RECENT SEC ENFORCEMENT CASES[1]

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Washington, DC

September 16, 2004

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[1] Parts of this outline have been used in other publications.

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As our capital markets continue to experience unprecedented growth and expansion, the Securities and Exchange Commission's ("Commission" or "SEC") enforcement program has been challenged to keep apace of market developments. Violations involving broker-dealers, mutual funds and investment advisers, fraudulent securities offerings, issuer disclosure, financial fraud, and insider trading continue to form the core of the enforcement program.

This Outline will review some of the Division's significant recent activity. Copies of orders, administrative releases, and litigation releases concerning the cases discussed below can be accessed on the Commission's web site at <www.sec.gov>.

I. FINANCIAL FRAUD AND OTHER DISCLOSURE AND REPORTING VIOLATIONS

1. **SEC v. Royal Dutch Petroleum Company and The "Shell" Transport and Trading Company, P.L.C.**, Litigation Release No. 18844 (August 24, 2004). *http://www.sec.gov/litigation/litreleases/lr18844.htm*

On August 24, 2004, the Commission announced a settlement of an enforcement action against foreign-based oil companies Royal Dutch Petroleum Company ("Royal Dutch") and The "Shell" Transport and Trading Company, p.l.c. (together, Shell) in connection with their overstatement of 4.47 billion barrels of previously reported proved hydrocarbon reserves. Royal Dutch is a Dutch corporation headquartered in The Hague, while Shell Transport is an English corporation headquartered in London.

According to the Commission's order and complaint, Shell overstated proved reserves reported in its 2002 Form 20-F by 4.47 billion barrels of oil equivalent, or approximately 23%. The order further concludes that Shell overstated the standardized measure of future cash flows reported in this filing by approximately $6.6 billion. The Commission's order also found, and the complaint alleged that, for the years 1998 through 2002, Shell materially misstated its reserves replacement ratio ("RRR"), a key performance indicator in the oil and gas industry.

The Commission also found and alleged that Shell's overstatement of proved reserves and its delay in correcting the overstatement, resulted from (i) its desire to create and maintain the appearance of a strong RRR, (ii) the failure of its internal reserves estimation and reporting guidelines to conform to SEC requirements, and (iii) the lack of effective internal controls over the reserves estimation and reporting process. These failures led Shell to record and maintain proved reserves it knew (or was reckless in not knowing) did not satisfy SEC requirements, and to report for certain years a stronger RRR than it actually had achieved. Shell was warned on several occasions prior to the fall of 2003 that reported proved reserves potentially were overstated and, in such critical operating areas as Nigeria and Oman depended upon unrealistic production forecasts. In each case, Shell either rejected the warnings as immaterial or unduly pessimistic, or attempted to "manage" the potential exposure by, for example, delaying de-booking of improperly recorded proved reserves until new, offsetting proved reserves bookings materialized.

Royal Dutch and Shell Transport agreed to settle these proceedings by consenting to a cease-and-desist order finding violations of the antifraud, internal controls, record-keeping and reporting provisions of the federal securities laws, and by paying $1 disgorgement and a $120 million penalty in a related civil action the Commission filed in U.S. District Court in Houston. Shell has also undertaken to commit an additional $5 million to develop and implement a comprehensive internal compliance program under the direction and oversight of the Group's legal director. The companies settled without admitting or denying the Commission's substantive findings.

2. **SEC v. Bristol-Myers Squibb Company,** Litigation Release No. 18820 (August 4, 2004). *http://www.sec.gov/litigation/litreleases/lr18820.htm*

On August 4, 2004, the Commission filed an enforcement action against Bristol-Myers Squibb Company, a New York-based company whose largest division, the U.S. Medicines Group, is based in New Jersey. The Commission's complaint, filed in the United States District Court for the District of New Jersey, alleges that Bristol-Myers perpetrated a fraudulent earnings management scheme by, among other things, selling excessive amounts of pharmaceutical products to its wholesalers ahead of demand, improperly recognizing revenue from $1.5 billion of such sales to its two largest wholesalers and using "cookie jar" reserves to meet its internal sales and earnings targets and analysts' earnings estimates.

In settling the Commission's action, Bristol-Myers agreed to an order requiring it to pay $150 million dollars and perform numerous remedial undertakings, including the appointment of an independent adviser to review and monitor its accounting practices, financial reporting and internal controls.

Specifically, the Commission's complaint alleges, among other things, that:

- From the first quarter of 2000 through the fourth quarter of 2001, Bristol-Myers engaged in a fraudulent scheme to inflate its sales and earnings in order to create the false appearance that the company had met or exceeded its internal sales and earnings targets and Wall Street analysts' earnings estimates.
- Bristol-Myers inflated its results primarily by (1) stuffing its distribution channels with excess inventory near the end of every quarter in amounts sufficient to meet its targets by making pharmaceutical sales to its wholesalers ahead of demand; and (2) improperly recognizing $1.5 billion in revenue from such pharmaceutical sales to its two biggest wholesalers. In connection with the $1.5 billion in revenue, Bristol-Myers covered these wholesalers' carrying costs and guaranteed them a return on investment until they sold the products. When Bristol-Myers recognized the $1.5 billion in revenue upon shipment, it did so contrary to generally accepted accounting principles.
- When Bristol-Myers' results still fell short of the Street's earnings estimates, the company tapped improperly created divestiture reserves and reversed portions of those reserves into income to further inflate its earnings.

- At no time during 2000 or 2001 did Bristol-Myers disclose that (1) it was artificially inflating its results through channel stuffing and improper accounting; (2) channel-stuffing was contributing to a buildup in excess wholesaler inventory levels; or (3) excess wholesaler inventory posed a material risk to the company's future sales and earnings.
- In addition, as a result of its channel-stuffing, Bristol-Myers materially understated its accruals for rebates due to Medicaid and certain of its prime vendors, customers of its wholesalers that purchased large quantities of pharmaceutical products from those wholesalers.

Bristol-Myers has agreed, without admitting or denying the allegations in the Commission's complaint, to the following relief: a permanent injunction against future violations of certain antifraud, reporting, books and records and internal controls provisions of the federal securities laws; disgorgement of $1; a civil penalty of $100 million; an additional $50 million payment into a fund for the benefit of shareholders; various remedial undertakings, including the appointment of an independent adviser to review, assess and monitor Bristol-Myers' accounting practices, financial reporting and disclosure processes and internal control systems.

On August 6, 2004, the Honorable Faith S. Hochberg, United States District Court Judge for the District of New Jersey, entered a Final Judgment Order against defendant Bristol-Myers Squibb Company. (Litigation Release No. 18822).

The Commission's investigation is continuing.

3. **In the Matter of Halliburton Company and Robert Charles Muchmore Jr.,** Administrative Proceeding File No. 3-11574 (August 3, 2004).
http://www.sec.gov/litigation/admin/33-8452.htm
SEC v. Gary V. Morris, Litigation Release No. 18817 (August 3, 2004).
http://www.sec.gov/litigation/litreleases/lr18817.htm
SEC v. Haliburton Company and Robert Charles Muchmore Jr., Litigation Release No. 18817 (August 3, 2004).
http://www.sec.gov/litigation/litreleases/lr18817.htm

On August 3, 2004 the SEC initiated enforcement proceedings against Halliburton Co., its former chief financial officer, Gary V. Morris, and its former controller, Robert C. Muchmore, Jr. The Commission's actions are in response to Halliburton's failure to disclose a 1998 change to its accounting practice. As a result of that undisclosed change, Halliburton's public statements regarding its income in 1998 and 1999 were materially misleading.

Halliburton and Muchmore have agreed to settle the enforcement actions by consenting to a Commission order to cease and desist from committing or causing future securities law violations. Additionally, Halliburton and Muchmore have agreed to pay penalties of $7.5 million and $50,000 respectively, in a related civil action. Halliburton's penalty for the disclosure failure reflects lapses in the company's conduct during the course of the Commission investigation, which commenced in mid-2002.

The Commission approved these enforcement actions following a thorough investigation that included the review of approximately 340,000 documents and sworn testimony from 23 individuals. The company's former Chief Executive Officer, Vice President Richard B. Cheney, provided sworn testimony and cooperated willingly and fully in the investigation conducted by the Commission's career staff.

The enforcement actions include all of the charges that the Commission deemed appropriate in light of the investigative record developed by its staff. These actions conclude the Commission's investigation of Halliburton's 1998 change to its accounting practice.

Halliburton provides a wide range of industrial construction services. In providing those services, Halliburton, at times, incurs cost overruns; the overruns may be recovered from Halliburton's customer depending on the terms of the construction contract and the nature of the overruns. Historically, Halliburton recognized income arising from cost overrun claims only in the financial quarter in which the claim was finally resolved with the customer. From 1993 to 1997, Halliburton had set forth this practice in its periodic filings with the Commission. In the second quarter of 1998, Halliburton changed its historical accounting practice and began recognizing revenues by offsetting losses on certain projects with revenues based on estimated probable recoveries on claims that had not been resolved with customers.

Under the new practice, Halliburton recognized revenues on certain claims that the company believed were probable of collection rather than, pursuant to the prior practice, claims that had been finally resolved with its customers. Although both of Halliburton's claims recognition practices, the historical one and the revised one, are appropriate under Generally Accepted Accounting Principles, there was a significant difference in their respective effects on Halliburton's financial presentation: the new practice reduced losses on several large construction projects. As a result, Halliburton's reported income was higher under the revised practice than it would have been under the prior practice.

Over six reporting periods, spanning approximately 18 months covering 1998 and 1999, Halliburton failed to disclose its change of accounting practice. In the absence of any disclosure, the investing public was deprived of a full opportunity to assess Halliburton's reported income — more particularly, the precise nature of that income, and its comparability to Halliburton's income in prior periods. It was not until March 2000 that Halliburton, in its 1999 Form 10-K, disclosed its change in accounting practice.

The following chart demonstrates the impact the undisclosed accounting change had on the company's pre-tax income in 1998 and 1999:

IMPACT ON HALLIBURTON'S PRE-TAX INCOME (in millions)					
Year	**Filing**	**Reported Pre-Tax Income**	**Reported Pre-Tax Income — Without Component of Unapproved Claim Revenue**	**$ Difference**	**% Difference**

1998					
	Form 10-Q [Q2]	$228.70	$183.30	$45.40	24.8%
	Form 10-Q [Q3]	($609.50)	($646.20)	$36.70	5.7%
	Form 10-K	$278.80	$190.90	$87.90	46.1%
1999					
	Form 10-Q [Q1]	$149.00	$129.80	$19.20	14.8%
	Form 10-Q [Q2]	$146.00	$135.80	$10.20	7.5%
	Form 10-Q [Q3]	$103.00	$92.30	$10.70	11.6%

These income figures appeared in Halliburton's filings with the Commission. They were also presented in the company's quarterly earnings releases and analyst teleconferences.

The Commission alleges that Morris and Muchmore were responsible for the company's failure to disclose the accounting change, over six quarters, in Halliburton's Commission filings. Additionally, Morris and Muchmore played key roles in the preparation and review of quarterly earnings releases and analyst teleconference scripts that included the affected income figures. They were, therefore, also responsible for the absence in the releases and scripts of any clarifying reference to the accounting change or its impact.

Halliburton and Muchmore neither admit nor deny the Commission's findings against them.

The enforcement action against Morris is unsettled, and has been filed in U.S. District Court in Houston, Texas.

4. **SEC v. Peter O. Marion,** Litigation Release No. 18796, (July 27, 2004).
http://www.sec.gov/litigation/litreleases/lr18796.htm;
SEC v. Michael Resnick, Mark P. Kaiser, Timothy J. Lee, and William Carter, Litigation Release No. 18797, (July 27, 2004).
http://www.sec.gov/litigation/litreleases/lr18797.htm

On July 27, 2004, the Commission filed a complaint in the United States District Court for the Southern District of New York alleging that Michael Resnick, Mark P. Kaiser, Timothy J. Lee and William Carter engaged in or substantially participated in a scheme to overstate the income of Royal Ahold (Koninklijke Ahold N.V.) (Ahold) by $700 million or more in SEC filings and other public announcements for at least fiscal years 2001 and 2002. Resnick, Kaiser, Lee, and Carter were top executives at Columbia, Md. based wholesale food distributor U.S. Foodservice, a major subsidiary of Ahold. The complaint alleges that they grossly inflated reported profits and induced numerous suppliers to submit false confirmations to the company's auditors in order to conceal their fraud.

The Commission alleges that Resnick, former CFO, Kaiser, former Chief Marketing Officer, Lee, former Executive Vice President of Purchasing, and Carter, former Vice President of Purchasing, violated the antifraud provisions; aided and abetted violations of the reporting provisions; and violated and aided and abetted violations of the books and records provisions of the Securities Exchange Act of 1934.

The Commission also alleges that Lee engaged in repeated instances of tipping material, nonpublic information regarding Ahold's April 2000 tender offer acquisition of U.S. Foodservice. As a result of the tipping, an associate of Lee realized profits of at least $363,000 from trading in the stock of U.S. Foodservice. The Commission alleges that Lee, through his insider tipping, violated the antifraud provisions of the Exchange Act. In a related action, the Commission charged one of Lee's tippees, Peter O. Marion, with insider trading.

The Commission seeks a final judgment ordering the defendants to disgorge all ill-gotten gains, including performance based bonuses; imposing civil money penalties; barring each of them from serving as an officer or director of a public company; and enjoining each of them from future violations or aiding and abetting violations of the antifraud and false reporting and record keeping provisions of the securities laws..

The Commission's complaint alleges that compensation for Resnick, Kaiser, Lee and Carter was based, in part, on USF's ability to meet or exceed budgeted earnings targets. They each received a substantial bonus in early 2002 because USF purportedly satisfied earnings goals for fiscal year 2001. They were each eligible for a substantial bonus if USF met earnings targets for fiscal year 2002. They engaged in or substantially participated in a scheme whereby USF "booked to budget" -- reporting earnings equal to or greater than the targets, regardless of the company's true performance.

The primary method used to carry out the fraudulent scheme to "book to budget" was to improperly inflate USF's promotional allowance income. A significant portion of USF's operating income was based on payments by its suppliers, usually referred to as promotional allowances. In a typical promotional allowance arrangement, USF would pay the full wholesale price for a product, then receive rebates of a portion of that price from the supplier if certain purchase volume and other conditions were met. They "booked to budget" by, among other things, causing USF to record fictitious promotional allowances sufficient to cover shortfalls to budgeted earnings. When questioned by Ahold's independent auditors about the promotional allowances recorded, Resnick, Kaiser, and Lee are alleged to have provided false and misleading justifications.

They covered-up the false earnings by making it appear that the inflated promotional allowance income had been earned by, among other things, (a) inducing suppliers to confirm false promotional allowance income, payments, and receivable balances; (b) manipulating the promotional allowance receivable and manipulating and misapplying cash receipts; and (c) making false and misleading statements, and material omissions, to the company's independent auditors, other company personnel, and/or Ahold personnel.

The Commission's complaint against Marion alleges that during the period Feb. 15, 2000, through March 1, 2000, after learning from Lee of Ahold's intention to acquire USF at a price of

$24 to $26 per share, Marion purchased 36,000 shares of USF common stock at an average price of $14.92 per share. On March 7, 2000, Ahold and USF publicly announced Ahold's tender offer for USF at $26 per share. Marion sold his shares at an average price of $25.02 shortly after the tender offer was announced. As a result of his trading, Marion made illegal profits of approximately $363,894. The Commission seeks a final judgment ordering Marion to disgorge all illegal profits, with prejudgment interest thereon; imposing civil money penalties; and enjoining him from future violations of the antifraud provisions of the securities laws.

The Commission's investigation is continuing. The Commission acknowledges the assistance and cooperation of the Office of the United States Attorney for the Southern District of New York, the New York Office of the Federal Bureau of Investigation, and the U.S Department of Labor, Employee Benefits Security Administration.

5. **SEC v. Peter C. Boylan**, Litigation Release No. 18826 (August 10, 2004). *http://www.sec.gov/litigation/litreleases/lr18826.htm*;
SEC v. Gemstar-TV Guide International, Inc. Litigation Release No. 18760 (June 23, 2004). *http://www.sec.gov/litigation/litreleases/lr18760.htm;*
SEC v. Henry C. Yuen et al., Litigation Release No. 18530 (January 6, 2004). *http://www.sec.gov/litigation/litreleases/lr18530.htm*;
SEC v. Henry C. Yuen and Elsie M. Leung, Litigation Release No. 18199 (June 20, 2003). *http://www.sec.gov/litigation/litreleases/lr18199.htm.*

During June of 2004, the Commission filed a complaint in federal court in Los Angeles charging Gemstar-TV Guide International, Inc. with improperly reporting its highly touted interactive program guide licensing and advertising revenues in its financial statements from 1999 through 2002.

Gemstar agreed to settle the case by, among other things, paying a $10 million civil penalty. That money will be distributed to harmed shareholders pursuant to Section 308 of the Sarbanes-Oxley Act of 2002. In assessing the penalty amount, the Commission considered the scope and severity of Gemstar's misconduct, Gemstar's initial failure to cooperate in the Commission's investigation or undertake remedial actions, and Gemstar's significant cooperation and remediation following a change in senior management and restructuring of its corporate governance.

During the relevant period, Gemstar generated revenues from the IPG by licensing the technology to third parties and selling advertising space on the IPG.

The Commission's complaint alleges that Gemstar materially overstated its revenues by nearly $250 million through the following means:

First, Gemstar recorded revenue under expired, disputed, or non-existent agreements, and improperly reported this as IPG licensing and advertising revenue.

Second, Gemstar recorded and reported revenue from a long-term agreement on an accelerated basis in contravention of GAAP and Gemstar's own stated and disclosed revenue

recognition policy, which required the recording and reporting of such revenue ratably over the terms of the agreement.

Third, Gemstar inflated its IPG advertising revenue by improperly recording and reporting revenue amounts from multiple-element transactions.

Fourth, Gemstar improperly recorded and reported IPG advertising revenue from non-monetary and barter transactions.

Finally, Gemstar improperly reported certain revenues as IPG advertising revenues when in fact those revenues were derived from the sale of print advertising.

The misstatements of revenue were reported in Forms 10-K, 10-Q, and 8-K filed with the Commission. These public statements misrepresented Gemstar's true financial performance and failed to disclose material information about that performance. The complaint further alleges that when Gemstar disclosed in its 2001 Form 10-K filed on April 1, 2002, that revenue from two transactions had been recorded under an expired licensing agreement and in a non-monetary transaction, Gemstar's stock price declined by approximately 37% the next day.

As part of its settlement, Gemstar, without admitting or denying the allegations in the Commission's complaint, agreed to a permanent injunction against future violations of the periodic reporting, recordkeeping, and internal controls provisions of the federal securities laws.

In determining to accept Gemstar's settlement offer, the Commission considered the following factors, among others, relating to the company's cooperation and remedial efforts:

- In April 2002, immediately after Gemstar filed its 2001 Form 10-K, the Commission contacted Gemstar and commenced an investigation. For nearly the next eight months, while Gemstar's former CEO and other senior officers remained in place, the company did not conduct a thorough or comprehensive internal investigation and did not take other appropriate remedial action, even when presented by the Commission with specific evidence of fraudulent conduct.

- As a result of its inadequate investigation, in August 2002 Gemstar issued a restatement reversing only approximately $20 million in revenue. Gemstar consequently continued to report overstated revenues to the investing public even after the Commission's investigation began.

- In November 2002, in connection with the restructuring of its corporate governance, Gemstar replaced its CEO, CFO, and general counsel and adopted extensive new internal controls. The company also retained a new independent auditor and a new independent outside counsel.

- Following the change in senior management, Gemstar (i) initiated a comprehensive investigation and re-audit of its financial statements; (ii) restated its financials three more times, reversing revenues by a total of $377 million; (iii) provided extensive and valuable assistance to the Commission in its investigation; and (iv) voluntarily agreed not to make

certain extraordinary severance payments to its former CEO and CFO for over six months, among other things.

Previously, on January, 6, 2004, the Commission filed securities fraud charges against three former senior executives of Gemstar-TV Guide International, Inc., Peter Boylan, Johathan Orlick, and Craig Waggy representing its former co-president, general counsel, and chief financial officer of its wholly owned subsidiary, TV Guide, Inc. The complaint charges that these executives participated in Gemstar's widespread and complex scheme to inflate its licensing and advertising revenue and to mislead investors about the company's true financial performance.

The January 6, 2004 action amended the Commission's complaint filed against Gemstar's former chief executive officer, Henry C. Yuen, and former chief financial officer, Elsie M. Leung, on June 19, 2003. The complaint seeks permanent injunctions, civil money penalties, disgorgement of ill-gotten gains (including salaries, bonuses and any proceeds from the sale of stock during the fraud), and bars from service as an officer or director of a public company.

Peter Boylan agreed to settle the federal court action filed by the Commission. As part of the settlement and subject to approval by the court, Boylan will consent to a fraud injunction, without admitting or denying the allegations in the Commission's complaint, and will pay a total of $600,000 in disgorgement and civil penalties.

The Commission's action is pending against four other former executives of Gemstar: Henry C. Yuen, former chief executive officer; Elsie M. Leung, former chief financial officer; Jonathan B. Orlick, former general counsel; and Craig Waggy, former CFO of TV Guide. The court has scheduled the trial of this matter to begin on January 18, 2005.

