stated, I DENY the Summary Disposition Motion.

Reconsideration Motion

On June 5, 2012, the Division filed a Motion for Reconsideration Regarding the Denial of its Request to Subpoena TD Ameritrade, Inc., (Reconsideration Motion). The subpoena requests from TD Ameritrade, Inc. (TD Ameritrade) for the period March 1, 2010, to the present: (1) account statements for all accounts in the name of Feldman and/or Judith Feldman; (2) electronic trading records for all accounts in these names, including but not limited to, the trade date, trade time, settlement date, quantity, price, type of transaction, account number, and account name and address; and (3) all buy-in notices issued to accounts held in these names.

The Division makes several arguments. First, it argues that the denial is unsupported by the Commission's Rules of Practice and is unfair. Reconsideration Motion at 3. It points out that Commission Rule of Practice 232 allows any party to request issuance of a subpoena and that the rule's Adopting Release did not exclude the Division. Id.; See Commission's Rules of Practice, Exchange Act Release No. 35833, 60 Fed. Reg. 32738, 32764 (June 23, 1995). Second, it argues that its subpoena request is relevant to sanctions, should the allegations in the OIP be proven by possibly clarifying whether the violations were recurrent or isolated and the degree of scienter involved, citing SEC v. Steadman, 603 F.2d 1126, 1140 (5th Cir. 1979). Reconsideration Motion at 3-4. Third, the Division believes that prohibiting it from obtaining a subpoena duces tecum after the OIP was issued could be fundamentally unfair and prejudicial because, for example, it would not allow the Division to request documents to test the accuracy of a witness's recollection during the hearing or pursue new information that it became aware of after the OIP was issued.[10] Id. at 4-5. Fourth, the Division claims that neither the comment in

[10] Neither of these scenarios is present here currently.

Rule of Practice 230(g)'s Adopting Release nor the Division's Enforcement Manual support denial of the subpoena because: (1) Rule 230(g) deals with investigative subpoenas while this subpoena was requested under Rule 232 in a situation similar to a request under Rule 45 of the Federal Rules of Civil Procedure; and (2) the Division's Enforcement Manual does not create any rights and the cited pages refer to an investigative subpoena in a litigated proceeding.[11] Id. Finally, the Division argues that denial of a subpoena in this situation could lead to a result where the Division might open a new investigation and issue an investigative subpoena to get the information it seeks. Id. at 6.

Feldman filed his Opposition to the Division's Motion for Reconsideration Regarding the Denial of its Request to Subpoena TD Ameritrade on June 18, 2012. Feldman argues that: (1) the Division has not advanced any new arguments, the investigation of these issues has ended, and the material sought is beyond the relevant period (October 18, 2008, to March 18, 2010); (2) any sanction should be based on conduct that occurred during the relevant period; (3) Feldman believes his trading was proper so the fact that he continued his trading strategy after receiving the Wells Notice could not show scienter with respect to violations; and (4) the Division overstates the ramifications of denial of the subpoena.

Ruling on Reconsideration Motion

The Division may issue an investigative subpoena independently, but must request from the hearing officer a subpoena in an administrative proceeding under the criteria set out in the Commission's Rule of Practice 232. As such, the Division's position with respect to the technical difference between Rules 230(g) and 232 is accurate. The disagreement here arises because the Division's subpoena request under Rule 232 appears to be for the same investigative purpose as an investigative subpoena under Rule 230(g). It is my understanding that the investigation as to the allegations is over when the OIP is issued, and that the Division should be ready to begin the hearing based on the materials in the existing investigative record. My belief, however, is not set out directly in the Commission's Rules of Practice, which is the reason for this dilemma.

Rule 232(b) states that a subpoena request by a party should be granted if the request does not appear to be unreasonable, oppressive, excessive in scope, or unduly burdensome. Feldman is a Respondent and the admissible evidence on the public interest determination is broad; therefore this subpoena is not excessive in scope. It is impossible to know whether this request is unreasonable, oppressive, or unduly burdensome without input from the recipient of the subpoena. For this reason, I reverse my ruling and GRANT the subpoena to TD Ameritrade.

Brenda P. Murray
Chief Administrative Law Judge

[11] The Order Following Prehearing Conference (May 25, 2012) cited the Enforcement Manual pages 41-42. Page 42, third paragraph, addresses administrative proceedings.