6. **In the Matter of i2 Technologies, Inc.** Litigation Release No. 18741 (June 9, 2004). *http://www.sec.gov/litigation/litreleases/lr18741.htm*

In June of 2004, the Commission brought enforcement proceedings against i2 Technologies, Inc. for misstating approximately $1 billion of software license revenues, including over $125 million of revenues it should never have recognized, over a nearly five-year period that ended in 2002. As a result of the misstatement, i2's periodic filings with the Commission and press releases - which portrayed i2's revenue and pro forma income positively - were false. Had i2, a Dallas-based developer and marketer of enterprise supply chain software and management solutions, accurately presented its financial condition for these periods, it would have disclosed increasingly negative results.

i2 agreed to settle the enforcement proceedings by consenting to a cease-and-desist order finding that the company violated the antifraud, internal controls, record-keeping and reporting provisions of the federal securities laws, and to pay a $10 million penalty in a related civil action filed in U.S. District Court. The entire penalty proceeds will be distributed to injured i2 shareholders. i2 also has undertaken to continue cooperating with the Commission's ongoing investigation. The company settled without admitting or denying the Commission's substantive findings against it. The Commission's Order found that:

Historically, i2 favored up-front recognition of software license revenue, purportedly in accordance with generally accepted accounting principals (GAAP). However, as i2 knew or was reckless in not knowing, immediate recognition of revenue was inappropriate for some of i2's software licenses because they required lengthy and intense implementation and customization efforts to meet customer needs. In some cases, i2 shipped certain products and product lines that lacked functionality essential to commercial use by a broad range of users. In other cases, the company licensed certain software that required additional functionality to be usable by particular customers. On still other occasions, i2 exaggerated certain product capabilities, or entered into side agreements with certain customers that were not properly reflected in the accounting for those transactions. In each case, significant modification and customization efforts were necessary to provide the required functionality.

i2 also improperly recorded revenue from four barter transactions during the relevant period. These transactions involved third-party purchases of software licenses from i2, from which i2 recognized revenue immediately, in exchange for i2's agreement to purchase from the other parties in the future a comparable amount of products or services. In some of these transactions, i2 paid a premium over the prevailing rates for those products or services, in an effort to equalize both sides of the deal. When i2 recorded revenue from these transactions, it could not determine the fair value of the items exchanged within reasonable limits. Accordingly, i2's up-front recognition of license revenue from these transactions was improper under GAAP.

These improper and deceptive means of recognizing revenue up-front enabled i2 to meet analysts' revenue and earnings expectations for certain reporting periods. In July 2003, i2 restated its financial results for the four years ended December 31, 2001, and the first three quarters of 2002. The restatement involved approximately $1 billion of revenues, and included revenue write-offs of over $125 million.

7. **SEC v. Symbol Technologies, Inc., Tomo Razmilovic, Kenneth Jaeggi, Leonard Goldner, Brian Burke, Michael DeGennaro, Frank Borghese, Christopher DeSantis, James Heuschneider, Gregory Mortenson, James Dean and Robert Donlon**. Litigation Release No. 18734 (June 3, 2004). *http://www.sec.gov/litigation/litreleases/lr18734.htm*

In June 2004, the Commission charged Symbol Technologies, Inc. with securities fraud and related violations of the reporting, record-keeping and internal control provisions of the federal securities laws. The SEC also charged eleven former Symbol executives in connection with their roles in the fraud.

The SEC's complaint alleges that from at least 1998 until early 2003, Symbol and the other defendants engaged in numerous fraudulent accounting practices and other misconduct that had a cumulative net impact of over $230 million on Symbol's reported revenue and over $530 million on its pre-tax earnings. Based in Holtsville, N.Y., Symbol supplies mobile information systems using bar code scanners and related technology and its stock is publicly traded on the New York Stock Exchange.

The Commission's complaint alleges as follows:

The defendants engaged in a fraudulent scheme to inflate revenue, earnings and other measures of financial performance in order to create the false appearance that Symbol had met or exceeded its financial projections. Defendant Tomo Razmilovic, Symbol's former president and CEO, and others at the company fostered a "numbers driven" corporate culture obsessed with meeting Wall Street estimates. With no regard for generally accepted accounting principles (GAAP) or their financial reporting obligations, the defendants used the following fraudulent schemes to align Symbol's reported financial results with market expectations: (a) a "Tango sheet" process through which baseless accounting entries were made to conform the unadjusted quarterly results to management's projections; (b) the fabrication and misuse of restructuring and other non-recurring charges to artificially reduce operating expenses, create "cookie jar" reserves and further manage earnings; (c) channel stuffing and other revenue recognition schemes, involving both product sales and customer services; and (d) the manipulation of inventory levels and accounts receivable data to conceal the adverse side effects of the revenue recognition schemes. Together with Razmilovic, defendants Kenneth Jaeggi, Brian Burke, Michael DeGennaro and Frank Borghese comprised most of Symbol's senior management team during the relevant period and directed the fraud. Defendants Christopher DeSantis, James Heuschneider, Gregory Mortenson, James Dean and Robert Donlon were Symbol executives during this period and implemented the schemes.

While the accounting fraud was occurring, defendant Leonard Goldner, Symbol's former general counsel, manipulated stock option exercise dates to enable certain senior executives, including himself, to profit unfairly at the company's expense.

In addition to committing securities fraud, some of the defendants interfered with two internal investigations into Symbol's accounting practices and delayed the Commission's investigation.

While these defendants were engaged in their efforts to derail the investigations and cover up the fraud, Symbol filed multiple periodic reports containing financial results that it has since restated, including its Form 10-K for 2001 and a Form 10-Q that Jaeggi falsely certified in violation of the new Sarbanes-Oxley certification provisions.

Settlements

Symbol has agreed to the following relief:

- a permanent injunction against future violations of the antifraud, reporting, books and records and internal controls provisions of the federal securities laws.
- a civil penalty of $37 million and nominal disgorgement of $1, all of which will be distributed to injured investors.
- various remedial measures, including the appointment of an independent examiner to review Symbol's accounting practices and internal control systems and assess the status of remedial actions undertaken or planned by the company in those and other areas, such as corporate governance.

Dean has also agreed, without admitting or denying the allegations, to the imposition of the non-monetary relief sought by the Commission. Specifically, he has agreed to a permanent injunction against committing, or aiding and abetting, future violations of the antifraud, reporting, books and records and internal controls provisions of the federal securities laws.

The Commission's claims for disgorgement and civil penalties against Dean, and all of its claims against the other individual defendants, remain pending.

8. **SEC v. Lucent Technologies Inc., Nina Aversano, Jay Carter, A. Leslie Dorn, William Plunkett, John Bratten, Deborah Harris, Charles Elliot, Vanessa Patrini, Michelle Hayes-Bullock, and David Ackerman.** Litigation Release No. 18715 (May 17, 2004). *http://www.sec.gov/litigation/litreleases/lr18715.htm*

During May of 2004, the Commission charged Lucent Technologies Inc. with securities fraud, and violations of the reporting, books and records and internal control provisions of the federal securities laws. The SEC also charged nine current and former Lucent officers, executives and employees, and one former Winstar Communications Inc. officer with securities fraud and aiding and abetting Lucent's violations of the federal securities laws. The SEC's complaint alleges that Lucent fraudulently and improperly recognized approximately $1.148 billion of revenue and $470 million in pre-tax income during its fiscal year 2000.

The SEC's complaint alleges that Lucent's violations of generally accepted accounting principles (GAAP) were due to the fraudulent and reckless actions of the defendants and deficient internal controls that led to numerous accounting errors by others. In their drive to realize revenue, meet internal sales targets and/or obtain sales bonuses, the complaint alleges, defendants, in their respective capacities as officers and employees of Lucent, improperly granted, and/or failed to disclose, various side agreements, credits and other incentives (collectively "extra-contractual commitments") to induce Lucent's customers to purchase the company's products. These extra-contractual commitments were made in at least ten transactions in fiscal 2000, and Lucent violated GAAP by recognizing revenue on these transactions both in circumstances: (a) where it could not be recognized under GAAP; and (b) by recording the revenue earlier than was permitted under GAAP.

In carrying out their fraudulent conduct, according to the complaint, these Lucent officers, executives and employees violated and circumvented Lucent's internal accounting controls, falsified documents, hid side agreements with customers, failed to inform personnel in Lucent's corporate finance and accounting structure of the existence of the extra-contractual commitments or, in some instances, took steps to affirmatively mislead them.

The complaint also alleges that David Ackerman, at the time an officer of Winstar, engaged in a scheme with Plunkett that resulted in Lucent improperly recording a $125 million software purchase by Winstar at the end of Lucent's fourth quarter of fiscal year 2000.

Lucent's Lack of Cooperation

Lucent's penalty for its failure to cooperate is based on the following conduct.

- Throughout the investigation, Lucent provided incomplete document production, producing key documents after the testimony of relevant witnesses, and failed to ensure that a relevant document was preserved and produced pursuant to a subpoena.
- During the interview, Lucent's counsel characterized Lucent's fraudulent booking of the $125 million software pool agreement between Lucent and Winstar as a "failure of communication" thus denying that an accounting fraud had occurred. Lucent's public statements undermined both the spirit and letter of its agreement in principle with the staff.
- After reaching an agreement in principle with the staff to settle the case, and without being required to do so by state law or its corporate charter, Lucent expanded the scope of employees that could be indemnified against the consequences of this SEC enforcement action.
- Lucent also failed over a period of time to provide timely and full disclosure to the staff on a key issue concerning indemnification of employees.

Settlements

- Lucent, Plunkett, Harris and Petrini have agreed to permanent injunctions against future violations of the anti-fraud, reporting, books and records and internal controls provisions of the federal securities laws.
- Lucent will pay a penalty of $25 million.
- Plunkett also will pay a civil penalty of $110,000 and has agreed to be permanently barred from acting as an officer or director of a public company.
- Harris will pay a civil penalty of $100,000 and has agreed to be barred from acting as an officer or director of a public company for five years.
- Petrini will pay a civil penalty of $60,000 and disgorge $109,505, representing profits gained as a result of the conduct alleged in the complaint, together with prejudgment interest thereon in the amount of $23,487.

The SEC will litigate this case against the remaining seven defendants.

9. **In the Matter of CMS Energy Corp. and Terry Woolley**, Administrative Proceeding File No. 3-11436 (March 17, 2004). *http://www.sec.gov/litigation/admin/33-8403.htm.*

In March 2004, the SEC settled a fraud enforcement action against CMS Energy Corporation (CMS), a Michigan-based energy company, in connection with over $5 billion in deceptive round-trip energy trades - massive pre-arranged trades that, despite lacking economic substance, grossly inflated CMS's reported revenues and propelled the company into the upper echelon of the energy-trading volume rankings.

Pursuant to a settled cease-and-desist Order, CMS and Terry Woolley, the former controller of CMS's energy-trading subsidiary, agreed to cease and desist from committing or causing violations of the antifraud, reporting, books and records and internal controls provisions of the federal securities laws. Woolley also agreed to pay a $25,000 penalty.

The SEC also filed a civil suit against Preston D. Hopper, CMS's former chief accounting officer, and Tamela C. Pallas, former chief executive of CMS Houston-based trading subsidiary, for fraud and other securities law violations. The complaint alleges that Pallas orchestrated the sham transactions to simulate robust operations within CMS's marketing and trading subsidiary, and Hopper failed to ensure disclosure of the true nature of the trades. The complaint further charges that Hopper sponsored improper accounting for the sham transactions and that, when CMS's outside auditors forced CMS to reverse the reporting of the round-trip trade revenue, Hopper fraudulently failed to disclose the reasons for the reversal. The Commission is seeking in its civil suit against Hopper and Pallas, among other things, civil money penalties and court orders barring them from serving as officers or directors of public companies.

The SEC finds in its Order that the massive round-trip trades conducted by CMS's trading subsidiary in 2000 and 2001, artificially increased CMS revenues and trading volumes. Between the third quarter of 2000 and the third quarter of 2001, CMS cited its artificially inflated revenue and trading volume in its filings with the SEC, press releases, earnings conference calls and investor presentations. By reflecting the results of the trades, CMS overstated its revenue by a total of $5.2 billion over five quarters: $1.0 billion, or 20%, for the last two quarters of 2000; and $4.2 billion, or 36%, for the first three quarters of 2001. CMS also overstated its trading subsidiary's reported energy-trading volume by 78% over the last two quarters of 2000 and 72% over the first three quarters of 2001.

10. **WorldCom - <u>SEC v. Scott D. Sullivan</u>**, Litigation Release No. 18605 / March 2, 2004. *http://www.sec.gov/litigation/litreleases/lr18605.htm.*

The SEC filed a civil enforcement action against Scott D. Sullivan, the former Chief Financial Officer of WorldCom, Inc. The Commission charged Sullivan with engaging in a fraudulent scheme to conceal WorldCom's poor financial performance. The Commission alleged that Sullivan, with the consent and knowledge of WorldCom's former Chief Executive Officer, caused numerous improper adjustments and entries in WorldCom's books and records, often in the hundreds of millions of dollars, to make the company's quarterly and yearly financial results appear to meet Wall Street's expectations. In addition, the Commission alleged that Sullivan made numerous false and misleading public statements about WorldCom's financial condition and performance, and signed a number of SEC filings that contained false and misleading material information.

The same day, in connection with the same conduct, Sullivan pleaded guilty to criminal charges filed by the U.S. Attorney's Office for the Southern District of New York. In addition, that office announced the related indictment of Bernard J. Ebbers, WorldCom's former Chief Executive Officer.

The Commission's complaint against Sullivan alleges that by September 2000, Sullivan and other senior WorldCom executives knew that WorldCom's true operating performance and

financial results were materially below the financial guidance they had given to Wall Street analysts and investors. Rather than disclose WorldCom's true financial condition and suffer the resulting decline in the company's share price, from approximately September 2000 through June 2002, Sullivan engaged in a scheme that fraudulently concealed WorldCom's true operational and financial results. The scheme involved improperly manipulating WorldCom's reported revenue, expenses, net income, earnings before interest, taxes, depreciation and amortization (EBITDA), and earnings per share.

The complaint charges that as part of the scheme, Sullivan instructed subordinates to book certain fraudulent adjustments and entries in WorldCom's general ledger. The adjustments and entries were designed to falsely increase WorldCom's reported revenue and falsely decrease WorldCom's reported expenses. During the same period, Sullivan and others made materially false or misleading statements or omissions to WorldCom's independent auditors in connection with audits and the preparation of filings with the Commission.

Simultaneously with the filing of the complaint, Sullivan has agreed, without admitting or denying the allegations of the complaint, to the entry of an order permanently enjoining him from violating, directly or indirectly, numerous provisions of the federal securities laws, including the antifraud, reporting, books and records, internal controls, and lying-to-auditors provisions. Sullivan has also agreed to the entry of an order that would permanently bar him from serving as an officer or director of a public company. The order further provides that any monetary relief will be decided by the Court at a hearing to be held upon motion of the Commission or the instance of the Court and that the Court will retain jurisdiction of the action for all purposes, including the imposition of additional equitable remedies or sanctions, if any, as determined following a hearing. The settlement is subject to the review by and approval of the Court.

In addition, Sullivan has agreed to a Commission administrative order, based on the injunction, suspending him from appearing or practicing before the Commission as an accountant, under Rule 102(e) of the Commission's Rules of Practice.

The Commission's action against Sullivan is its fifth civil enforcement action related to the WorldCom fraud. The first was filed against WorldCom, Inc. on June 27, 2002, the day after WorldCom announced that it intended to restate its financial results for five quarters—all quarters in 2001 and the first quarter of 2002 (Litigation Release No. 17588). The Commission sought, among other things, the appointment of a corporate monitor for WorldCom, and on July 3, 2002, U.S. District Judge Jed S. Rakoff appointed former SEC Chairman Richard Breeden to that position. Since then, WorldCom has admitted that beginning in 1999, as a result of undisclosed and improper accounting, it materially overstated the income it reported in its financial statements by at least $9 billion. It also filed for bankruptcy under Chapter 11 of the U.S. Bankruptcy Code.

On Nov. 26, 2002, the Commission obtained a judgment against WorldCom that provided the full injunctive relief sought against the company. In addition, the judgment ordered WorldCom to undertake extensive reviews of its corporate governance and internal controls, as well as required the company to establish a training and education program for WorldCom

officers and employees to minimize the possibility of future violations of the federal securities laws (Litigation Release No. 17866).

Subsequently, the U.S. District Court ordered WorldCom to satisfy the SEC's civil monetary penalty judgment by paying $500 million in cash and transferring $250 million worth of common stock in the reorganized company when it emerges from bankruptcy into a fund for later distribution to victims of the company's fraud, pursuant to Section 308 (Fair Funds for Investors) of the Sarbanes-Oxley Act of 2002 (Litigation Release Nos. 17829, 18219 and 18277).

On July 19, 2004, the United States District Judge Jed S. Rakoff issued an order approving the SEC's proposed plan for distributing to defrauded investors the penalty paid by WorldCom (now known as MCI) in the SEC's civil action against the company. (Litigation Release No. 18789).

Previously, the Commission filed civil actions against former WorldCom Controller David F. Myers (Litigation Release No. 17753); former WorldCom Director of General Accounting Buford "Buddy" Yates, Jr. (Litigation Release No. 17771); and Betty L. Vinson and Troy M. Normand, former accountants in WorldCom's General Accounting Department (Litigation Release No. 17783). All of these actions are pending.

11. **Enron Cases**

a. SEC v. Richard A. Causey and Jeffrey K. Skilling, Litigation Release No. 18582 (Feb. 19, 2004). *http://www.sec.gov/litigation/litreleases/lr18582.htm;* and **SEC v. Andrew S. Fastow**, Litigation Release No. 18543 (January 14, 2004). *http://www.sec.gov/litigation/litreleases/lr18543.htm.*

In January 2004, the Commission charged Richard A. Causey, the former Chief Accounting Officer of Enron Corp., with violating, and aiding and abetting the violation of, the antifraud, periodic reporting, books and records, and internal controls provisions of the federal securities laws. In February 2004, The Commission amended the Commission Complaint to charge Jeffrey K. Skilling, Enron Corp.'s former President, Chief Executive Officer and Chief Operating Officer, with the same violations. The Amended Complaint further alleges that Skilling sold Enron stock while in possession of material, non-public information that generated unlawful proceeds of approximately $63 million.

The Commission is seeking disgorgement of all ill-gotten gains, civil money penalties, a permanent bar from acting as a director or officer of a publicly held company, and an injunction against future violations of the federal securities laws. The Commission brought this action in coordination with the Justice Department's Enron Task Force, which filed related criminal charges against Causey and Skilling.

As alleged in the Complaint, Causey, Skilling, and others at Enron, engaged in a wide-ranging scheme to manipulate Enron's publicly reported earnings through a variety of devices designed to produce materially false and misleading financial results. As alleged, Causey and

others fraudulently manipulated Enron's merchant asset portfolio; improperly used "off-balance-sheet" special purpose entities ("SPEs"); manipulated Enron's "business segment reporting" to conceal losses at Enron's retail energy business, Enron Energy Services ("EES"); manipulated expenses to conceal losses at Enron's broadband unit, Enron Broadband Services ("EBS"); and manipulated reserves in Enron's wholesale energy trading business to conceal earnings volatility and losses. The Complaint also alleges that Causey, and others, made false and misleading statements concerning Enron's financial results and the performance of its businesses, and that these misrepresentations also were reflected in Enron's public filings with the Commission.

In addition, the Commission's Complaint describes Causey's role in the infamous "Raptor" transactions. Beginning in the spring of 2000, Enron and LJM engaged in a series of financial transactions with four SPEs called Raptor I, Raptor II, Raptor III and Raptor IV (collectively referred to as the "Raptors"). Raptor I was designed to protect Enron from having to report publicly decreases in value in large portions of its energy "merchant asset portfolio" and technology investments by allowing Enron to "hedge" the value of those investments with an allegedly independent third party, known as Talon. The Raptor I structure, however, was invalid under applicable accounting rules because, among other things, (i) Talon was not independent from Enron and LJM's investment in Talon was not at risk, and (ii) Causey and Fastow had entered into an oral side agreement that LJM would receive its initial investment in Talon ($30 million) plus a large profit ($11 million) from Enron, all prior to Talon engaging in any of the hedging transactions. To satisfy the side deal, Causey, Fastow, and others manufactured a transaction between Enron and Talon that generated a $41 million payment to LJM. Causey and others caused Enron to purchase a "put" on its own stock that had no business purpose, but instead was designed to ensure that LJM was returned its initial investment plus its promised profit. After satisfying the side deal, Enron used Raptor I to hedge the value of Enron's already-inflated assets. Causey and Fastow also used Raptor I to fraudulently misrepresent Enron's financial position by back-dating a hedge so that Enron could capture the all-time high stock value of one of the Enron assets at a time when they knew that the value had already declined.

Also in January, the Commission settled civil fraud charges against Andrew S. Fastow, Enron’s former chief financial officer. The complaint, filed on October 2, 2002 in U.S. District Court in Houston, alleged that Fastow defrauded Enron’s shareholders and enriched himself and others by, among other things, entering into undisclosed side deals, manufacturing earnings for Enron through sham transactions, and inflating the value of Enron’s investments.

Without admitting or denying the allegations in the Commission's complaint, Fastow agreed to be enjoined permanently from violating the antifraud, periodic reporting, books and records, and internal control provisions of the federal securities laws, and to be barred permanently from acting as an officer or director of a public company.

The Commission settled its action in coordination with the Justice Department's Enron Task Force, which entered into a guilty plea with Fastow on related criminal charges. In resolving the parallel civil and criminal proceedings, Fastow agreed to serve a ten-year sentence, disgorge more than $23 million and to cooperate with the government's continuing investigation.

As alleged in the Commission's complaint, Fastow participated in a series of fraudulent transactions. Three of the transactions - RADR, Chewco, and Southampton - were part of an

alleged scheme to hide Fastow's interest in and control of certain entities in order to avoid consolidating those entities in Enron's financial statements. This was done, according to the complaint, for self-enrichment and to mislead analysts, rating agencies, and others about Enron's true financial condition.

b. **SEC v. Richard A. Causey, Jeffrey K. Skilling and Kenneth L. Lay,** Litigation Release No. 18776 (July 8, 2004). *http://www.sec.gov/litigation/litreleases/lr18776.htm*

During July of 2004, the Commission initiated civil charges against Kenneth L. Lay, former Chairman and Chief Executive Officer of Enron Corp., for his role in a wide-ranging scheme to defraud by falsifying Enron's publicly reported financial results and making false and misleading public representations about Enron's business performance and financial condition.

The Commission also alleges Lay profited from the scheme to defraud by selling large amounts of Enron stock at prices that did not reflect its true value. The sales also occurred while Lay was in possession of material non-public information concerning Enron and generated unlawful proceeds in excess of $90 million during 2001. Specifically, Lay sold over $70 million in Enron stock back to the company to repay cash advances on an unsecured Enron line of credit. In addition, while in possession of material non-public information, Lay amended two program trading plans to enable him to sell an additional $20 million in Enron stock in the open market. Lay's proceeds from the sales constitute illegal gains resulting from his scheme to defraud.

In this action, the Commission is seeking disgorgement of all ill-gotten gains, civil money penalties, a permanent bar from acting as a director or officer of a publicly held company, and an injunction against future violations of the federal securities laws.

The Commission, subject to the approval of the Honorable Melinda Harman, U.S. District Court Judge, filed a Second Amended Complaint seeking to add Lay to its pending action against Jeffrey K. Skilling, Enron's former President, CEO and Chief Operating Officer, and Richard A. Causey, Enron's former Chief Accounting Officer. The proposed amended complaint charges Lay with violating, and aiding and abetting violations of, the antifraud, periodic reporting, books and records, and internal controls provisions of the federal securities laws.

The Commission's investigation is continuing.

c. **Canadian Imperial Bank of Commerce, Daniel Ferguson, Ian Schottlaender, Mark Wolf**, Litigation Release No. 18517 (December 22, 2003). h*ttp://www.sec.gov/litigation/litreleases/lr18517.htm*

On December 22, 2003, the Commission charged Canadian Imperial Bank of Commerce ("CIBC") and three of its executives with aiding and abetting Enron Corp.'s securities fraud. The Commission's complaint, filed in U.S. District Court in Houston, alleges that CIBC and the three executives aided and abetted Enron's manipulation of its reported financial results through a series of complex structured finance transactions over a period of several years preceding Enron's bankruptcy. The 34 financings were structured as "asset sales" for accounting and financial reporting purposes, allowing Enron to hide from investors and rating agencies the true extent of its borrowings. Between June 1998 and October 2001, Enron used these disguised

loans to increase reported earnings by more than $1 billion, to increase reported operating cash flows by almost $2 billion, and to avoid disclosure of more than $2.6 billion in debt on its financial statements. Enron's alternative, borrowing money using the asset as collateral, would have given Enron access to cash to meet its operating expenses, but carried with it financial reporting consequences -- increased debt, no positive effect on cash flow, and no positive effect on earnings -- that would have had a detrimental impact on Enron's credit rating and stock price.

Simultaneously with the filing of the complaint, CIBC consented to entry of a final judgment settling the Commission's action against it. In the consent, CIBC has agreed, without admitting or denying the allegations of the complaint, to the entry of a final judgment permanently enjoining it from future violations of the antifraud, books and records, and internal control provisions of the federal securities laws. CIBC also has agreed to pay $80 million: $37.5 million in disgorgement, a $37.5 million civil penalty and $5 million in prejudgment interest. The Commission intends to have these funds paid into a court account pursuant to the Fair Fund provisions of Section 308(a) of the Sarbanes-Oxley Act of 2002 ("Fair Fund") for ultimate distribution to victims of the fraud.

Daniel Ferguson and Mark Wolf, without admitting or denying the Commission's allegations, also consented to the entry of a final judgment that permanently enjoins each from violating the same antifraud, books and records, and internal control provisions of the federal securities laws. In addition, Ferguson has agreed to pay a total of $563,000: disgorgement of $265,000, a penalty of $265,000, and prejudgment interest of $33,000, and has agreed to the entry of an order barring him from serving as an officer or director of a publicly traded company for a period of five years. Wolf, who is no longer employed by CIBC, has agreed to pay a total of $60,000: $27,500 as disgorgement, a penalty of $27,500, and prejudgment interest of $5,000. The Commission will likewise direct those monies to Enron fraud victims pursuant to the Fair Fund provisions. Ian Schottlaender, a former managing director in CIBC's corporate leveraged finance group in New York City, is contesting the matter.

The complaint further alleges that the transactions met neither the requirement that the equity stake be at risk, nor the requirement that the transferor relinquish control over the asset.

d. SEC v. J.P. Morgan Chase & Co., Litigation Release No. 18252 (July 28, 2003). *http://www.sec.gov/litigation/litreleases/lr18252.htm*

On July 28, 2003, the Commission charged J.P. Morgan Chase & Co. with aiding and abetting Enron Corp.'s securities fraud. The Commission's complaint, filed in U.S. District Court in Houston, alleges that J.P. Morgan Chase aided and abetted Enron's manipulation of its reported financial results through a series of complex structured finance transactions, called "prepays," over a period of several years preceding Enron's bankruptcy. These transactions were used by Enron to report loans from J.P. Morgan Chase as cash from operating activities. The structural complexity of these transactions had no business purpose aside from masking the fact that, in substance, they were loans from J.P. Morgan Chase to Enron. Between December 1997 and September 2001, J.P. Morgan Chase effectively loaned Enron a total of approximately $2.6 billion in the form of seven such transactions.

Simultaneous with the filing of the complaint, J.P. Morgan Chase agreed to file a consent and final judgment settling the Commission's action against it. In the consent, J.P. Morgan Chase has agreed, without admitting or denying the allegations of the complaint, to the entry of a final judgment permanently enjoining it from future violations of the antifraud provisions of the federal securities laws. Morgan Chase also has agreed to pay disgorgement, penalties and interest in the amount of $135 million.

The Commission alleges that J.P. Morgan Chase knew that Enron engaged in prepays to match its so-called mark-to-market earnings (paper earnings based on changes in the market value of certain assets held by Enron) with cash flow from operating activities and allowed Enron to hide the true extent of its borrowings from investors and rating agencies because sums borrowed in prepay transactions appeared as "price risk management liabilities" rather than "debt" on Enron's balance sheet.

e. In re Citigroup, Securities Exchange Act Release No. 48230 (July 28, 2003). *http://www.sec.gov/litigation/admin/34-48230.htm*

On the same day as the complaint against J.P. Morgan Chase was filed, the Commission instituted and settled enforcement proceedings against Citigroup, Inc. for its role in Enron Corp.'s and Dynegy's manipulation of financial statements. Enron and Dynegy misled its investors by characterizing what were essentially loan proceeds as cash from operating activities.

Like the J.P. Morgan Chase prepays, the Citigroup prepays passed the commodity price risk from Enron to a Citigroup-sponsored special purpose vehicle to Citigroup and back to Enron. As in the J.P. Morgan Chase prepays, Enron's future obligations under the Citigroup prepays consisted of repayments of principal and interest that were independent of any changes in the price of the underlying commodity.

Additionally, the Commission's action against Citigroup is based on two other transactions with Enron, each of which was also a structure that transformed cash from financing into cash from operations. Citigroup knowingly helped Enron structure a transaction that allowed Enron to generate cash from operating activities by selling Treasury bills bought with the proceeds of a loan. Enron also structured special purpose entity capitalized by Citigroup with a $194 million loan and $6 million in equity. According to the Commission, however, in substance, the transaction was a $200 million financing project from Citigroup, because Citigroup was not at risk for its equity investment in the project.

The Citigroup action also contains findings relating to a transaction with Dynegy — Project Alpha — which was a complex financing that Dynegy used to borrow $300 million. According to the Commission's findings, Citigroup knew that Dynegy implemented Alpha to address the mismatch between its mark-to-market earnings and operating cash flow, and that it characterized as cash from operations what was essentially a loan transaction. As Citigroup knew, Dynegy, too, was concerned that the mismatch between earnings and cash flow from

operations would raise questions about the quality of Dynegy's earnings and its ability to sustain those earnings.

f. <u>SEC v. Kevin A. Howard, Michael W. Krautz, Kenneth D. Rice, Joseph Hirko, Kevin P. Hannon, Rex T. Shelby, and F. Scott Yeager</u>, Litigation Release 18122 (May 1, 2003). *http://www.sec.gov/litigation/litreleases/lr18122.htm*

The SEC filed an Amended Complaint charging Kenneth D. Rice, former chief executive officer, Joseph Hirko, former chief executive officer, Kevin P. Hannon, former chief operating officer, Rex T. Shelby, a former senior vice president, and F. Scott Yeager, a former senior vice president, of Enron Broadband Services, Inc. ("EBS"), a wholly-owned subsidiary of Enron Corp., with violating the antifraud provisions of the federal securities laws.

The Amended Complaint alleges that Rice, Hirko, Hannon, Shelby and Yeager engaged in a wide-ranging fraudulent scheme to, among other things, inflate the value of Enron stock through a series of false and misleading statements and the omission of material information in such public statements about the technology, financial condition, performance and value of EBS. The false and misleading statements took the form of press releases over a two-year period as well as presentations and statements made at Enron's annual analyst conference in January 2000 and 2001. The false statements sought to distinguish the capabilities of the Enron Intelligent Network ("EIN"), Enron's broadband network, from other networks by claiming that it contained built-in intelligence - a software control layer called the "Broadband Operating System" or the "BOS" - that allowed it to perform more sophisticated applications than other networks. The BOS and its predecessor, InterAgent, however, did not work as Enron claimed and the EIN was unable to perform the applications that were represented it could perform. In addition, Rice and Hannon made false statements and material omissions concerning the value of Enron's broadband business and its commercial success at the January 2001 analyst conference.

As a result of the false statements Enron's stock was artificially inflated. Rice, Hirko, Hannon, Shelby and Yeager then sold large amounts of Enron stock at the inflated levels, at a time when they knew that the statements were false and misleading and when they were in possession of material non-public information concerning the true status of the technology and EBS' commercial success. The unlawful profits were substantial: Hirko -- $53.0 million; Rice -- $40.3 million; Yeager -- $35.1 million; Shelby -- $17.5 million; and Hannon -- $9.0 million.

The Amended Complaint charges Rice, Hirko, Hannon, Shelby and Yeager with violating the antifraud provisions of the federal securities laws. The Commission is seeking disgorgement of their ill-gotten gains, civil money penalties, a permanent bar from acting as an officer or director of a publicly held company, and an injunction against future violations of the federal securities laws.

This action amends the Complaint filed against Kevin A. Howard and Michael W. Krautz, two former EBS executives, on March 12, 2003. That Complaint as well as the Amended Complaint alleges that Howard and Krautz engaged in a sham transaction, known as "Project Braveheart," which caused Enron to overstate its reported net income for the year 2000 by $53

million and for first quarter 2001 by $58 million. The Amended Complaint alleges that the fictitious net income generated through Project Braveheart was an integral part of a broader fraudulent scheme to deceive the public about EBS.

g. SEC v. Merrill Lynch & Co., Inc., et al., Litigation Release No. 18038 (March 17, 2003). *http://www.sec.gov/litigation/litreleases/lr18038.htm*

On March 17, 2003 the SEC charged Merrill Lynch & Co. Inc. and four of its former senior executives with aiding and abetting Enron Corp.'s securities fraud. The Commission's complaint, filed in U.S. District Court in Houston, alleges that Merrill Lynch and its former executives aided and abetted Enron Corp.'s earnings manipulation by engaging in two fraudulent year-end transactions in 1999. The transactions had the purpose and effect of overstating Enron's reported financial results. Specifically, Enron used these transactions to add approximately $60 million to its fourth quarter of 1999 income (improving net income from $199 million to $259 million or 33 percent) and to increase its full year 1999 earnings per share from $1.09 to $1.17.

Simultaneous with the filing of this action, the Commission agreed to accept Merrill Lynch's offer to settle this matter. Merrill Lynch, without admitting or denying the allegations in the complaint, agreed to pay $80 million dollars in disgorgement, penalties and interest and agreed to the entry of a permanent anti-fraud injunction prohibiting future violations of the federal securities laws. The Commission intends to have these funds paid into a court account pursuant to the Fair Fund provisions of Section 308(a) of the Sarbanes-Oxley Act of 2002 for ultimate distribution to victims of the fraud.

The four former Merrill Lynch executives named in the complaint, Robert S. Furst, Schuyler M. Tilney, Daniel H. Bayly and Thomas W. Davis, are contesting the matter.

As alleged in the Commission's complaint, the first transaction was an asset-parking arrangement whereby on Dec. 29, 1999, Merrill Lynch bought an interest in certain Nigerian barges from Enron with an express understanding that Enron would arrange for the sale of this interest by Merrill Lynch within six months at a specified rate of return. In substance, this transaction was, at best, a bridge loan because the risks and rewards of ownership of the interest in the barges did not pass to Merrill Lynch.

As further alleged in the complaint, Merrill Lynch and the named executives knew that Enron would record $28 million in revenue and $12 million in pre-tax income in connection with this transaction. The Commission alleges that Merrill Lynch and the named executives entered into this transaction solely to accommodate Enron, despite express concerns that Merrill Lynch could appear to be aiding and abetting Enron's earnings manipulation. In 2000, Enron arranged to take Merrill Lynch out of the barge deal on the agreed time frame at the agreed rate of return.

In the second transaction, also closed in the last days of December 1999, Merrill Lynch and Enron entered into two energy options — one physical and one financial — that Merrill Lynch knew had the purpose and effect of inflating Enron's income by approximately $50 million. The complaint details that, at year-end 1999, the trading under these options was not scheduled to begin for approximately nine months. Before the transaction was closed, the

complaint alleges, Enron told Merrill Lynch that, despite a nominal term of four years, it might want to unwind this transaction early.

Merrill Lynch believed that the two trades were essentially a wash and knew that the transaction would have a significant impact on Enron's reported results, bonuses, and stock price. Merrill Lynch demanded a multi-million dollar fee for entering into this transaction; Enron ultimately agreed to pay Merrill Lynch a structured fee to be paid over four years with a net present value of $17 million.

Merrill Lynch offered, and the Commission has agreed, to settle the Commission's charges against the company. Simultaneous with the filing of the complaint, Merrill Lynch filed a consent and final judgment settling the Commission's action against it. In the consent, Merrill Lynch has agreed, without admitting or denying the allegations of the complaint, to be permanently enjoined from violating the anti-fraud, reporting, books and records, and internal controls provisions of the federal securities laws in the future.

12. **SEC v. Hollinger International, Inc**., Litigation Release No. 18551, (January 21, 2004) *http://www.sec.gov/litigation/litreleases/lr18550.htm.*

On January 16, 2004, the Commission filed a civil injunctive complaint against the Chicago-based Hollinger International, Inc. ("Hollinger International") in the United States District Court for the Northern District of Illinois alleging that, from at least 1999 through 2001, the company's Commission filings contained misstatements and omitted to state material facts regarding transfers of corporate assets to certain of Hollinger International's insiders and related entities. The same day, the SEC sought and obtained an emergency partial final judgment and an order of permanent injunction, which was later vacated in part.

Under the order, Hollinger International was required to maintain its Special Committee to, among other things, continue its investigation of alleged misconduct and its efforts to recover and maintain corporate assets. In the event the Special Committee's authority were in any way impaired, including through a change in control of the company, Richard C. Breeden (the current Counsel to the Special Committee) would serve as a court-ordered Special Monitor to protect the interests of Hollinger International shareholders.

On March 1, 2004, this judgment was vacated in part. Holligner Inc. ("Inc."), Hollinger International's parent company and majority shareholder, brought a motion to intervene and vacate the part of the judgment concerning the court appointed Special Monitor. Specifically, Inc. sought to vacate the part of the judgment that stated that if Inc. votes to remove any of Hollinger International's current directors or fails to reelect any director, a Special Monitor would automatically be appointed to oversee Hollinger International's activities. The court found that this part of the judgment could impair Inc.'s unfettered right under Delaware law to remove and elect members of Hollinger International's board of directors. The court found that because Inc. had a legitimate interest at stake, the SEC should have given Inc. notice and alerted the previous judge to the possible adverse affect it could have on Inc. Because the SEC did not do this, the court vacated the part of the judgment that affected the exercise of Inc.'s voting rights to elect or remove directors. The court did not make a finding that the judgment was in

contravention of Delaware Corporate law or that the judgment could not be entered as currently worded, rather, the court found that Inc. should have been given notice and an opportunity to be heard before the judgment was entered. SEC v. Hollinger International Inc., 2004 U.S. Dist. LEXIS 3240 (N.D. Ill. 2004).

A hearing will be set at a later date to determine whether it is appropriate to require Hollinger International to pay disgorgement, prejudgment interest and civil penalties. In addition, Hollinger International has expressly agreed that the Commission may file additional charges against it at a later time, including for the same conduct alleged in the complaint.

13. **SEC v. Robert Quattrone, et al.,** Litigation Release No.18534 (January 7, 2004). *http://www.sec.gov/litigation/litreleases/lr18534.htm*

On January 7, 2004, the Commission filed a civil complaint in the United States District Court for the District of New Jersey charging ten defendants with violating the antifraud and other provisions of the federal securities laws in connection with a multi-year financial fraud at Suprema Specialties, Inc. (Suprema). Suprema is a now defunct manufacturer and distributor of cheese products based in Paterson, New Jersey.

The defendants include Arthur Christensen, the former controller of Suprema; John Van Sickell, the former operations manager of Suprema's Paterson, New Jersey plant; five entities that purported to buy from or sell products to Suprema in the round-tripping scheme, Battaglia & Company, Inc. (Battaglia), California Milk Market (CMM), LNN Enterprises, Inc. (LNN), Packing Products, Inc. (Packing Products), and West Coast Commodities, Inc. (WCC); and three persons who owned or operated these entities, Lawrence Fransen, Robert Quattrone, and George Vieira. Vieira was also sued in connection with his conduct as the former chief operating officer of Suprema's Manteca, California plant.

Without admitting or denying the SEC's charges, all of the defendants have consented to the entry of judgments providing for full injunctive and other relief, while deferring for determination at a later date the amount of any disgorgement, prejudgment interest and civil penalties to be awarded.

In its complaint, the SEC charged that, from at least 1998 through February 2002, when Suprema filed for bankruptcy, the defendants were engaged in a financial fraud that consisted of three components. First, Suprema and certain of its customers and vendors, including the five entities named as defendants, engaged in "round-tripping" transactions that generated approximately $700 million in fictitious sales revenue, or approximately 60% of Suprema's total reported revenue of approximately $1.13 billion over the relevant time period. Second, imitation cheese and non-cheese products were falsely re-labeled as premium cheeses to fraudulently inflate Suprema's reported inventory. Third, certain of Suprema's cheese products were adulterated with imitation cheese and non-cheese ingredients in order to reduce Suprema's costs illegally, contrary to statements in its filings with the SEC that Suprema sold "natural" or "all natural" cheeses that met applicable federal standards. According to the SEC's complaint, all three components of the fraudulent scheme resulted in material misstatements in Suprema's periodic reports filed with the SEC during its fiscal years 1998 through 2001 and the first quarter

of 2002, as well as in the registration statements Suprema filed with the SEC for its secondary public offerings in 2000 and 2001.

Based on these allegations, the SEC charged Christensen, Fransen, Quattrone, Van Sickell, Vieira, Battaglia, CMM, LNN, Packing Products, and WCC with: (i) securities fraud (ii) aiding and abetting Suprema's violations of the periodic reporting, books and records, and internal accounting controls provisions of Exchange Act (iii) aiding and abetting misrepresentations by Suprema's officers and directors to the company's accountants. Christensen and Van Sickell were also charged with violating the antifraud provisions of Section 17(a) of the Securities Act of 1933 and, along with Vieira, knowingly circumventing internal accounting controls and falsifying corporate books and records.

Without admitting or denying the allegations of the SEC's complaint, all of the defendants agreed to settle the SEC's charges. Subject to the Court's approval, these settlements would result in judgments ordering permanent injunctive relief against future violations of the federal securities laws, permanent officer and director bars against the individual defendants (with the exception of Christensen, who would be subject to a ten-year bar in recognition of his level of cooperation), and deferment of any disgorgement, interest, or civil penalties until decided by the court upon motion by the SEC at a later date.

In a related proceeding, the United States Attorney for the District of New Jersey filed criminal charges against Fransen, Quattrone, Van Sickell, and Vieira. At a plea hearing in the U.S. District Court for the District of New Jersey held earlier the same day, Fransen, Quattrone, and Vieira each plead guilty to one count of securities fraud and one count of conspiracy to commit securities fraud, bank fraud, and mail fraud and to make false statements to auditors. In the same proceeding, Van Sickell plead guilty to one count of food adulteration and misbranding with intent to defraud and one count of conspiracy to commit securities fraud, bank fraud, and mail fraud, to make false statements to auditors, and to introduce adulterated and misbranded food into interstate commerce. (U.S. v. Lawrence Fransen, CR04-10 (D.N.J.); U.S. v. George Vieira, CR04-11 (D.N.J.); U.S. v. John Van Sickell, CR04-12 (D.N.J.); and U.S. v. Robert Quattrone, CR04-13 (D.N.J.)).

14. **SEC v. Parmalat Finanziaria S.p.A.,** Litigation Release No. 18527 (December 30, 2003). *http://www.sec.gov/litigation/litreleases/lr18527.htm*

The SEC charged Parmalat Finanziaria S.p.A. ("Parmalat") with securities fraud. The Commission's complaint, filed in U.S. District Court in the Southern District of New York, alleges that Parmalat engaged in one of the largest and most brazen corporate financial frauds in history.

The Commission's complaint alleges as follows: From August through November 2003, Parmalat fraudulently offered $100 million of unsecured Senior Guaranteed Notes to U.S. investors by materially overstating the company's assets and materially understating its liabilities. As Parmalat acknowledged in a press release dated December 19, 2003, the assets in its 2002 audited financial statements were overstated by at least €3.95 billion (approximately

$4.9 billion). In addition, Parmalat falsely stated to U.S. investors that it used its "excess cash balances" — which actually did not exist — to repurchase corporate debt securities worth €2.9 billion (approximately $3.6 billion), when in fact it had not repurchased those debt obligations and they remained outstanding. The $100 million note offering failed after Parmalat's auditors raised questions about certain Parmalat accounts.

The complaint further alleges that as of the end of 2002, Parmalat purportedly held the €3.95 billion worth of cash and marketable securities in an account at Bank of America in New York City in the name of Bonlat Financing Corporation ("Bonlat"), a wholly owned subsidiary incorporated in the Cayman Islands. Bonlat's auditors certified its 2002 financial statements based upon a false confirmation that Bonlat held these assets at Bank of America. The bank account and the assets did not exist and the purported confirmation had been forged. These non-existent assets are reflected on Bonlat's 2002 books and records and, in turn, in Parmalat's 2002 consolidated financial statements, as well as in its consolidated financial statements as at June 30, 2003, which were provided to U.S. investors to whom Parmalat offered notes from August through November 2003. The complaint further alleges that a private placement memorandum that Parmalat provided to U.S. investors in August 2003 contained numerous material misstatements about the company's financial condition. For example, the memorandum falsely states: "Liquidity is high with significant cash and marketable securities balances...."

The complaint further alleges that on December 9, 2003, Parmalat's Chairman and Chief Executive Officer, and his son, a senior Parmalat executive, met with representatives from a New York City-based private equity and financial advisory firm regarding a possible leveraged buyout of Parmalat. During that meeting, one of the New York firm's representatives noted that Parmalat's financial statements showed that the company had a large amount of cash. In response, the son stated that the cash was not there, and that Parmalat really had only €500 million in cash. Later, Parmalat's Chief Financial Officer joined the meeting. During a discussion of Parmalat's outstanding debt, the CFO stated that Parmalat's debt was actually €10 billion, much higher than the balance sheet showed. The CFO indicated that the balance sheet was incorrect because the company had not repurchased €2.9 billion of Parmalat bonds. The balance sheet falsely reflected that the bonds had been repurchased.

The complaint further alleges that based on these revelations, the New York firm's representatives offered to send members of the firm's restructuring group to meet with Parmalat representatives. The following day, representatives of the firm's restructuring group met with the Parmalat representatives, and informed them that Parmalat needed to publicly disclose the facts disclosed to the New York firm if that firm were to continue to have any involvement. When it became clear that the Parmalat representatives were unwilling to do so, the New York firm's representatives terminated their discussions with Parmalat.

The complaint further alleges that from 1998 through 2002, Parmalat and certain of its top managers and directors, including its then Chairman and CEO and its CFO, actively marketed and sold nearly $1.5 billion in notes and bonds to U.S. investors. Parmalat also sponsored an American Depositary Receipts ("ADR") program. Parmalat's ADRs were originally privately placed in the U.S. on August 9, 1996. Before December 19, 2003, the price of Parmalat

ADRs had been artificially inflated by the materially false and misleading statements described above.

Parmalat is charged with violating the antifraud provisions of the Securities Act. The Commission seeks against Parmalat a permanent injunction from future securities fraud violations and a substantial civil penalty.

On July 28, 2004, the Securities and Exchange Commission ("Commission") filed an amended complaint in its lawsuit against Parmalat Finanziaria S.p.A. in U.S. District Court in the Southern District of New York.

Parmalat Finanziaria has agreed, without admitting or denying the allegations of the amended complaint, to be permanently enjoined from violating the antifraud provisions of the securities laws. In addition, Parmalat Finanziaria has agreed to adopt changes to its corporate governance to promote future compliance with the federal securities laws, including adopting by-laws providing for governance by a shareholder-elected board of directors, the majority of whom will be independent and serve finite terms; specifically delineating in the by-laws the duties of the board of directors; adopting a Code of Conduct governing the duties and activities of the board of directors; adopting an Insider Dealing Code of Conduct; and adopting a Code of Ethics. The by-laws will also require that the positions of chairman of the board of directors and managing director be held by two separate individuals. Parmalat Finanziaria's consent also provides for the continuing jurisdiction of the U.S. District Court to enforce its provisions. (Litigation Release No. 18803).

The Commission's investigation into federal securities law violations related to the fraud at Parmalat Finanziaria is continuing.

15. **SEC v. Vivendi Universal, S.A., Jean-Marie Messier, and Guillaume Hannezo**, Litigation Release No. 18523 (December 24, 2003). *http://www.sec.gov/litigation/litreleases/lr18523.htm.*

On December 23, 2003, the Commission filed a settled enforcement action against Vivendi Universal, S.A. (Vivendi), a media and environmental services conglomerate, its former CEO, Jean-Marie Messier (Messier), and its former CFO, Guillaume Hannezo (Hannezo). The settlements include Vivendi's consent to pay a $50 million civil money penalty. The settlements also include Messier's agreement to relinquish his claims to a €21 million severance package that he negotiated just before he resigned his positions at Vivendi, and payment of disgorgement and civil penalties by Messier and Hannezo that total over $1 million.

The Commission's Complaint describes a course of conduct by Vivendi, Messier, and Hannezo that disguised Vivendi's cash flow and liquidity problems, improperly adjusted accounting reserves to meet earnings before income taxes, depreciation, and amortization (EBITDA) targets, and failed to disclose material financial commitments, all in violation of the antifraud provisions of the federal securities laws.

All of the defendants consented to the settlements without admitting or denying the Commission's allegations. The settled action permanently enjoins Vivendi, Messier, and Hannezo from further violations of the federal securities laws and includes other substantial relief:

- Vivendi is required to pay a civil money penalty in the amount of $50 million and disgorgement of $1;
- Messier is required to relinquish his claim to a severance package of about €21 million, to pay a civil money penalty of $1,000,000, and disgorgement of $1;
- Hannezo is required to disgorge $148,149, and to pay a penalty of $120,000; and
- Messier and Hannezo are prohibited from serving as an officer or director of a public company for, respectively, 10 and 5 years.

The Commission intends to direct that disgorgement and penalties paid in this case be paid to defrauded investors, including those who held Vivendi's ordinary shares and its American Depository Shares during the time period alleged in the Commission's Complaint, pursuant to Section 308 (Fair Funds for Investors) of the Sarbanes-Oxley Act of 2002.

The €21 million payment, now valued at approximately $25 million (including interest), to which Messier is relinquishing his claim has already been placed in an escrow account as a result of the Commission's successful litigation pursuant to Section 1103 of the Sarbanes-Oxley of 2002. On the SEC's motion, the District Court in New York ordered Vivendi to place those funds in escrow on September 24, 2003.

16. **SEC v. Stoffer et al**., Litigation Release No. 18503, (December 12, 2003) *http://www.sec.gov/litigation/litreleases/lr18503.htm*

On December 10, 2003, the Commission filed a civil enforcement action against four former senior executives of Nicor Energy LLC, alleging that the executives inflated net income by $11 million in 2001. Nicor Energy is a joint venture between Nicor Inc. and Dynegy Inc. In its complaint, the SEC alleged that the executives used an array of improper accounting tools for the express purpose of hitting earnings targets.

In its case, filed in the U.S. District Court for the Northern District of Illinois, the SEC alleged that the defendants, using Nicor as a conduit, defrauded the investing public regarding Nicor Energy's financial condition and results of operations for its fiscal year ended December 31, 2001. As a result of the fraud, Nicor Energy falsely reported to Nicor net income of $4.097 million instead of losses of $7.47 million for 2001, and these results were in turn reported to Nicor's investors.

In addition, the U.S. Attorney for the Northern District of Illinois has filed indictments for three of the four executives, and one other individual. Named as defendants in the complaint are: Kevin M. Stoffer, Nicor Energy's former president and Chief Executive Officer and a

resident of Naperville, Illinois; Andrew J. Johnson, Nicor Energy's former Director of Financial Services and a resident of Elmhurst, Illinois; John Fringer, Nicor Energy's former Vice President of Power Services and Regulatory Affairs and a resident of Naperville, Illinois; and John F. Weir, Nicor Energy's former Director of Gas Services and Major Markets and a resident of Trevor, Wisconsin.

The complaint charged the defendants with violating the antifraud and internal control provisions of the federal securities laws. It further charged the defendants with aiding and abetting Nicor Energy's violations of those same provisions. The complaint finally charged Stoffer as a controlling person for Nicor Energy's violations of those provisions.

The SEC seeks an order permanently enjoining the defendants from violating federal securities laws, granting civil penalties and permanently barring the defendants from serving as an officer or director of a public company.

17. **In the Matter of Gateway, Inc.**, Securities Act Release No. 8338 (November 13, 2003). *http://www.sec.gov/litigation/admin/33-8338.htm;* **SEC v. John J. Todd, Robert D. Manza and Jeffrey Weitzen**, Litigation Release No. 18454 (November 14, 2003). *http://www.sec.gov/litigation/litreleases/lr18454.htm.*

On November 13, 2003, the Commission filed fraud charges against the former chief executive officer, chief financial officer, and controller of San Diego-based Gateway, Inc., for engaging in a fraudulent earnings manipulation scheme to meet Wall Street analysts' expectations, and for making false statements and concealing from the investing public important information about the success of Gateway's personal computer business, in the second and third quarters of 2000.

The defendants are Jeffrey Weitzen, Gateway's former chief executive officer and a member of its board of directors; John J. Todd former senior vice president and chief financial officer of Gateway; and Robert D. Manza, a certified public accountant who was Gateway's controller during the relevant time period.

The SEC's complaint alleges that defendants misrepresented or failed to disclose (1) significant trends in Gateway's business; (2) that PC sales growth was declining; (3) that, by the end of the third quarter, only a small percentage of net income was associated with PC sales; and (4) that revenue and earnings included various one-time transactions. Through these actions, the defendants gave the false and misleading impression that Gateway, unlike many of its competitors, was outpacing an industry trend of decreasing sales of personal computers.

The Commission's complaint alleges that in approximately May 2000, when defendants realized that the company would not meet the expectations of the Wall Street analysts who followed Gateway's stock, they embarked on a fraudulent scheme to "close the gap" between analysts' expectations and the company's actual revenue and earnings. The scheme included contacting individuals whose credit applications had previously been denied by the company, and offering them pre-approved financing to facilitate sales.

Todd allegedly authorized a variety of improper accounting actions, all of which failed to comply with generally accepted accounting principles (GAAP). As a result of the improper accounting actions, Gateway announced that, for the third quarter of 2000, it exceeded analysts' expectations for revenue by $30 million, met analysts' expectations for earnings per share (EPS) of $0.46, and experienced year-over-year revenue growth of 16%. The improper actions by defendants caused Gateway's net income for the third quarter of 2000 to be overstated by more than ten cents EPS, or 30%, and inflated reported revenue by $154 million, or 6.5%.

In its complaint, the Commission charged Weitzen, Todd, and Manza with violating the antifraud and false statements to accountants provisions of the federal securities laws. The Commission further charged Todd and Manza with violating record-keeping and internal controls provisions, and aiding and abetting Gateway's violations of the reporting and record-keeping provisions. Finally, the Commission charged Weitzen with violating the antifraud and reporting provisions as a control person of Gateway.

In a separate administrative proceeding, Gateway, without admitting or denying the Commission's findings, agreed to the entry of a Commission order that it cease and desist from violations of the antifraud, reporting, books and records, and internal controls provisions of the federal securities laws. In its cease-and-desist order, the Commission found that, through the conduct described above, Gateway violated the antifraud, reporting, and record-keeping provisions of the federal securities laws. The Commission also found that Gateway violated the internal controls provision by failing to observe consistent quarter-end cutoff dates and times, which caused it to have accounting periods of different lengths from quarter to quarter.

18. **SEC v. Spiegel, Inc.,** Litigation Release No. 18347 (September 12, 2003). *http://www.sec.gov/litigation/litreleases/lr18347.htm.*

On March 7, 2003, the Commission filed a civil injunctive action alleging that Spiegel, Inc. (“Spiegel”) violated the federal securities laws by withholding material information from the public. Spiegel consented to the entry of a permanent injunction without admitting or denying the allegations in the Commission’s complaint. The complaint alleged that Spiegel withheld the fact that on or about the beginning of 2002, its independent auditor had notified Spiegel that it may not be able to continue as a “going concern.” The complaint further alleged that Spiegel’s independent auditor later issued an audit report on or about January or February 2002 which stated that the audit firm had “substantial doubts” about Spiegel’s ability to continue as a going concern.

On September 11, 2003, the Honorable Judge James B. Zagel entered an Order (“Order”) pursuant to a motion by the Commission providing that the Independent Examiner’s Report dated September 5, 2003 be made available to the public. The Order requires that the Independent Examiner’s report be included in the filings for this matter, and also requires that the report be posted on the official website for the United States District Court for the Northern District of Illinois (*http://www.ilnd.uscourts.gov*) on September 15, 2003.

The Independent Examiner’s Report was completed as a result of Spiegel’s partial settlement with the Securities and Exhange Commission in this matter.

The complaint alleged that Spiegel decided not to make its required 10-K and 10-Q filings to conceal the "going concern" issue from the public. Instead, the company filed a series of Forms NT (notices of late filing) indicating that Spiegel was not in a position to file because various lending agreements were not in place. According to the complaint, statements made by Spiegel executives confirm that Spiegel chose not to make its required filings to avoid disclosing the going concern notice and to avoid the negative "disruptions" that the disclosure of this information would cause. The complaint further alleged that Spiegel failed to disclose its auditor's "going concern" notice in various press releases and public statements that discussed the company's financial condition.

19. **SEC v. Paul A. Allaire, G. Richard Thoman, Barry D. Romeril, Philip D. Fishbach, Daniel S. Marchibroda and Gregory B. Tayler,** Litigation Release No. 18174 (June 5, 2003). *http://www.sec.gov/litigation/litreleases/lr18174.htm.*

On June 5, 2003, the SEC filed a civil fraud injunctive action in the United States District Court for the Southern District of New York charging six former senior executives of Xerox Corporation, including its former chief executive officers, Paul A. Allaire and G. Richard Thoman, and its former chief financial officer, Barry D. Romeril, with securities fraud and aiding and abetting Xerox's violations of the reporting, books and records and internal control provisions of the federal securities laws. The complaint alleges that the executives engaged in a fraudulent scheme that lasted from 1997 to 2000 that misled investors about Xerox's earnings to polish its reputation on Wall Street and to boost the company's stock price. The scheme involved the use of accounting devices that were not disclosed to investors, many of which violated generally accepted accounting principles ("GAAP"). The complaint alleges that the defendants' fraudulent conduct was responsible for accelerating the recognition of equipment revenues by approximately $3 billion and increasing pre-tax earnings by approximately $1.4 billion in Xerox's 1997-2000 financial results. The six defendants have agreed to pay over $22 million in penalties, disgorgement and interest without admitting or denying the SEC's allegations.

The complaint names as defendants several individuals who held senior positions at Xerox during 1997 through the publication of Xerox's 2000 financial statements, including Paul A. Allaire, former CEO, G. Richard Thomas, former President and COO, Barry D. Romeril, former CFO, Phillip D. Fishbash, former Controller, Daniel S. Marchibroda, former Assistant Controller, and Gregory B. Taylor, former Controller.

The defendants have settled by consenting, without admitting or denying the SEC's allegations, to the entry of a final judgment that permanently enjoins each of them from violating the reporting, anti-fraud and books and records provisions of the Exchange Act. The settlement also provides for officer and director bars against Allaire, Thoman, Romeril and Fishbash, and requires each of them to pay civil penalties which total $1,950,000, and disgorgement and prejudgment interest totaling $19,403,132.

In addition, both Romeril and Tayler have agreed to the entry by the SEC of an Order pursuant to Rule 102(e) of the SEC's Rules of Practice that suspends each of them (based on the

entry of the injunction in the federal court action) from appearing or practicing before the SEC as an accountant. This Order will suspend Romeril permanently and suspend Tayler for three years with a right to apply for reinstatement after the three-year period.

The Commission previously brought two other injunctive actions based on the same fraudulent scheme as is alleged against the senior Xerox executives, as well as other allegations. On April 11, 2002, the Commission brought an injunctive action against Xerox. Without admitting or denying the allegations of the complaint, Xerox consented to the entry of a Final Judgment that permanently enjoined the company from violating the antifraud, reporting and record keeping provisions of the federal securities laws. Xerox also paid a $10 million civil penalty, agreed to restate its financial statements and agreed to hire a consultant to review the company's internal accounting controls and policies. SEC v. Xerox Corporation, Civil Action No. 02-CV-2780 (DLC) (S.D.N.Y.) (April 11, 2002). See Litigation Release No. 17465 (April 11, 2002)Accounting and Auditing Enforcement Release No. 1542 (April 11, 2002). In addition, on January 29, 2003, the Commission brought an injunctive action against Xerox's former auditor, KPMG LLP, and four of its audit partners in connection with the audits of Xerox from 1997 — 2000. The action against KPMG and its partners is currently in litigation. SEC v. KPMG LLP, Joseph T. Boyle, Michael A. Conway, Anthony P. Dolanski and Ronald A. Safran, Civil Action No. 03 CV 0671 (DLC) (S.D.N.Y.) (January 29, 2003). See Litigation Release No. 17954 (January 29, 2003);Accounting and Auditing Enforcement Release No. 1709 (January 29, 2003).

20. **SEC v. HealthSouth Corporation and Richard M. Scrushy**, Litigation Release No. 18044 (March 20, 2003). *http://www.sec.gov/litigation/litreleases/lr18044.htm.*

The SEC filed accounting fraud charges in federal district court in the Northern District of Alabama against HealthSouth Corporation ("HRC"), the nation's largest provider of outpatient surgery, diagnostic and rehabilitative healthcare services, and its Chief Executive Officer and Chairman Richard M. Scrushy. The Commission's complaint alleges that since 1999, at the insistence of Scrushy, HRC systematically overstated its earnings by at least $1.4 billion in order to meet or exceed Wall Street earnings expectations. The false increases in earnings were matched by false increases in HRC's assets. By the third quarter of 2002, HRC's assets were overstated by at least $800 million, or approximately 10 percent. The complaint further alleges that, following the Commission's order last year requiring executive officers of major public companies to certify the accuracy and completeness of their companies' financial statements, Scrushy certified HRC's financial statements when he knew or was reckless in not knowing they were materially false and misleading.

Pursuant to the scheme, on a quarterly basis, HRC's senior officers would present Scrushy with an analysis of HRC's actual, but as yet unreported, earnings for the quarter as compared to Wall Street's expected earnings for the company. If HRC's actual results fell short of expectations, Scrushy would tell HRC's management to "fix it" by recording false earnings on HRC's accounting records to make up the shortfall.

HRC's senior accounting personnel then convened a meeting to "fix" the earnings shortfall. At these meetings, HRC's senior accounting personnel discussed what false accounting

entries could be made and recorded to inflate reported earnings to match Wall Street analysts' expectations. These entries primarily consisted of reducing a contra revenue account, called "contractual adjustment," and/or decreasing expenses, (either of which increased earnings), and correspondingly increasing assets or decreasing liabilities.

Scrushy has personally profited from the scheme to artificially inflate earnings. He has sold at least 7,782,130 shares of HRC stock since 1999, when HRC's share price was affected by HRC's artificially inflated earnings. Moreover, Scrushy received salary and bonus payments based on HRC's artificially inflated earnings.

In mid-2002, certain HRC senior officers and Scrushy discussed the impact of the scheme to inflate earnings because they were concerned about the consequences of the August 14, 2002 financial statement certification required under Commission Order No. 4-460, *Order Requiring the Filing of Sworn Statements Pursuant to Section 21(a)(1) of the Securities Exchange Act of 1934* (June 27, 2002). ("Order 4-460").

The Commission alleges Scrushy knew or was reckless in not knowing that HRC's financial statements materially overstated its operating results. Nevertheless, on August 14, 2002, he and HRC's Chief Financial Officer certified under oath that HRC's 2001 Form 10-K contained no "untrue statement of material fact." In truth, the financial statements filed with this report overstated HRC's earnings, identified as "Income Before Income Taxes And Minority Interests" on HRC's income statement, by at least 4,700 %.

The Commission alleges that HRC's and Scrushy's actions violated and/or aided and abetted violations of the antifraud, reporting, books-and-records, and internal controls provisions of the federal securities laws. The Commission is seeking a permanent injunction against HRC and Scrushy, civil money penalties from both defendants, disgorgement of all ill-gotten gains and losses avoided by both defendants as a result of the conduct alleged plus prejudgment interest thereon. The Commission also is seeking an order (i) prohibiting Scrushy from serving as an officer or director of a public company, (ii) freezing the assets of Scrushy, (iii) requiring HRC to escrow in an interest-bearing account, all extraordinary payments (including compensation) to any director, officer, partner, controlling person, agent, or employee, and (iv) preserving HRC's documents.

The Commission also obtained emergency relief on March 19, 2003 against HRC in the District Court. HealthSouth consented to the entry of an order by the Court (1) requiring that the company place in escrow, under the Court's supervision, all extraordinary payments (whether compensation or otherwise) to its directors, officers, partners, controlling persons, agents, or employees, pursuant to the provisions of the Sarbanes-Oxley Act of 2002, (2) prohibiting the company and its employees from destroying documents relating to the company's financial activities and/or the allegations in the Commission's case against HealthSouth in Scrushy, and (3) providing for expedited discovery in the Commission's case. On May 7, 2003 the District Court dismissed the Commission’s request for an asset freeze as to Scrushy.

Pursuant to a separate Commission order issued on March 19, 2003, trading in the securities of HRC was suspended for two business days due to the materially misleading information in the marketplace.

Since April of 2003, the SEC has filed complaints against nine other former officers of Healthsouth. See Lit. Rel. No. 18059, (Apr. 1, 2003) w*ww.sec.gov/litigation/-litreleases/lr18059.htm,* Lit. Rel. No. 18070, (Apr. 4, 2003) *www.sec.gov/litigation/-litreleases/lr18070.htm*, and SEC v. Michael Martin and Malcolm E. McVay, Litigation Release No. LR-8339 (September 10, 2003). *http://www.sec.gov/litigation/litreleases/lr18339.htm.*

On April 22, 2003, former treasurer and CFO of HealthSouth, Malcolm E. McVay, agreed to plead guilty to accounting fraud charges. On May 2, 2003, two former HealthSouth CFOs, Michael D. Martin and Malcolm E. McVay, pleaded guilty in Federal District Court in Birmingham, Ala., to conspiracy to commit wire fraud and securities fraud and to filing false records. On May 6, 2003, Aaron Beam pleaded guilty to bank fraud.

21. **SEC v. Joel M. Arnold, William L. Eveleth, Grant Graham, Thomas W. Hall, Douglas K. Hutchins, Bryan K. Treadway, John M. Walker, and Richard L. Weston,** Litigation Release No. 17996, (February 25, 2003). *http://www.sec.gov/litigation/litreleases/lr17996.htm.*

The Commission filed civil fraud charges against eight current and former officers and employees of Qwest Communications International Inc., alleging that they inflated the company's revenues by approximately $144 million in 2000 and 2001 in order to meet earnings projections and revenue expectations. The Commission's complaint alleges that the defendants artificially accelerated Qwest's recognition of revenue in two equipment sale transactions for its Global Business Markets unit. When Qwest and Global Business determined that Qwest was falling short of its quarterly revenue targets and would not achieve the projected growth for the quarters ending June 30, 2001, and September 30, 2000, the defendants bridged the revenue gap by fraudulently mischaracterizing these transactions.

The complaint alleges that Joel Arnold, the former senior vice president of Global Business; Grant Graham, the former chief financial officer of Global Business; Thomas W. Hall, the former senior vice president of a division of Global Business; Bryan K. Treadway, the former assistant controller of Qwest; John M. Walker, the former vice president of sales for a division of Global Business; and Douglas K. Hutchins, a former director of Global Business, planned and carried out an elaborate scheme to inflate revenues in connection with the sale of Internet equipment and service to the Arizona School Facilities Board ("ASFB"). The scheme involved artificially separating the equipment sale from the installation services and wrongfully characterizing the sale as a bill-and-hold transaction under generally accepted accounting principles. It also included accelerated delivery of equipment necessary for the two-year project and delivery of equipment that was not approved for the ASFB project. To support immediate

recognition of revenue for sale of the equipment, the defendants prepared false letter agreements for ASFB and a fraudulent internal memorandum. As a result of the fraudulent transaction, Qwest recognized approximately $33.6 million in revenue in the quarter ended June 30, 2001. Without the fictitious revenue from the ASFB transaction, Qwest would have fallen short of its projected 12 to 13 percent revenue growth for the quarter.

The complaint also alleges that Richard L. Weston, the former senior vice president in Product Development for Qwest's Internet Solutions unit, and William L. Eveleth, the current CFO of Qwest's Corporate Planning and Operational Finance unit and senior vice president of Finance, Arnold, and Graham participated in a scheme in which Qwest artificially characterized one transaction with Genuity, Inc., an Internet service provider, as two separate contracts. In the first contract Qwest purported to sell equipment to Genuity at an improperly inflated price. In a second contract, Qwest agreed to provide services to Genuity at a loss to Qwest, and reassumed all risk of loss and obsolescence on the equipment purportedly sold pursuant to the first contract. As a result of the fraudulent transaction, Qwest improperly recognized $100 million in revenue and claimed $80 million in earnings before interest, taxes, depreciation, and amortization in the quarter ended September 30, 2000. Without the fictitious revenue from the Genuity transaction, Qwest would not have achieved the projected double-digit growth for the quarter, and would have recognized growth of 9.8 percent above the same quarter of the prior year rather than the announced 12.4 percent.

The Commission's lawsuit, which was brought in federal court in the District of Colorado, seeks anti-fraud injunctions, civil money penalties, disgorgement of ill-gotten gains (including compensation, bonuses and stock trading profits during the relevant period) and, as to certain defendants, permanent bars from service as an officer or director of a public company. The Commission filed its action at the same time that the United States Attorney's Office filed indictments against certain individuals for conduct in the ASFB transaction that is the subject of the Commission's complaint.

II. CASES INVOLVING ACCOUNTANTS AND AUDITORS

1. **In the Matter of Grant Thornton LLP, Doeren Mayhew & Co. P.c., Peter M. Behrens, CPA, Marvin J. Morris, CPA, and Benedict P. Rybicki, CPA.,** Administrative Proceeding File No. 3-11377 (January 20, 2004). *http://www.sec.gov/litigation/admin/33-8355.htm*

   Grant Thornton and Doeren Mayhew Settle SEC Administrative Proceeding Relating to Audit of MCA Financial Corporation, Press Release No. 2004-106 (August 5, 2004). *http://www.sec.gov/news/press/2004-106.htm*

On January 20, 2004, the Commission instituted public administrative proceedings pursuant to Commission Rule 102(e) and cease-and-desist proceedings against Grant Thornton LLP, Doeren Mayhew & Co. P.C., Peter M. Behrens, Marvin J. Morris and Benedict P. Rybicki for misconduct in connection with their audit of MCA Financial Corporation's financial statements for the fiscal year ended January 31, 1998.

At the time, MCA was a mortgage banking company based in Southfield, Michigan. Grant Thornton is a national accounting firm headquartered in Chicago, Illinois. Doeren Mayhew is an accounting firm based in Troy, Michigan. Grant Thornton and Doeren Mayhew jointly audited MCA's 1998 annual financial statements. Behrens, a 46-year-old resident of Troy, Michigan, is a partner in the Detroit office of Grant Thornton. Morris, a 60-year-old resident of Grosse Pointe Park, Michigan, and Rybicki, a 40-year-old resident of Grosse Pointe Park, Michigan, are directors of Doeren Mayhew.

In the Order Instituting Proceedings the Commission's Division of Enforcement alleges that in connection with the 1998 MCA audit, the respondents caused and aided and abetted MCA's violations of the antifraud and reporting provisions of the federal securities laws, violated or caused and aided and abetted violations of the audit requirements of the Exchange Act and engaged in improper professional conduct.

Specifically, the Division alleges that during the audit, the respondents knew that MCA failed to disclose several million dollars of material, related party transactions in its 1998 annual financial statements. Despite this knowledge, Grant Thornton and Doeren Mayhew jointly issued a report containing an unqualified opinion on MCA's 1998 annual financial statements and consented to the inclusion of their report in MCA's debenture offering materials. The respondents failed to inform MCA's Board of Directors that MCA's 1998 annual financial statements did not disclose millions of dollars of material, related party transactions.

On August 5, 2004, The Commission accepted the offers of settlement of Grant Thornton LLP, Doeren Mayhew & Co. P.C., Peter M. Behrens, Marvin J. Morris and Benedict P. Rybicki. The Commission had previously instituted the administrative proceeding against the respondents based on their deficient audit of MCA Financial Corporation. The respondents consented to the Commission's entry of the Order Making Findings and Imposing Remedial Sanctions without admitting or denying the Commission's findings. (Admin. Proc. Release No. 34-50148).

As part of the Order, Grant Thornton undertakes to: pay $1.5 million as a penalty; require its entire professional staff to undergo fraud-detection training and provide at least $1 million to fund such training; and suspend certain joint audits with other auditing firms for a period of five years. In addition, Grant Thornton is censured and required to pay disgorgement and prejudgment interest of $59,749.41.

Pursuant to the Order, Doeren Mayhew, which voluntarily discontinued conducting public audits as of March 19, 2003, undertakes not to accept new public company auditing engagements for six months. In addition, if Doeren Mayhew engages in audits of public companies after the expiration of six months, Doeren Mayhew undertakes to establish and implement certain policies and procedures specifically designed to improve the quality of its public company audit practice for a period of three years. Doeren Mayhew also is censured and required to pay disgorgement and prejudgment interest of $115,126.86.

Pursuant to the Order, Morris, Behrens and Rybicki are denied the privilege of appearing or practicing before the Commission for periods of five years, three years and one year,

respectively, from the entry of the Order. Accordingly, by the entry of this Order, this matter is resolved as to all respondents in this proceeding.

2. **In the Matter of PricewaterhouseCoopers,** Exchange Act Release No. 34-47900 (May 22, 2003). *http://www.sec.gov/news/press/2003-69.htm.*

The Commission issued a settled enforcement action against PricewaterhouseCoopers LLP (PwC) for improper professional conduct in connection with its audit of SmarTalk TeleServices, Inc.'s (SmarTalk) year-end 1997 financial statements. As described in the SEC's order, SmarTalk, a now-bankrupt provider of pre-paid telephone cards and wireless services, filed with the Commission an annual report on Form 10-K, which contained materially false and misleading financial statements. Those financial statements were audited by PwC.

The SEC found that PwC, through Philip Hirsch, formerly with PwC and the engagement partner on the audit, failed to comply with Generally Accepted Auditing Standards (GAAS) in the conduct of its audit. In addition, the SEC found that in late July 1998, after the audit was completed and after Hirsch left the firm, PwC identified potential issues with SmarTalk's 1997 financial statements and its audit and became aware of a class action -shareholder lawsuit alleging accounting fraud against SmarTalk. The SEC found that from the end of July through early August 1998, with the knowledge of several PwC partners with firm-wide responsibility, PwC made revisions to its working papers. The SEC also found that PwC voluntarily produced documents to the staff in February 1999 that included listings of computer files showing that certain working paper files had been accessed in early August 1998, but PwC did not tell the staff until November 1999, that some working papers and other documents relating to PwC's audit report had been revised, created and discarded.

The SEC censured PwC for engaging in "improper professional conduct" within the meaning of Rule 102(e) of the SEC's Rules of Practice by virtue of its failure to adequately audit a $25 million restructuring reserve established by SmarTalk at fiscal year-end 1997 and to adequately audit amounts charged against the restructuring reserve at year-end 1997. PwC, without admitting or denying the SEC's findings, agreed to pay $1 million. It also agreed to significant remedial undertakings, including establishing and maintaining policies and procedures to preserve working papers intact and retaining an independent consultant to, among other things, review PwC's software system to confirm that it is designed to meet the objectives of those policies and procedures.

The SEC found that PwC, through Hirsch in connection with the audit of SmarTalk's 1997 financial statements, engaged in repeated instances of unreasonable conduct, each resulting in a violation of applicable professional standards. The SEC also found that the failures of Hirsch to comply with GAAS in the conduct of the audit bind and are imputed to PwC. Furthermore, the SEC found that it is appropriate to sanction and seek other relief from PwC for the audit failures because PwC made undocumented changes to its 1997 audit working papers and discarded other documents relevant to its audit.

The SEC also instituted a settled administrative proceeding against Hirsch for improper professional conduct under Rule 102(e). Hirsch, without admitting or denying the SEC's

findings, consented to an order denying him the privilege of appearing or practicing before the Commission as an accountant, with the right to apply to resume appearing or practicing before the Commission after one year. Previously, the SEC instituted settled enforcement actions against SmarTalk's CFO Glen Andrew Folck for violating or causing violations of certain antifraud, reporting, and books and records provisions of the federal securities laws. Folck, without admitting or denying the SEC's findings and allegations, consented to a cease and desist order, paid $22,844 in disgorgement and prejudgment interest and also paid a $50,000 civil penalty. See Litigation Release No. 18002 (February 27, 2003).

3. **SEC v. Kenneth Wilchfort and Marc Rabinowitz,** Litigation Release No. 18102 (April 24, 2003). *http://www.sec.gov/litigation/litreleases/lr18102.htm.*

On April 23, 2003, the SEC filed a settled Complaint in the United States District Court for the District of Columbia against two Ernst & Young LLP ("E&Y") partners, Kenneth Wilchfort and Marc Rabinowitz, in connection with audits of Cendant Corporation ("Cendant") and its predecessor, CUC International ("CUC"). The Complaint alleges that the two partners aided and abetted Cendant's and CUC's violations of the reporting provisions of the federal securities laws and seeks a permanent injunction. Without admitting or denying the Commission's allegations, Wilchfort and Rabinowitz consented to the entry of judgments enjoining them from violating the reporting provisions of the federal securities laws. Without admitting or denying the findings in the Commission's Orders, Wilchfort and Rabinowitz also consented to the issuance of administrative orders, based on the injunctions, suspending them from appearing or practicing before the Commission as accountants and providing that they may apply for reinstatement after four years.

The Complaint alleges that Wilchfort and Rabinowitz were E&Y's partners responsible for providing audit and accounting advisory services to Cendant and CUC. The Complaint further alleges that, despite the fact that Cendant and CUC provided them with false documents and otherwise lied to them, Wilchfort and Rabinowitz improperly failed to detect that Cendant's and CUC's financial statements were not presented in conformity with generally accepted accounting principles. The Complaint alleges that Wilchfort and Rabinowitz had a duty to withhold their firm's audit report containing an unqualified opinion and take appropriate steps to prevent these financial statements from being filed with the Commission and circulated to investors. The Complaint also alleges that, by failing to do so, Wilchfort and Rabinowitz aided and abetted Cendant's and CUC's violations of the reporting provisions of the federal securities laws.

The judgments will permanently enjoin Wilchfort and Rabinowitz from, directly or indirectly, aiding and abetting any issuer of a registered security by filing any report required by the federal securities laws that fails to contain information and documents as the Commission requires to keep reasonably current the information and documents required to be included in the report, in violation of the reporting provisions of the federal securities laws.

The Commission previously brought related civil actions and administrative proceedings against nine individuals, as well as against the issuer. *See* Lit. Rel. Nos. 16910 and 16587; Exchange Act Rel. Nos. 42933-6, 43034.

4. **SEC v. KPMG LLP, Joseph T. Boyle, Michael A. Conway, Anthony P. Dolanski and Ronald A. Safran,** Litigation Release No. 17954 (January 29, 2003). *http://www.sec.gov/litigation/litreleases/lr17954.htm.*

The SEC filed a civil fraud injunctive action in the United States District Court for the Southern District of New York against KPMG LLP and four KPMG partners - including the head of the firm's department of professional practice - in connection with KPMG's audits of Xerox Corporation from 1997 through 2000. The complaint charges the firm and four partners with fraud, and seeks injunctions, disgorgement of all fees and civil money penalties.

The complaint alleges that KPMG and its partners permitted Xerox to manipulate its accounting practices to close a $3 billion "gap" between actual operating results and results reported to the investing public. Year after year, the defendants falsely represented to the public that their audits were conducted in accordance with GAAS and that Xerox's financial reports fairly represented the company's financial condition and were prepared in accordance with GAAP.

The four partners named as defendants, all of whom are certified public accountants, are Michael A. Conway, KPMG's Senior Professional Practice Partner, Joseph T. Boyle, the "relationship partner" on the Xerox engagement in 1999 and 2000, Anthony P. Dolanski, the lead engagement partner overseeing Xerox's audits from 1995 through 1997, and Ronald A. Safran was the lead engagement partner on the 1998 and 1999 Xerox audits.

The Commission's complaint alleges that beginning at least as early as 1997, Xerox initiated or increased reliance on various accounting devices to manipulate its equipment revenues and earnings. Most of these "topside accounting devices" violated GAAP and most improperly increased the amount of equipment revenue from leased office equipment products which Xerox recognized in its quarterly and annual financial statements filed with the Commission and distributed to investors and the public. This improper revenue recognition had the effect of inflating equipment revenues and earnings beyond what actual operating results warranted. In addition, the complaint alleges that the defendants fraudulently permitted Xerox to manipulate reserves to boost the company's earnings.

According to the complaint, KPMG affiliate offices in Europe, Brazil, Canada and Japan, as well as KPMG auditors at Xerox's main U.S. operations facility in Rochester, N.Y., repeatedly warned the defendant KPMG partners, who had overall responsibility for the Xerox audit engagement, that manipulative actions taken by Xerox to improve revenues and earnings were unnecessary, were not adequately tested, and distorted true business results. The defendant KPMG partners, who worked near Xerox headquarters in Stamford, Connecticut or at KPMG's New York headquarters, gave little weight to these warnings from on-the-scene KPMG affiliates and did not demand that Xerox justify the reasons for departures from historic accounting methods or establish the accuracy of the new, manipulative practices.

On April 11, 2002, the Commission brought an injunctive action against Xerox based on the same allegations of accounting fraud as are alleged against the KPMG defendants, as well as other allegations. Without admitting or denying the allegations of the complaint, Xerox consented to the entry of a Final Judgment that permanently enjoined the company from violating the antifraud, reporting and record keeping provisions of the federal securities laws. Xerox also paid a $10 million civil penalty, agreed to restate its financial statements and agreed to hire a consultant to review the company's internal accounting controls and policies. *SEC v. Xerox Corporation*, Lit. Rel. No. 17465, AAER No. 1542 (April 11, 2002).

On October 3, 2003, the Commission filed an amended complaint in the civil fraud injunctive action pending in the United States District Court for the Southern District of New York against KPMG LLP and four KPMG partners to include charges of fraud against an additional KPMG partner, Thomas J. Yoho, in connection with KPMG's audits of Xerox Corporation from 1997 through 2000. The SEC seeks injunctions, disgorgement of all fees and civil money penalties against KPMG and the five KPMG partners named as defendants.

Thomas J. Yoho, a certified public accountant, was the Concurring Review partner for KPMG on the Xerox audit from 1994 until after the 2000 audit was completed and KPMG was replaced as Xerox's outside audit firm. Among the responsibilities of the Concurring Review partner are to review key audit workpapers and audit reports and confer with the rest of the engagement team as necessary to give additional assurance that financial statements conform to accounting, reporting and regulatory requirements. The amended complaint alleges that from 1997 to 2001, Yoho learned that Xerox used a series of non-GAAP accounting practices and regularly made significant top-side accounting adjustments in order to compensate for poor operational performance.

III. FOREIGN PAYMENT CASES

1. **SEC v. ABB Ltd,** Litigation Release No. 18775, (July 6, 2004). *http://www.sec.gov/litigation/litreleases/lr18775.htm.*

On July 6, 2004, the Commission filed a settled enforcement action in the United States District Court for the District of Columbia charging ABB Ltd, a global provider of power and automation technologies headquartered in Zurich, Switzerland, with violating the anti-bribery, books-and-records, and internal-accounting-controls provisions of the Foreign Corrupt Practices Act (FCPA). Simultaneously with the filing of the complaint, and without admitting or denying its allegations, ABB consented to the entry of a final judgment enjoining it from future FCPA violations, and requiring it (i) to pay $5.9 million in disgorgement and prejudgment interest, (ii) to pay a $10.5 million penalty, which would be deemed satisfied by two of its affiliates' payments of criminal fines totaling the same amount in parallel criminal proceedings brought by the Department of Justice; and (iii) to retain an independent consultant to review the company's FCPA compliance policies and procedures.

In its complaint, the Commission charged that, from 1998 through early 2003, ABB's U.S. and foreign-based subsidiaries doing business in Nigeria, Angola and Kazakhstan, offered and

made illicit payments totaling over $1.1 million to government officials in these countries. According to the complaint, all of the payments were made to influence acts and decisions by the foreign officials receiving the payments, in order to assist ABB's subsidiaries in obtaining and retaining business. The complaint further alleged that the payments were made with the knowledge and approval of certain management level personnel of the relevant ABB subsidiaries, and that at least $865,726 of the payments were made after ABB became a reporting company in the United States in April 2001. Finally, the complaint charged that ABB improperly recorded these payments in its accounting books and records, and lacked any meaningful internal controls to prevent or detect such illicit payments.

According to the Commission, by making these payments through its subsidiaries, ABB violated the anti-bribery provisions of the FCPA. The Commission further charged that, by improperly recording these payments, ABB violated the books-and-records provisions of the FCPA. Finally, the Commission charged that, by failing to devise or maintain an effective system of internal controls to prevent or detect these violations of the FCPA, ABB violated the internal accounting controls provisions of the FCPA.

In determining to accept ABB's settlement offer, the Commission considered the full cooperation that ABB provided to the Commission staff during its investigation. The Commission also considered the fact that ABB brought this matter to the attention of the Commission's staff and the U.S. Department of Justice. Based in part upon ABB's cooperation, the Commission determined to allow ABB's $10.5 million civil penalty obligation to be deemed satisfied by two of its affiliates' payments of criminal fines totaling $10.5 million in a parallel criminal proceeding brought by the U.S. Department of Justice.

In that parallel proceeding, the U.S. Department of Justice filed criminal FCPA charges against two ABB subsidiaries, who entered guilty pleas before the Honorable Vanessa Gilmore, United States District Judge for the Southern District of Texas: Houston-based ABB Vetco Gray, Inc., and Aberdeen, Scotland-based ABB Vetco Gray UK, Ltd. (United States v. ABB Vetco Gray, Inc. and ABB Vetco Gray UK, Ltd., Case No. 04-CR-279-01 (S.D. Texas)). In particular, ABB Vetco Gray, Inc. and ABB Vetco Gray UK, Ltd. each agreed to plead guilty to two felony counts of violating the anti-bribery provisions of the FCPA and to pay criminal fines that, between them, total $10.5 million.

The Commission acknowledges the assistance of the Department of Justice in its investigation, which is continuing

2. **In the Matter of American Rice, Inc., Joseph A. Schwartz, Jr., Joel R. Malebranche and Allen W. Sturdivant,** Securities Exchange Act of 1934
   Release No. 47286, (January 30, 2003). *http://www.sec.gov/litigation/admin/34-47286.htm.*

From at least January 1998 to August 1999, American Rice employees, at the direction of an American Rice vice president, made numerous bribery payments to Haitian customs officials to illegally reduce American Rice's import taxes.

American Rice was an issuer with a class of securities registered with the Commission pursuant to the registration requirements of the Exchange Act. American Rice processed and

marketed rice in international and domestic markets under a variety of brand names. Malebranche, Schwartz, and Sturdivant were employees of American Rice who were involved in the scheme.

The payments assisted American Rice to obtain or retain its business of selling rice in Haiti at a favorable price in violation of the Foreign Corrupt Practices Act ("FCPA"). Other employees helped carry out the bribery scheme by preparing fake shipping documents. American Rice inaccurately recorded the bribery payments in its consolidated books and records as routine business expenditures. American Rice also failed to devise and maintain an adequate system of internal accounting controls to detect and prevent improper payments to foreign government officials and to provide reasonable assurance that transactions were recorded as necessary to permit the preparation of financial statements in conformity with Generally Accepted Accounting Principles.

The respondents settled with the SEC. The SEC ordered American Rice, Malebranche, Schwartz, and Sturdivant to cease and desist from causing any violation and any future violation of prohibited foreign practice provisions. In addition the SEC ordered American Rice to cease and disease from committing or causing any violation and any future violation of the periodical or reporting provisions under the Exchange Act. Finally, the SEC ordered Schwartz to cease and desist from committing or causing any violation and any future violation of provisions prohibiting the falsification of accounting records.

IV. BROKER-DEALER CASES

1. **SEC v. Deutsche Bank Securities Inc.**, Litigation Release No. 18854 (August 26, 2004). *http://www.sec.gov/litigation/litreleases/lr18854.htm*

The Commission settled charges against Deutsche Bank Securities Inc. (DBS), a brokerage firm and investment bank headquartered in New York, New York, arising from an investigation of research analyst conflicts of interest. This settlement is related to the global settlement that ten other firms reached with the Commission, NASD, Inc., the New York Stock Exchange, Inc. (NYSE), and state securities regulators in April 2003.

The Commission filed a complaint against DBS in the U.S. District Court for the Southern District of New York, alleging violations of the federal securities laws and NASD and NYSE rules. In the SEC action, DBS has agreed to a federal court order that will enjoin the firm from future violations of the federal securities laws and NASD and NYSE rules and requires the firm to make changes in the operations of its equity research and investment banking departments. As part of the settlement, DBS has agreed to pay $25 million as disgorgement and $25 million in penalties for the conflicts of interest. DBS has agreed to pay an additional penalty of $7.5 million for failing to timely produce all e-mail during the investigation. One-half of the $57.5 million total of these payments - $28.75 million - will be paid in connection with the SEC action and related proceedings by the NASD and NYSE and will be placed into a distribution fund for the benefit of customers of the firm. The remainder will be paid to resolve related proceedings by state securities regulators. In addition, DBS will pay, over five years, $25

million to provide the firm's clients with independent research, and $5 million to be used for investor education.

According to the Commission's Complaint, from at least July 1999 through June 2001, DBS research analysts were subject to inappropriate influence by investment banking at the firm. The Complaint also alleged that DBS published exaggerated or unwarranted research or research that lacked a reasonable basis, received payments from other firms to publish research on certain companies without ensuring that such payments were disclosed, and made payments to other firms for those firms to publish research on DBS's underwriting clients. The firm also failed to maintain appropriate supervision over its research operations. Finally, during the investigation, DBS failed to timely produce all e-mail in response to regulatory requests and subpoenas.

DBS has agreed to settle the Commission's action and has consented, without admitting or denying the allegations of the Complaint, to the entry of a final judgment.

2. **Seven Broker-Dealer Firms Settle Enforcement Actions Involving Non-Disclosure of Payments for Research**. Press Release No. 2004-117 (August 25, 2004). *http://www.sec.gov/news/press/2004-117.htm*

On August 25, 2004, the Commission announced settled enforcement actions against seven broker-dealers for failing to disclose they had received payments for providing research coverage of certain public companies. The seven firms are:

- Needham & Company, Inc. (Needham)
- Janney Montgomery Scott LLC (Janney)
- Morgan Keegan & Co., Inc. (Morgan Keegan)
- Prudential Equity Group, LLC f/k/a Prudential Securities, Inc. (Prudential Equity)
- Adams Harkness & Hill, Inc. (Adams Harkness)
- Friedman, Billings, Ramsey & Co., Inc. (Friedman Billings)
- SG Cowen & Co., LLC f/k/a SG Cowen Securities Corporation (SG Cowen)

The Commission found that during the period 1999 through 2002, these firms received payments for research from other broker-dealers that were underwriting securities offerings for certain public, or soon-to-be public, companies. The underwriting broker-dealers paid the firms to issue research or "cover" their issuer clients. None of the firms disclosed in their published research reports the receipt and amount of the payments, as required.

In connection with the settlement, the Commission found that:

- During 1999 through 2001, Needham received four payments ranging from $75,000 to $100,000 for issuing research.
- During 1999 and 2000, Janney received three payments ranging from $23,800 to $50,000 for issuing research.
- During 1999 through 2002, Morgan Keegan received three payments ranging from $49,000 to $200,000 for issuing research.

- During 1999 and 2000, Adams Harkness received three payments ranging from $25,000 to $200,000 for issuing research.
- During 1999 through 2000, Prudential Equity received three payments ranging from $50,000 to $200,000 for issuing research.
- In 2001, Friedman Billings and SG Cowen each received one payment of $100,000 for issuing research.

Without admitting or denying the findings, the seven firms have consented to orders that they cease-and-desist from committing any violations and any future violations.

In addition, the Commission fined four of the firms for violating the record-keeping requirements concerning business-related internal e-mail communications during the period July 1999 through June 2001. Each of the four firms – Adams Harkness, Janney, Morgan Keegan, and Needham – consented, without admitting or denying the findings, to a cease-and desist order. The firms also have consented to undertakings to ensure that they are in compliance with the record-keeping requirements.

Pursuant to the enforcement actions, the seven firms will pay penalties totaling $3,650,000. The following chart details the penalties paid by each firm:

Firm	**Penalty**
Janney	$875,000*
Morgan Keegan	$875,000*
Needham	$700,000*
Adams Harkness	$575,000*
Prudential Equity	$375,000
Friedman Billings	$125,000
SG Cowen	$120,000
I. Total	**$3,650,000**

*Includes a penalty for failing to retain all business-related internal e-mail.

3. **In re Bear Wagner Specialists LLC,** Exchange Act Release No. 34-49498, (March 30, 2004). *http://www.sec.gov/litigation/admin/34-49498.htm*;
In re Fleet Specialists, Inc., Exchange Act Release No. 34-49499, (March 30, 2004). *http://www.sec.gov/litigation/admin/34-49499.htm*;
In re LaBranche & Co. LLC, Exchange Act Release No. 34-49500, (March 30, 2004). *http://www.sec.gov/litigation/admin/34-49500.htm*;
In re Spear, Leeds & Kellogg Specialists LLC, Exchange Act Release No. 34-49501, (March 30, 2004). *http://www.sec.gov/litigation/admin/34-49501.htm*;
In re Van der Moolen Specialists USA, LLC, Exchange Act Release No. 34-49502, (March 30, 2004). *http://www.sec.gov/litigation/admin/34-49502.htm*;
In the Matter of SIG Specialists, Inc., Exchange Act Release, (July 26, 2004). *http://www.sec.gov/news/press/2004-99.htm*;

<u>In the Matter of Performance Specialist Group, LLC,</u> Exchange Act Release, (July 26, 2004). *http://www.sec.gov/news/press/2004-99.htm.*

On March 30, 2004, the SEC and NYSE settled enforcement actions against five NYSE specialist firms: Bear Wagner Specialists LLC; Fleet Specialist, Inc.; LaBranche & Co., LLC; Spear, Leeds & Kellogg Specialists LLC; and Van der Moolen Specialists USA, LLC. The firms agreed to pay a total of $241,823,257 in penalties and disgorgement, consisting of $87,735,635 in civil money penalties and $154,087,622 in disgorgement, and implement steps to improve their compliance procedures and systems.

In a joint investigation, the NYSE and SEC found that, between 1999 and 2003, the five firms, through particular transactions by certain of their registered specialists, violated federal securities laws and Exchange rules by executing orders for their dealer accounts ahead of executable public customer or "agency" orders. Through these transactions, the firms violated their basic obligation to match executable public customer buy and sell orders and not to fill customer orders through trades from the firm's own account when those customer orders could be matched with other customer orders. Through this conduct, the firms improperly profited from trading opportunities; disadvantaged customer orders, which either received inferior prices or went unexecuted altogether; and breached their duty to serve as agents to public customer orders. In the settlements, the firms have neither admitted nor denied the allegations.

The settlement provides that the firms' $241 million payment will go to a Distribution Fund for the benefit of injured customers. This includes the $87,735,635 in civil penalties, which, under the Sarbanes-Oxley Act of 2002, may be distributed to victims in SEC enforcement actions. Without admitting or denying the charges, the firms also will consent to charges that they (a) failed to maintain a fair and orderly market through their improper proprietary trading; (b) violated various NYSE rules; and (c) in certain interpositioning transactions involving six stocks at each firm, failed adequately to supervise certain of their individual specialists, who themselves engaged in fraud through that proprietary trading in violation of Exchange Act.

The NYSE and SEC found that the improper proprietary trading took various forms. Sometimes, certain of the firms' specialists "interpositioned" the firms' dealer accounts between customer orders by trading into both of them in succession - for example, buying into a customer market sell order first, and then selling, at a higher price, into the opposite market buy order, thus allowing the firm dealer account to profit from the spread. The regulators also found that the specialists traded for their dealer accounts ahead of executable agency orders on the same side of the market, orders that were executed later at prices inferior to the prices of dealer account trades. At other times, the specialists traded ahead of executable limit orders, which then went unexecuted and ultimately were cancelled by the customers entering the orders.

The NYSE and SEC found that the interpositioning transactions, in particular, were heavily concentrated in a few stocks overseen by a small number of specialists at each firm. With certain interpositioning transactions in six stocks at each firm, the NYSE and SEC found that certain unnamed individual specialists engaged in fraud by violating their implied representations to public customers that they were limiting dealer transactions to those "reasonably necessary to maintain a fair and orderly market." None of the specialist firms,

according the findings, had in place reasonable systems or procedures to monitor, detect, or prevent those violations.

On July 26, 2004, the SEC and NYSE settled enforcement actions against two NYSE specialist firms: SIG Specialists, Inc. and Performance Specialist Group LLC. The firms will pay a total of $5.2 million in penalties and disgorgement, consisting of $1.7 million in civil money penalties and $3.5 million in disgorgement, and implement steps to improve their compliance procedures and systems. The settlement provides that the firms' $5.2 million payment will go to a Distribution Fund for the benefit of injured customers.

4. **Fifteen Firms to Pay Over $21.5 Million in Penalties to Settle SEC and NASD Breakpoints Charges**, Press Release 2004-17, (February 12, 2004). *http://www.sec.gov/news/press/2004-17.htm.*

The SEC and NASD brought enforcement and disciplinary actions against a total of 15 firms for failure to deliver mutual fund breakpoint discounts during 2001 and 2002. Breakpoint discounts are volume discounts applicable to front-end sales charges on Class A mutual fund shares (front-end loads). The SEC and NASD each brought cases against a group of 7 firms, and The NASD separately brought actions against the other 8 firms. The 15 firms have agreed to compensate customers for the overcharges, pay fines in an amount equal to their projected overcharges that total over $21.5 million, and undertake other corrective measures.

To resolve these actions, each of the 15 firms agreed to review all front-end load mutual fund trades in excess of $2,500 conducted between January 1, 2001 and November 3, 2003; to provide written notification of the firm's problem delivering breakpoint discounts to each customer who purchased front-end load mutual funds from January 1, 1999 through November 3, 2003, and advise these customers that they may be entitled to a refund; to provide refunds where appropriate; and to pay a fine equal to the amount of the firm's projected overcharges.

The names of the firms charged, fines to be paid (equal to projected overcharges to customers), and projected rates of missed breakpoints, are as follows:

Firms settling with the SEC and NASD in separate actions:		
Wachovia Securities, LLC	$4,844,465	28.77%
UBS Financial Services Inc.	$4,621,768	30.03%
American Express Financial Advisors Inc.	$3,706,693	29.70%
Raymond James Financial Services, Inc.	$2,595,129	31.78%
Legg Mason Wood Walker, Inc.	$2,315,467	34.61%
Linsco/Private Ledger Corp.	$2,232,805	35.64%
H.D. Vest Investment Securities, Inc.	$ 725,216	33.39%
Firms settling with NASD only:		
Bear, Stearns & Co. Inc.	$280,469	52.00%

Lehman Brothers Inc.	$123,882	59.96%
Cresap, Inc.	$ 99,458	88.48%
SWS Financial Services	$ 66,468	89.69%
Kirkpatrick, Pettis, Smith, Polian Inc.	$ 39,935	53.56%
Southwest Securities, Inc.	$ 36,971	89.02%
David Lerner Associates, Inc.	$ 32,711	64.88%
Brecek & Young Advisors, Inc.	$ 31,224	53.74%

The SEC orders find that the firms, by failing to disclose to certain customers that they were not receiving the benefit of applicable breakpoint discounts, violated antifraud provisions of the Securities Act of 1933. The NASD made findings that the firms violated the NASD's just and equitable principles of trade rule by failing to give customers the benefit of applicable breakpoint discounts and by failing to disclose to those customers that they were not receiving the benefit of applicable discounts. In addition, the Commission charged six of the seven firms (all but Raymond James Financial Services) with failing to disclose on customer confirmations the remuneration the firms received in connection with the front-end loads, in violation of Exchange Act Provisions. H.D. Vest also resolved charges by the Commission related to unsuitable sales of Class B mutual fund shares. The fine imposed on Cresap, Inc. was reduced to $50,000 based on the firm's demonstrated financial condition.

The NASD and Commission orders further state that broker-dealers that sell mutual fund shares to retail customers must disclose applicable breakpoint discount information to their customers and must have procedures reasonably designed to ascertain information necessary to determine the availability and appropriate level of breakpoints. A failure to do so can result not only in the customer being deprived of a benefit to which he or she is entitled, but also in the broker-dealer and registered representative receiving increased commissions at the customer's expense.

5. **In the Matter of Fidelity Brokerage Services LLC,** Securities Exchange Act of 1934
Release No. 50138, (August 3, 2004). *http://www.sec.gov/litigation/admin/ 34-50138.htm.*

The Commission and the New York Stock Exchange initiated and settled enforcement actions against Fidelity Brokerage Services, LLC as a result of the alteration or destruction of documents in numerous Fidelity Brokerage branch offices. In settlement of these actions, Fidelity Brokerage will pay a total of $2 million, consisting of a $1 million civil penalty imposed by the SEC and a $1 million fine imposed by the NYSE. In addition to these coordinated enforcement actions, the NYSE separately took disciplinary actions in related cases against seven individuals.

In a joint investigation, the SEC and the NYSE found that between January 2001 and July 2002, Fidelity Brokerage violated the broker-dealer record-keeping requirements of the federal securities laws because employees in at least 21 of its 88 branch offices altered or

destroyed the firm's books and records. The violations related to Fidelity Brokerage's annual internal inspections, which were designed to determine whether branch offices were complying with the firm's policies and procedures, NYSE rules, and the federal securities laws. The firm's managers pressured branch office employees to obtain perfect inspections and gave advance notice of when the inspections would occur. Certain Fidelity employees took advantage of the advance notification and improperly prepared for the inspections.

In preparing for these inspections, the employees discovered that some branch office records were incomplete or not completed in accordance with firm policies and procedures. The employees then altered or destroyed the records so that the inspectors would not discover the incomplete records. The records included new account applications, letters of authorization, and variable annuity forms maintained at the branch offices.

These actions were not discrete or isolated. At least 62 employees engaged in some form of this conduct in at least 21 branch offices, primarily in the firm's Western region. The conduct caused Fidelity Brokerage to maintain inaccurate or incomplete books and records in violation of the federal securities laws and NYSE rules.

On August 3, 2004, the SEC instituted an administrative proceeding against Fidelity Brokerage. In addition to finding that Fidelity Brokerage violated the broker-dealer books and records provisions of the Securities Exchange Act of 1934, the SEC also found that Fidelity Brokerage failed reasonably to supervise the employees who altered or destroyed the records. The SEC's order censures Fidelity Brokerage, orders it to cease and desist from violating the above provisions, and orders it to pay a $1 million civil penalty. As part of its settlement, Fidelity Brokerage neither admitted nor denied the SEC's findings. In determining to accept Fidelity Brokerage's settlement offer, the SEC considered remedial acts promptly undertaken and cooperation afforded its staff.

On August 2, the NYSE's hearing panel decision against Fidelity Brokerage became final. The NYSE hearing panel censured Fidelity Brokerage and ordered it to pay a $1 million fine. Fidelity Brokerage neither admitted nor denied the NYSE's findings. In addition to the joint investigation and coordinated enforcement actions involving Fidelity Brokerage, the NYSE separately took disciplinary actions in related cases against seven individuals, including six former registered representatives of the firm (at the firm's Tigard, Oregon branch office) and one former customer service representative (at the Salt Lake City, Utah branch office), namely: Stephanie Arpin-Meier of Yukon, Okla.; Robert Bierman of West Linn, Ore.; Bradley Kemp Fisher of Lake Oswego, Ore.; Robert Larry Lockwood of Tigard, Ore.; Robert Justin McDonald of Portland, Ore.; Tyler Wayne Obray of Cedar Hill, Ore.; and John A. Leonard of Bountiful, Utah, the customer service representative. In addition, NYSE disciplinary proceedings are currently pending with respect to the branch office managers of the Tigard and Salt Lake City branch offices.

The NYSE hearing panel found that during an internal inspection at the Tigard branch in July 2002, the six registered representatives altered records of their member firm employer after the fact, thereby causing their member firm employer to preserve inaccurate books and records. The hearing panel also found that during an internal inspection at the Salt Lake City branch in July 2002, the customer service representative concealed documents from the firm. The NYSE

imposed the following penalties: on Fisher and McDonald, a censure and three-month bar; on Arpin-Meier, Bierman, Obray, and Leonard, a censure and two-month bar; and on Lockwood, a censure and one-month suspension. All seven individuals consented to these penalties without admitting or denying guilt.

6. **<u>In the Matter of Robertson Stephens, Inc.,</u>** Securities Exchange Act of 1934 Release No. 49077, (January 14, 2004). *http://www.sec.gov/litigation/admin/34-49077.htm.*

On January 9, 2004, the Commission issued an Order in this proceeding in which it found that Respondent Robertson Stephens, Inc. ("RSI") willfully violated the broker-dealer antifraud, record keeping and reporting provisions of the securities laws. Pursuant to the Order, on January 14, 2003, RSI paid $5 million to the Commission's Comptroller.

In the Order, the Commission found that RSI and certain senior executives of the firm had formed a series of investment limited partnerships referred to collectively as the "Bayview" partnerships. An entity controlled by RSI was the general partner of each of the limited partnerships. Two of the limited partnerships, Bayview 99 I and II, were formed to invest in a portfolio of companies that was chosen by an investment committee consisting of senior RSI executives. Another limited partnership, Bayview Corvis, also formed in 1999, invested solely in the securities of Corvis Corporation ("Corvis"), a telecommunications and Internet equipment company that, at the time of the Bayview investment, was privately-held.

The Commission's order found that the Research Analyst's statements regarding Corvis during the January 23, 2001 investment committee meeting — that he would not buy Corvis stock at the market price, but would buy it if it was trading at $12 to $14 per share — were inconsistent with the buy rating on Corvis included in the January 16, 2001 research report, which had been issued when Corvis stock was trading at about $23 per share. In addition, the sales of Corvis stock on January 24, 2001 by the two Bayview partnerships, the Research Analyst, and all but one of the senior RSI executives who attended the investment committee meeting, were inconsistent with the Corvis rating included in RSI's January 16, 2001 research report. During this period, RSI did not issue any report that accurately reflected the Research Analyst's actual views regarding the price at which he would recommend that Corvis be bought.

The Commission order also found that RSI's January 26, 2001 research report on Corvis also was materially misleading because the report included a buy recommendation on Corvis that directly contradicted the Research Analyst's statements to the investment committee made only three days earlier.

The Commission order found that RSI willfully violated the antifraud provisions of the securities laws by issuing the materially misleading "buy" ratings on Corvis in research reports published on January 16, 2001 and on January 26, 2001.

On February 23, 2004, after no comments were received in response to the proposed distribution plan for disgorgement, the plan was approved.

7. **<u>SEC v. Daniel Calugar and Security Brokerage, Inc.,</u>** Litigation Release No. 18524, (December 24, 2003). *http://www.sec.gov/litigation/litreleases/lr18524.htm.*

On December 22, 2003, the Commission filed civil fraud charges against Security Brokerage, Inc. of Las Vegas and its president and majority owner, Daniel Calugar, for their participation in a scheme to defraud mutual fund shareholders through improper late trading and market timing. From at least 2001 to 2003, Calugar, trading through Security Brokerage, reaped profits of approximately $175 million from improper late trading and market timing, principally through mutual funds managed by Alliance Capital Management and Massachusetts Financial Services (MFS). Calugar, age 49, is an attorney with residences in Las Vegas and Los Angeles.

Based on the Commission's application, United States District Judge Robert Clive Jones of the District of Nevada issued a temporary restraining order freezing the assets of the defendants, prohibiting the destruction of documents, and granting expedited discovery. The Commission applied for the emergency relief after learning that on December 18, 2003, Calugar had transferred $50 million of proceeds from his scheme out of MFS. This transfer occurred on the same day that the Commission instituted an enforcement action against Alliance in connection with market timing activity. The Commission's action against Alliance identified Calugar as the largest market timer at Alliance.

The Commission's complaint, filed in United States District Court in Las Vegas, alleges as follows:

- Late Trading: Because Security Brokerage was a self-clearing broker-dealer, it was permitted to submit trades that it received from its clients before 4:00 p.m. EST to the National Securities Clearing Corporation (NSCC) after 4:00 p.m. EST. Security Brokerage created false internal records in which the order time for all trades was entered as 3:59 p.m. EST. Calugar, who was trading on his own behalf and therefore making trading decisions, routinely sent trades for his own account to the NSCC one to two hours after 4:00 p.m. EST, even though he had no legitimate reason for doing so.

- Market Timing: From at least 2001 to September 2003, the defendants engaged in extensive market timing of Alliance and MFS funds despite knowing that the prospectuses for those funds either prohibited or discouraged timing and that timing was not available to most investors. With Alliance, Calugar agreed to make long-term investments (referred to as "sticky assets") in Alliance hedge funds in exchange for Alliance permitting him to engage in market timing in its mutual funds. Calugar made a similar proposal to MFS which was not accepted, but he nevertheless continued to engage in market timing in MFS funds.

Security Brokerage and Calugar are charged with violating the antifraud provisions of the federal securities laws. In addition to the emergency relief granted by the court, the Commission is seeking a judgment of permanent injunction, disgorgement of ill-gotten gains, and monetary penalties.

8. **<u>SEC v. Mutuals.com, Inc., Connely Dowd Management, Inc., MTT Fundcorp, Inc., Richard Sapio, Eric McDonald, and Michele Leftwich</u>**, Litigation Release

No. 18489, (December 4, 2003).
http://www.sec.gov/litigation/litreleases/lr18489.htm.

On December 4, 2003, the Commission filed a civil securities fraud action in the United States District Court for the Northern District of Texas, against Mutuals.com, Inc., its CEO, its president, and its compliance officer, as well as two affiliated broker-dealer firms. According to the SEC's complaint, the defendants fraudulently helped institutional brokerage customers and advisory clients to carry out and conceal thousands of market timing trades and illegal late trades in shares of hundreds of mutual funds. The SEC initially detected the alleged misconduct during an examination of the Mutuals.com investment complex in October 2003.

The SEC asked the court to enjoin the defendants from further securities law violations, and also sought civil money penalties and disgorgement of illicit profits plus prejudgment interest. The Commission also sought, and the defendants consented to, the appointment of a Special Monitor to oversee the defendants' business operations, including the management of the Mutuals.com Trust mutual funds (formerly known as 1-800 MUTUALS Advisor Series), pending resolution of the civil litigation.

In its complaint, the SEC alleges that Mutuals.com, CDM and MTT facilitated thousands of market timing trades and late trades. According to the complaint, the only "advisory services" Mutuals.com provided for its clients was advice on how to employ deceptive trading techniques to engage in improper mutual fund trades, as well as assistance in the implementation of those techniques and concealment of the illicit trading.

With respect to the defendants' market timing scheme, the SEC alleges that, between July 2001 and September 2003, hundreds of mutual fund companies and two clearing firms admonished Mutuals.com that its clients' and customers' market timing activity was improper, and, by September 2003, approximately 294 different mutual fund companies had banned or otherwise restricted Mutuals.com from trading in their shares. In response, according to the Commission's complaint, Mutuals.com officials devised and perpetrated a number of deceptive acts and practices to conceal their clients' market timing activities.

With respect to late trading, the SEC's complaint alleges that, at least during 2003, Mutuals.com and its affiliated broker-dealers routinely received trading instructions from customers after 4:00 p.m. EST and executed those trades as if the trading instructions had been received prior to that time. According to the SEC, Mutuals.com and its affiliates attempted to conceal late trading activities by omitting portions of the trading information they were required to provide to clearing agents.

The SEC alleges that, by way of the conduct alleged in the complaint: (i) each of the proposed defendants violated and aided and abetted their customers' and clients' violations of the antifraud provisions; (ii) Mutuals.com, CDM and MTT violated the broker-dealer antifraud provisions of the securities laws; (iii) Sapio, McDonald and Leftwich aided and abetted those violations; and (iv) Mutuals.com, CDM and MTT violated the provision of the Investment Company Act of 1940 which prohibits the purchase or sale of mutual fund shares except at a

price based on the current NAV of such shares that is next calculated after receipt of a buy or sell order.

9. **<u>Ten Top Investment Firms Settle Enforcement Actions Involving Conflicts of Interest Between Research and Investment Banking</u>,** SEC Release No. 2003-54, (April 28, 2003). *http://www.sec.gov/news/press/2003-54.htm.*

On April 28, 2003, the Commission, the Attorney General of New York, the North American Securities Administrators, NASD, the New York Stock Exchange, and state securities regulators announced that enforcement actions against ten of the nation's top investment firms had been completed. These ten firms are: Bear, Stearns & Co. Inc. (Bear Stearns), Credit Suisse First Boston LLC (CSFB), Goldman, Sachs & Co. (Goldman), Lehman Brothers Inc. (Lehman), J.P. Morgan Securities Inc. (J.P. Morgan), Merrill Lynch, Pierce, Fenner & Smith, Incorporated (Merrill Lynch), Morgan Stanley & Co. Incorporated (Morgan Stanley), Citigroup Global Markets Inc. f/k/a Salomon Smith Barney Inc. (SSB), UBS Warburg LLC (UBS), U.S. Bancorp Piper Jaffray Inc. (Piper Jaffray).

Pursuant to the enforcement actions, the ten firms will pay a total of $875 million in penalties and disgorgement, consisting of $387.5 million in disgorgement and $487.5 million in penalties (which includes Merrill Lynch's previous payment of $100 million in connection with its prior settlement with the states relating to research analyst conflicts of interest). Under the settlement agreements, half of the $775 million payment by the firms other than Merrill Lynch will be paid in resolution of actions brought by the SEC, NYSE and NASD, and will be put into a fund to benefit customers of the firms. The remainder of the funds will be paid to the states. In addition, the firms will make payments totaling $432.5 million to fund independent research, and payments of $80 million from seven of the firms will fund and promote investor education. The total of all payments is roughly $1.4 billion.

Under the terms of the settlement, the firms will not seek reimbursement or indemnification for any penalties that they pay. In addition, the firms will not seek a tax deduction or tax credit with regard to any federal, state or local tax for any penalty amounts that they pay under the settlement. The firms are also required to comply with significant requirements that dramatically reform their future practices, including separating the research and investment banking departments at the firms, how research is reviewed and supervised, and making independent research available to investors.

The enforcement actions allege that, from approximately mid-1999 through mid-2001 or later, all of the firms engaged in acts and practices that created or maintained inappropriate influence by investment banking over research analysts, thereby imposing conflicts of interest on research analysts that the firms failed to manage in an adequate or appropriate manner. In addition, the regulators found supervisory deficiencies at every firm.

The enforcement actions allege the following additional charges. CSFB, Merrill Lynch and SSB issued fraudulent research reports in violation of the federal securities law provisions relating to broker-dealer misconduct and fraud as well as various state statutes. Bear Stearns, CSFB, Goldman, Lehman, Merrill Lynch, Piper Jaffray, SSB and UBS Warburg issued research

reports that were not based on principles of fair dealing and good faith and did not provide a sound basis for evaluating facts, contained exaggerated or unwarranted claims about the covered companies, and/or contained opinions for which there were no reasonable bases in violation of NYSE and NASD rules as well as state ethics statutes.

Additionally, UBS Warburg and Piper Jaffray received payments for research without disclosing such payments in violation of the antifraud provisions of the federal securities laws as well as NYSE and NASD rules. Those two firms, as well as Bear Stearns, J.P. Morgan and Morgan Stanley, made undisclosed payments for research in violation of NYSE and NASD rules and state statutes. Furthermore, CSFB and SSB engaged in inappropriate spinning of "hot" Initial Public Offering (IPO) allocations in violation of SRO rules requiring adherence to high business standards and just and equitable principles of trade, and the firms' books and records relating to certain transactions violated the broker-dealer record-keeping provisions of the antifraud provisions of the federal securities laws and NYSE and NASD rules. Under the terms of the settlement, an injunction will be entered against each of the firms, enjoining it from violating the statutes and rules that it is alleged to have violated. The firms neither admitted nor denied the allegations contained in the enforcement actions.

These enforcement actions also reform industry practices regarding the relationship between investment banking and research and will bolster the integrity of equity research. Further, seven of the firms will collectively pay $80 million for investor education. The SEC, NYSE and NASD have authorized that $52.5 million of these funds be put into an Investor Education Fund that will develop and support programs designed to equip investors with the knowledge and skills necessary to make informed decisions. The remaining $27.5 million will be paid to state securities regulators and will be used by them for investor education purposes.

In addition to the other restrictions and requirements imposed by the enforcement actions, the ten firms have collectively entered into a voluntary agreement restricting allocations of securities in hot IPOs – offerings that begin trading in the aftermarket at a premium – to certain company executive officers and directors, a practice known as "spinning." This will promote fairness in the allocation of IPO shares and prevent firms from using these shares to attract investment banking business.

On October 31, 2003, the District Judge for the Southern District of New York approved the $1.4 billion global settlement. Press Release 2003-144, (October 31, 2003). *http://www.sec.gov/news/press/2003-144.htm*.

In April 2003, Jack Grubman, a former managing director of SSB, was censured and permanently barred from the securities industry. The SEC, the New York Attorney General's Office, the NASD and the NYSE ordered him to pay a total of $15 million. The regulators charged that Grubman issued fraudulent, misleading, and otherwise flawed research reports under SSB's name. As a result, Grubman aided and abetted SSB's violations of antifraud provisions of the federal securities laws and violated NASD and NYSE rules as well as New York State law. Grubman neither admitted nor denied these allegations, facts, conclusions, and findings. SEC Press Release No. 2003-55, (April 28, 2003). *http://www.sec.gov/news/press/2003-55.htm*.

Also, in April 2003, Henry Blodget, a former managing director at Merrill Lynch, Pierce, Fenner & Smith, Incorporated and the senior research analyst and group head for the Internet sector at the firm, was censured and permanently barred from the securities industry. He will pay $4 million to settle the charges against him. Litigation Release No. 18115, (April 28, 2003), *http://www.sec.gov/litigation/litreleases/lr18115.htm.*

10. **SEC v. J.P. Morgan Securities, Inc.**, Litigation Release No. 18385, (October 1, 2003). *http://www.sec.gov/litigation/litreleases/lr18385.htm.*

The Commission settled a civil injunctive action in federal court against J.P. Morgan Securities Inc., a subsidiary of J.P. Morgan Chase & Co., relating to the firm's allocation of stock to institutional customers in initial public offerings ("IPOs") it underwrote during 1999 and 2000. The action enjoins J.P. Morgan from violating regulations of the SEC and the NASD and orders it to pay a $25 million civil penalty.

In settlement of this matter, J.P. Morgan has consented, without admitting or denying the allegations of the complaint, to a final judgment that would permanently enjoin J.P. Morgan from violating Rule 101 of the Commission's Regulation M, which prohibits underwriters from directly or indirectly bidding for, purchasing, or attempting to induce any person to bid for or purchase any offered security in the aftermarket during a restricted period prior to the completion of their participation in the distribution of IPO shares.

According to the Commission's complaint, during the restricted period (i.e., prior to J.P. Morgan's completion of participation in the distribution of IPO shares), J.P. Morgan solicited and communicated to certain customers that providing "aftermarket interest" would help them obtain allocations of hot and oversubscribed IPOs. J.P. Morgan attempted to induce certain customers to make aftermarket purchases. The company also told some of these customers that other customers had provided aftermarket interest at higher price levels, encouraging them to increase the prices they were willing to pay. For example, a sales representative told a customer that its aftermarket price limit was "sort of out of the game" and there was "interest at much higher levels."

J.P. Morgan knew that some of these customers usually or always flipped (immediately sold) their IPO allocations. A number of these customers bought in the aftermarket and then sold their allocation or closed out their entire position within days of the IPOs.

J.P. Morgan accepted, and in at least one instance sought, aftermarket interest from certain customers who said they intended to purchase an amount of shares in the aftermarket equal to the size of their IPO allocation ("1 for 1") or intended to purchase specific amounts of shares in the aftermarket that were pegged to different allocation amounts without any reference to a fixed total position size. Some customers who gave this type of aftermarket interest received large allocations even though this aftermarket interest did not provide information as to a customer's desired position size or whether a customer intended to be a long-term holder.

After the restricted period, J.P. Morgan solicited aftermarket orders by making follow-up calls to customers who had previously indicated aftermarket interest. Further, J.P. Morgan often tracked whether customers followed through on their aftermarket interest and actually purchased in the aftermarket. When customers did not follow through, J.P. Morgan encouraged its sales force to place follow-up calls to these customers to solicit orders to purchase stock. In addition, in a number of instances, J.P. Morgan described certain customers' aftermarket interest as promises, obligations and commitments.

J.P. Morgan also violated NASD Conduct Rule 2110 by persuading one or more customers in July 1999 to take shares in a "cold" IPO by promising the reward of an oversubscribed IPO in the future. The settlement enjoins J.P. Morgan from violating NASD Conduct Rule 2110. J.P. Morgan also consents to an order to pay a $25 million civil penalty.

- **Failure to Supervise Cases**

1. **In re SG Cowen Securities Corporation**, Exchange Act Release No. 48335, (August 14, 2003). *http://www.sec.gov/litigation/admin/34-48335.htm*;
In re Lehman Brothers, Inc., Exchange Act Release No. 48336, (August 14, 2003). *http://www.sec.gov/litigation/admin/34-48336.htm.*

On August 14, 2003, the Commission and the New York Stock Exchange filed joint actions against SG Cowen Securities Corporation and Lehman Brothers, Inc. for failing to supervise Frank D. Gruttadauria, a former branch office manager and broker. Beginning in 1987, while employed at a series of broker- dealers, Gruttadauria misappropriated over $115 million from his customers. He stole approximately $47 million of this total during the 27-month period that SG Cowen employed him and $21.5 million during the 15-month period that Lehman Brothers employed him. Gruttadauria also sent his victims falsified account statements that vastly inflated the holdings in their accounts, and diverted the genuine statements for most of these victims. When Gruttadauria surrendered to authorities in February 2002, these statements showed that the accounts of Gruttadauria's victims had a total of over $285 million, when they actually had less than $2 million. Gruttadauria is serving a seven-year jail term.

As part of the joint actions, SG Cowen will pay penalties of $5 million and Lehman Brothers will pay $2.5 million, split equally between the SEC and the NYSE. In connection with the settlement, SG Cowen has also agreed to make immediate payments of out-of-pocket losses suffered prior to the time the accounts were transferred to Lehman Brothers to former customers from whom Gruttadauria stole cash or securities and who have not already been paid through settlements with the firm. Last year, Lehman Brothers voluntarily paid back to customers the net amount that Gruttadauria took from their accounts during the period that Lehman Brothers employed him. Customers also will have an opportunity to pursue claims for additional monies beyond these losses through a special arbitration process to which the firms have agreed as part of the settlements.

In addition to participating in the special arbitration process, SG Cowen will pay up front to former customers from whom Gruttadauria stole funds and who have not already resolved

their claims against the firm the difference between amounts they invested and amounts they withdrew or transferred to Lehman Brothers pursuant to a method set forth in the SEC order and the NYSE decision against SG Cowen.

Without admitting or denying the findings of the SEC and the NYSE, SG Cowen and Lehman Brothers consented to findings that they separately engaged in conduct inconsistent with the NYSE's just and equitable principles of trade by failing to have and implement adequate systems to supervise Gruttadauria and failed to maintain complete and accurate books and records.

Both firms agreed, pursuant to the SEC order and NYSE decision, to a censure based on their failures reasonably to supervise Gruttadauria. Further, both firms agreed, pursuant to the SEC's order, to cease and desist from any further violations of the books and records provisions of the federal securities laws.

The Commission found that both SG Cowen and Lehman Brothers failed to supervise Gruttadauria in numerous ways. As a producing branch manager, Gruttadauria was in a position that SG Cowen and Lehman brothers should have known was not adequately supervised. Gruttadauria also had access to incoming and outgoing correspondence which allowed him to evade the firms' correspondence review procedures when sending falsified account statements to his victims in the firms' envelopes and with the firms' postage markings. In addition, both firms lacked procedures for monitoring Gruttadauria's use of the personal computer system that he used to create falsified account statements and other account documents. They also lacked an adequate system for applying its procedures for detecting and preventing unauthorized third-party transfers.

2. **In re UBS PaineWebber, Inc.**, Exchange Act Release No. 48371, (August 20, 2003). http*://www.sec.gov/litigation/admin/34-48371.htm.*

The Commission instituted administrative proceedings against UBS PaineWebber, Inc. for failing to supervise a former registered representative, Enrique E. Perusquia, who defrauded his clients of tens of millions of dollars. PaineWebber simultaneously consented, without admitting or denying the Commission's findings, to the issuance of a Commission order finding that PaineWebber failed reasonably to supervise Perusquia and imposing a censure and a civil penalty of $500,000.

Perusquia, who was a Senior Vice President and registered representative at PaineWebber from June 1994 to March 1998, engaged in an extended fraud during the entire period of his employment. Perusquia has previously been subject to civil and criminal charges and is currently serving a sentence of 78 months in prison. Perusquia invested large portions of his clients' funds in a small group of highly speculative gold mining firms while he simultaneously received secret payments from the mining companies. In addition, Perusquia misappropriated funds from client accounts and engaged in unauthorized margin trading. Perusquia's clients held their funds at a Swiss bank. As a result of this arrangement, Perusquia's supervisors at PaineWebber did not know who the actual clients were. The subsequent collapse

of the gold mining firms, combined with Perusquia's other misconduct, caused Perusquia's clients to lose tens of millions of dollars.

The Order finds that PaineWebber did not have a procedure to ensure that Perusquia's supervisors knew basic information about the clients whose assets Perusquia was trading, such as their identities, contact information for the clients, their asset bases, their investment objectives or the suitability of the trades placed on their behalf by Perusquia. Nor did the firm establish a procedure to ensure that Perusquia's supervisors received and reviewed account statements or other trading summaries for the clients.

The SEC and the U.S. Attorney's Office for the Northern District of California (USAO) had previously filed three separate actions against Perusquia. In a civil complaint filed by the SEC in the United States District Court for the Northern District of California, the Court entered a default judgment against Perusquia, enjoined him from future violations of the antifraud provisions of the federal securities laws, ordered him to disgorge $3.6 million, imposed $1.6 million in pre-judgment interest and imposed a civil penalty of $3.6 million. In a subsequent administrative proceeding against Perusquia, the Commission barred him from associating with a broker-dealer. And, in a criminal action filed by the USAO, Perusquia pled guilty, was ordered to make restitution of $68 million and was sentenced to 78 months in prison.

3. **In re Spear, Leeds & Kellogg, L.P.**, Securities Exchange Act of 1934 Release No. 48199, (July 21, 2003). http*://www.sec.gov/litigation/admin/34-48199.htm.*

In an administrative proceeding instituted on July 21, 2003, the Commission found that Spear, Leeds & Kellogg failed reasonably to supervise certain employees with a view to preventing them from aiding and abetting a client in unlawful "marking the close" trades on the floor of the New York Stock Exchange in 1999. "Marking the close" refers to the manipulative practice of attempting to influence the closing price of a stock by executing purchase or sale orders at or near the close of the market. During the relevant period, SLK lacked adequate procedures specifically to detect and prevent marking the close.

The Commission found that as of October 15, 1999, client accounts managed by the affiliates of Baron capital, a broker-dealer, owned more than 10% of Southern Union Company's (SUG) outstanding shares. Pursuant to a merger agreement entered into in June 1999, SUG would acquire Pennsylvania Enterprises ("PNT") for a combination of cash and SUG stock to be determined by the average closing price of SUG stock during a ten-day period which began on October 19 and ended on November 1, 1999 (the "pricing period"). The higher the average closing price of SUG, the less cash SUG would pay. If the average closing price of SUG was less than $17.30, PNT had the right to terminate the merger. On the morning of October 18, 1999, SUG stock hit a six-month low of $17.625 per share.

During the merger pricing period, Baron Capital marked the close of SUG by effecting purchases of SUG stock at or near the close of trading in order to raise and maintain the price of SUG stock.

SLK order clerks on the trading floor received the purchase orders from Baron Capital and conveyed the order to SLK floor brokers for execution pursuant to Baron Capital's instructions. Recorded telephone conversations between Baron Capital traders and two SLK order clerks and other evidence indicate that the two SLK order clerks were aware, or were reckless in disregarding, that Baron Capital was entering a series of purchase orders to be executed at the close of the market in order to raise or maintain SUG's stock price, and that the SLK order clerks assisted Baron Capital in marking the close.

SLK executed Baron Capital's purchase orders of SUG stock pursuant to the client's instructions and without regard for executing purchases at the lowest or best price available. Virtually all of the purchases of SUG executed by SLK on behalf of Baron Capital were made at the offer and were executed on a plus or zero plus tick. This should have raised concerns by SLK that Baron Capital was seeking to mark the closing price of SUG stock.

During the relevant period, while SLK had adopted written policies and procedures designed to promote general compliance with regulations governing order execution, SLK lacked adequate procedures to monitor for marking the close. Under SLK's written procedures, the compliance manual required the Floor supervisor to "spot check" order tickets on a periodic basis to ensure that they were complete and to conduct a daily review of the previous day's activity sheets to check client transactions. The Floor supervisor was, in effect, supervising himself with respect to the trades he executed.

Without admitting or denying the Commission's findings, SLK consented to the entry of an Order Instituting Administrative Proceedings, Making Findings, and Imposing Remedial Sanctions. In addition to being censured, SLK agreed to pay a civil money penalty of $225,000 and a fine of $225,000 to the NYSE. SLK also agreed to employ an independent consultant to review and improve SLK's internal controls.

V. <u>MUTUAL FUNDS AND INVESTMENT ADVISERS</u>

1. <u>Three Former Employees of Invesco Funds Group, Inc. Agree to Settle Charges Relating to Market Timing Abuses</u>, Press Release No. 2004-123 (August 31, 2004). *http://www.sec.gov/news/press/2004-123.htm*

On August 31, 2004, the Commission announced settled enforcement actions against Timothy J. Miller, the former chief investment officer and a portfolio manager for Invesco Funds Group, Inc. (IFG); Thomas A. Kolbe, the former national sales manager of IFG; and Michael D. Legoski, a former assistant vice president in IFG's sales department. The Commission issued orders alleging that Miller, Kolbe and Legoski violated federal securities laws by facilitating widespread market timing trading in certain Invesco funds in contravention of those funds' public disclosures.

The Commission ordered Miller, Kolbe and Legoski to pay $1 in disgorgement each, and penalties in the amounts of $150,000, $150,000 and $40,000, respectively. In addition, for their

roles in the misconduct, the Commission prohibited Miller, Kolbe and Legoski from associating with an investment adviser or investment company for a period of one year, and further prohibited Miller and Kolbe from serving as an officer or director of an investment adviser or an investment company for three years and two years, respectively. The Commission also barred Legoski from associating with any broker or dealer for a period of one year.

Among other things, the Commission's Orders make the following factual findings:

- From 2001 through July 2003, IFG permitted select investors to make excessive exchanges and redemptions in select Invesco funds. Under some of the market timing agreements, IFG required that the market timers invest "sticky" assets in other Invesco funds. IFG realized additional advisory fees from the assets under management resulting from the timing agreements. However, in the aggregate, the market timing trades made under the agreements were detrimental to the funds' shareholders. By entering into the market timing agreements, IFG breached its fiduciary duty to the funds it managed.
- During this same time period, the Invesco funds' prospectuses represented that shareholders could make up to four exchanges out of each fund per twelve-month period. The funds reserved the right to modify the exchange policy if such a modification was determined to be in the "best interests" of the fund. Since IFG's market timing agreements provided for more than the disclosed number of exchanges, and since IFG did not make a "best interests" determination before entering into the timing agreements, the agreements contravened the prospectus disclosures.
- In his role as IFG's chief investment officer, Miller was responsible for approving the marking timing agreements. Legoski was responsible for policing the funds to identify market timing activities, and he played a significant role in negotiating the agreements IFG made with approved market timers. Kolbe supervised Legoski's activities and was also personally involved in negotiating a market timing agreement for a related offshore fund complex. All three of these individuals knew, or were reckless in not knowing, that the market timing program they facilitated was unlawful.

The Commission's Orders find that Miller, Kolbe and Legoski aided and abetted IFG's violations of the Investment Advisers Act of 1940, and that Miller caused IFG's violation of the Investment Company Act of 1940. The Orders require each of them to cease and desist from violating or causing future violations of these provisions. Miller, Kolbe and Legoski consented to entry of the Commission's Orders without admitting or denying the findings.

2. **Janus Capital Management Agrees to Pay $100 Million to Settle SEC Fraud Charges for Undisclosed Market Timing Agreements**, Press Release No. 2004-111 (August 18, 2004). *http://www.sec.gov/news/press/2004-111.htm*

On August 18, 2004, the Commission announced a settled enforcement action against Janus Capital Management LLC (JCM), a registered investment adviser based in Denver,

Colorado, for entering into undisclosed market timing agreements with certain investors. The Commission ordered JCM to pay disgorgement of $50 million and civil penalties of $50 million, for a total payment of $100 million. JCM also consented to a cease-and-desist order and a censure, and agreed to undertake certain compliance and mutual-fund governance reforms.

In the Order, the Commission found that:

- JCM negotiated market timing agreements with 12 entities pursuant to which these entities were permitted to market time certain Janus mutual funds. At the same time JCM entered into these agreements, the prospectuses for the funds being timed stated, or at least strongly implied, that JCM did not permit frequent trading or market timing in these funds.
- Some of JCM's market timing agreements were entered into with the understanding that the market timer would make long term investments, so-called "sticky assets," in certain Janus mutual funds. In addition, JCM waived all redemption fees that would have otherwise been assessed against the market timers for their frequent trading activity.
- While the timing activity by the market timers caused dilution to the affected mutual funds, the market timing agreements financially benefited JCM in that JCM realized additional advisory fees from the timed funds and sticky assets under its management. Because of JCM's financial interest in the increased assets under management, JCM had a conflict of interest with the Janus mutual funds subject to the market timing agreements. JCM failed to disclose the conflict of interest to the Board of Trustees and the shareholders of the affected mutual funds, thereby breaching JCM's fiduciary duty to the mutual funds.

JCM consented to the entry of the Commission's Order without admitting or denying the findings.

3. In the Matter of CIHC, Inc., Conseco Services, LLC, and Conseco Equity Sales, Inc., Administrative Proceeding File No. 3-11578 (August 9, 2004).
http://www.sec.gov/litigation/admin/33-8455.pdf
In the Matter of Inviva Inc., and Jefferson National Life Insurance Company, Administrative Proceeding File No. 3-11579 (August 9, 2004).
http://www.sec.gov/litigation/admin/33-8456.pdf

On August 9, 2004, the Commission brought the first enforcement action charging insurance companies with securities fraud for facilitating market timing of mutual funds through the sale of variable annuities. The insurance companies are subsidiaries of Conseco, Inc. (CIHC, Inc., Conseco Services, LLC, and Conseco Equity Sales, Inc.), and the company to which Conseco sold its variable annuity business in 2002, Inviva, Inc., and its subsidiary Jefferson National Life Insurance Company.

The insurance companies have agreed to settlements that include a total payment of $20 million in disgorgement and penalties as well as undertakings of compliance reforms. The

Commission's Orders find that the prospectuses through which the insurance companies sold the variable annuities misleadingly represented, among other things, that the annuities were "not designed for professional market timing organizations." In fact, the insurance companies affirmatively marketed and sold the annuities to professional market timers. Eventually, market timing assets constituted the majority of assets invested in the variable annuity products. The insurance companies profited by the fees earned from the sales of the annuities to the market timers.

The Commission's Orders find:

- Variable annuities are combined securities and insurance products designed primarily for individual retirement and tax purposes. Nevertheless, from late 1999 through October 2002, Conseco Variable Insurance Company (CVIC) (CIHC was the corporate parent of CVIC), Conseco Services, and Conseco Equity Sales, Inc. (CES), sold the Monument and Advantage Plus variable annuity products to hedge funds and other individuals and entities to market time the mutual fund portfolios offered through the variable annuities. Conseco Services employees were aware that these market timers, in contrast to the typical variable annuity customer, had no interest in the tax deferral or retirement features of variable annuities.

- The Monument and Advantage Plus prospectuses stated that these products were "not designed for professional market timing organizations" and indicated that CVIC in its "sole discretion" could restrict exchanges "that we consider disadvantageous" to other annuity contract holders. The prospectuses failed to disclose that CVIC was marketing and selling the products to market timers. In addition, the prospectuses failed to disclose the risk that market timing might have a negative impact on other variable annuity purchasers' investment returns.

- In October 2002, Inviva purchased CVIC and later renamed it Jefferson National. Inviva and Jefferson National continued to allow a group of hedge funds and other select customers to engage in market timing through the Monument and Advantage Plus variable annuity products.

- The Jefferson National prospectuses repeated the above language from the CVIC prospectuses. Further, the Jefferson National prospectus reserved the right to limit any "substantive" transfers that it determined "in its sole discretion, could adversely affect the management of the investment portfolio." However, as at CVIC, Inviva and Jefferson National failed to disclose that Jefferson National was selling the products to market timing customers, and was facilitating the market timers in carrying out a market timing strategy.

- In some cases, mutual fund advisers were aware of and permitted the market timing of the mutual funds. In other cases, Respondents did not inform the underlying fund complexes that Conseco Services and Inviva employees tolerated and actively solicited market timers. Many of these complexes prohibited market timing or did not tolerate timers.

- Ultimately, hedge funds and other market timers invested approximately $120 million in Monument and Advantage Plus variable annuities. In the Monument product, the market timing assets dwarfed the assets of other variable annuity purchasers. Through their frequent trading, the market timers diluted the value of the underlying mutual funds that were timed, and caused the funds to incur additional costs.

The Commission's Orders find that CIHC, Conseco Services, CES, Inviva, and Jefferson National violated the anti fraud provisions of the securities laws and the prohibition against providing false records and reports. The Orders require Conseco Services, CES, Inviva, and Jefferson National to cease and desist from violating these provisions. CIHC, Conseco Services, CES, Inviva, and Jefferson National consented to entry of the respective Orders without admitting or denying the findings.

Under the settlements, CIHC, Conseco Services, and CES have agreed to pay $15 million, including disgorgement of $7.5 million and civil penalties of $7.5 million. Inviva and Jefferson National will pay $5 million, including disgorgement of $3.5 million and a civil penalty of $1.5 million. These amounts will be distributed to shareholders of mutual funds affected by the market timing.

Inviva and Jefferson National will also undertake compliance measures to protect against future violations. These measures include retaining an independent consultant to review compliance procedures designed to prevent and detect market timing.
The Commission acknowledges the assistance of the New York Attorney General in connection with this matter.

4. **In the Matter of Franklin Advisors Inc,** Administrative Proceeding File No. 3-11572 (August 2, 2004). *http://www.sec.gov/litigation/admin/ia-2271.pdf*

On August 2, 2004, Franklin Advisers, Inc., an investment adviser firm in the fourth largest mutual fund complex in the U.S., agreed to pay $50 million dollars and undergo compliance reforms to settle charges that it allowed rapid in-and-out trading, known as market timing, in mutual funds it managed, contrary to fund prospectus language.

Under the settlement, Franklin will pay $50 million, including disgorgement of $30 million and a civil penalty of $20 million. These amounts will be distributed to shareholders of mutual funds affected by the market timing.

Franklin will also undertake compliance measures designed to protect against future violations. These measures include establishing an enhanced compliance oversight and reporting structure and undergoing biannual compliance reviews conducted by an independent third-party.

The Commission's order finds that Franklin engaged in the following misconduct.

- During at least 1996-2001, Franklin entertained requests to conduct market timing under a standard different from that expressed in the prospectuses for the mutual funds it managed. Although the prospectuses contained numerical guidelines regarding the frequency and dollar amounts of timing trades the funds might allow, Franklin actually

decided whether to grant market timing requests based solely on whether its portfolio managers thought the proposed trading would be disruptive to the fund involved. Contrary to what the public would have understood from reading the prospectuses, the prospectus guidelines were irrelevant to Franklin's decisions.

- During 1998-2000, Franklin allowed a representative of a broker-dealer to market time a fund that prohibited investments by market timers.
- Franklin failed to disclose that over 30 identified market timers were allowed to freely market time for several months in 2000, contrary to prospectus language that indicated market timing would be monitored and restricted.
- After other identified timers were told to stop their activities in September 2000, Franklin gave one favored timer permission to continue to time $75 million in assets with unlimited trades for several more months.
- Also after September 2000, Franklin gave a known market timer permission to time a mutual fund that prohibited investments by market timers simultaneously with the timer making a $10 million investment in a new hedge fund.

The Commission's order finds that Franklin violated the antifraud provisions of the Investment Advisers Act of 1940 and the prohibition against providing false reports and records under the Investment Company Act of 1940, and requires Franklin to cease and desist from violating these provisions. Franklin consented to entry of the order without admitting or denying the findings.

Headquartered in San Mateo, California, Franklin is an adviser for many funds in the Franklin Templeton Investments complex, the fourth largest mutual fund complex in the U.S.

5. <u>In the Matter of Banc One Investment Advisors Corporation and Mark A. Beeson,</u>

Administrative Proceeding File No. 3-11530 (June 29, 2004).
http://www.sec.gov/litigation/admin/ia-2254.htm

In June of 2004, the Commission settled an enforcement action against Banc One Investment Advisors Corporation (BOIA), a registered investment adviser based in Columbus, Ohio, and Mark A. Beeson, age 46, of Westerville, Ohio, former President and CEO of One Group Mutual Funds (One Group) and Senior Managing Director of BOIA.

The Commission ordered BOIA to pay disgorgement of $10 million and a civil penalty of $40 million and ordered Beeson to pay a civil penalty of $100,000. BOIA also consented to a cease-and-desist order and a censure, and agreed to undertake certain compliance and mutual-fund governance reforms. In addition, Beeson consented to a two-year bar from the mutual-fund industry and a three-year prohibition on serving as an officer or director of a mutual fund or investment adviser.

The Commission found that BOIA violated, and Beeson aided and abetted and caused violations of, the federal securities laws by: (1) allowing excessive short-term trading in One Group funds by hedge-fund manager Edward J. Stern in the hope of attracting additional business, which created a conflict of interest because the trading increased BOIA's advisory fees but was potentially harmful to One Group funds; (2) failing to charge Stern redemption fees as required by One Group's international-fund prospectuses when other investors were charged the redemption fees; (3) having no written procedures in place to prevent the nonpublic disclosure of One Group portfolio holdings and improperly providing confidential portfolio holdings to Stern when other shareholders were not provided the same information; and (4) causing One Group funds to participate in joint transactions (a BOIA affiliate loaned money to Stern for the purpose of market-timing), raising a conflict of interest. The Commission also found, among other things, that BOIA allowed excessive short-term trading in One Group funds by a Michigan market timer in violation of fund prospectuses and failed to collect required redemption fees from a Texas hedge fund.

The Commission ordered BOIA to pay disgorgement of $10 million and a civil penalty of $40 million and ordered Beeson to pay a civil penalty of $100,000. BOIA also consented to a cease-and-desist order and a censure, and agreed to undertake certain compliance and mutual-fund governance reforms. In addition, Beeson consented to a two-year bar from the mutual-fund industry and a three-year prohibition on serving as an officer or director of a mutual fund or investment adviser.

The Commission's Order further finds that BOIA willfully violated, and Beeson aided and abetted and caused violations of provisions regarding the reporting and prohibited transactions of investment advisors, and the destruction of public records, and requires them to cease and desist from violating these provisions. BOIA and Beeson consented to the entry of the Commission's Order without admitting or denying the findings.

6. **<u>In the Matter of Pilgrim Baxter & Associates, LTD.</u>** Administrative Proceeding File No. 3-11524 (June 21, 2004). *http://www.sec.gov/litigation/admin/ia-2251.htm*

In June of 2004, the Commission settled charges against Pilgrim Baxter & Associates, Ltd. (PBA) in the Commission's pending action in federal district court in Philadelphia.

The Commission's complaint charged that PBA violated the federal securities laws by, among other things, permitting a select group of investors to trade rapidly in and out of the PBHG Funds, reaping profits and diluting the value of the funds to the detriment of long-term investors.

The settlement involves the dismissal of the district court action as to PBA and the entry of a Commission Order instituting settled administrative and cease-and-desist proceedings. Based on the findings in that Order, the Commission ordered PBA to pay $90 million — $ 40 million in disgorgement and $50 million in civil penalties. PBA also consented to a censure and an order to cease and desist, and further agreed to undertake a series of compliance and mutual fund governance reforms. The pending district court action will continue against individual defendants Harold J. Baxter and Gary L. Pilgrim.

The Commission's Order finds, among other things:

- From at least June 1998 through December 2001, PBA permitted a select group of investors to trade rapidly in and out of certain PBHG funds, reaping profits and diluting the value of the funds to the detriment of long-term investors that the funds purported to cultivate. PBA earned advisory fees on these timers' funds.
- Beginning in at least 1996, PBHG Funds prospectuses disclosed that investors would be permitted to make no more than four exchanges per year into the PBHG Cash Reserves Fund from any other PBHG fund. The prospectuses did not disclose any exception to this policy for any investor or investors.
- From 1998 through mid-2001, more than two-dozen PBHG Funds accountholders conducted short-term trading of the PBHG Funds through the PBHG Cash Reserve Fund that was far in excess of the disclosed limitation of four exchanges per year.
- The detrimental timing permitted by PBA was exacerbated by the self-dealing of its principals and founders, Gary L. Pilgrim and Harold J. Baxter. PBA permitted a hedge fund in which Pilgrim invested to engage in rapid trading of the PBHG Growth Fund, which Pilgrim himself managed. Moreover, PBA provided 30-day stale PBHG portfolio holdings information to the customers of a New York brokerage firm headed by a personal friend of Baxter. These customers, in turn, used this information to facilitate market timing of the PBHG Funds and to exercise hedging strategies through other financial and brokerage institutions.

The Commission's Order finds that PBA willfully violated the misuse of public information provision, and the prohibited transactions provision, and the falsification of records and reports provision. PBA consented to the entry of the Commission's Order without admitting or denying the findings.

7. <u>In the Matter of Strong Capital Management, Inc., Strong Investor Services, Inc., Strong Investments, Inc., Richard S. Strong, Thomas A. Hooker, Jr. and Anthony J. D'Amato.</u> Administrative Proceeding No. 3-11498 (May 20, 2004). *http://www.sec.gov/litigation/admin/34-49741.htm*

During May of 2004, the Commission settled an enforcement action against Strong Capital Management, Inc. (SCM), its founder and majority owner, Richard S. Strong, two affiliated entities and two other SCM executives, for allowing and, in the case of Strong, engaging in undisclosed frequent trading in Strong mutual funds in violation of their fiduciary duties to the Strong funds and their investors. The settled order requires the payment of more that $140 million in monetary remedies, and imposes regulated industry bars and other relief

The Commission's Order finds, among other things:

- SCM entered into an express agreement with hedge fund manager Edward Stern allowing his hedge funds (the Canary hedge funds) to market time certain Strong funds, in order to obtain non-mutual fund business from Stern and his family. <u>The agreement enabled the</u>

Canary hedge funds to make approximately 135 round trip trades in four Strong funds, realizing gross profits of $2.7 million from December 2002 to May 2003. Under SCM's policies and procedures, other shareholders would have been ejected from the Strong funds for engaging in similar trading.

- Richard Strong engaged in frequent trading in several Strong funds, including one fund he managed. Between 1998 and 2003, he engaged in several hundred such trades, making gross profits of $4.1 million and net profits of $1.6 million.
- SCM failed to disclose the arrangement with Stern, and Strong and SCM failed to disclose Strong's personal trading, to the Strong funds' Boards of Directors or shareholders. In fact, the Strong funds' prospectuses and SCM's policies and practices created the misleading impression that frequent trading of the kind practiced by Strong and the Canary hedge funds would not be allowed.
- SCM provided the Canary hedge funds with the month-end portfolio holdings for the funds in which Canary traded before other shareholders could see the same information, to the possible detriment of the funds and their shareholders.
- SCM's affiliated transfer agent, Strong Investor Services, Inc. (SIS), and its affiliated broker-dealer, Strong Investments, Inc. (SII), facilitated SCM's violations by allowing the Canary hedge funds' frequent trading.
- Anthony J. D'Amato, SCM's Executive Vice President and a resident of Elm Grove, Wis., aided and abetted SCM's violations by approving the arrangement with the Canary hedge funds.
- Thomas A. Hooker, SCM's Compliance Officer, aided and abetted SCM's and Strong's violations by failing, after he learned of Strong's frequent trading, to follow up on a directive to monitor the trading and ensure it stopped.

Based on these findings, the Commission ordered (1) SCM to pay $40 million in disgorgement and $40 million in civil penalties; (2) Strong to pay $30 million in disgorgement and $30 million in civil penalties; (3) D'Amato to pay $375,000 in disgorgement and $375,000 in civil penalties; and (4) Hooker to pay a $50,000 civil penalty.

In addition, the Commission (1) barred Strong from association with any investment adviser, investment company, broker, dealer, municipal securities dealer or transfer agent; (2) barred D'Amato from association with any investment adviser, investment company, broker or dealer; and (3) barred Hooker from association with any investment adviser or investment company. SCM, SII and SIS consented to censures and undertook compliance and mutual fund governance reforms. All parties consented to cease-and-desist orders.

The Commission's Order finds that SCM and Strong engaged in prohibited transactions under the Investment Advisers Act; D’Amoto and SCM violated this misuse of nonpublic information provision and a provision against making false statements; D'Amato, SII, Hooker, and SIS aided and abetted violations of the prohibited transactions provision. SCM, Strong, SII,

SIS, D'Amato and Hooker consented to entry of the Commission's Order without admitting or denying the findings.

8. **SEC v. PIMCO Advisors Fund Management LLC, PIMCO Advisors Fund Management LLC, PEA Capital LLC f/k/a/ PIMCO Equity Advisors LLC, PIMCO Advisors Distributors LLC, Stephen J. Treadway, and Kenneth W. Corba.** Litigation Release No. 18697 (May 6, 2004). *http://www.sec.gov/litigation/litreleases/lr18697.htm*

   PIMCO Equity Mutual Funds' Adviser, Sub-Adviser, and Distributor to Pay $50 Million to Settle Fraud Charges for Undisclosed Market Timing, Press Release No. 2004-127 (September 13, 2004). *http://www.sec.gov/news/press/2004-127.htm*

During May of 2004, the Commission filed civil fraud charges in federal court against PIMCO Advisors Fund Management LLC (PAFM), PEA Capital LLC (PEA), PIMCO Advisors Distributors LLC (PAD), Stephen J. Treadway, the chief executive officer of PAFM and PAD as well as the chairman of the board of trustees for the PIMCO Funds: Multi-Manager Series, and Kenneth W. Corba, PEA's former CEO, for their defrauding of PIMCO mutual fund investors, in connection with an undisclosed market timing arrangement with Canary Capital Partners LLC. From February 2002 to April 2003, Canary engaged in approximately 108 round-trip exchanges in an aggregate amount of over $4 billion in several PIMCO Funds pursuant to its special market timing arrangement.

PAFM is an investment adviser for the PIMCO Funds: Multi-Manager Series, PEA is the investment sub-adviser for several of the PIMCO Funds, and PAD is a broker-dealer that serves as the distributor for the PIMCO Funds.

The SEC's complaint, filed in United States District Court in Manhattan, alleges as follows.

- From February 2002 to April 2003, the PIMCO Funds' advisers provided "timing capacity" in their mutual funds to Canary in return for long-term investments (referred to as "sticky assets") in a mutual fund and a hedge fund from which PAFM and PEA earned management fees. The prospectuses for the mutual funds failed to disclose to investors that an agreement had been made to permit timing in the funds in exchange for sticky assets. In addition, the prospectuses also gave the misleading impression that the PIMCO mutual funds discouraged timing.

- At the height of the agreement, Canary used over $60 million in timing capacity in several different mutual funds and invested $27 million in sticky assets into a mutual fund and a hedge fund. Even as it allowed Canary to engage in this market timing activity, the distributor of the PIMCO Funds, PAD, simultaneously prevented numerous other shareholders from engaging in the same rapid trading as Canary by issuing warning letters, freezing accounts, or blocking trades. Finally, PEA disclosed nonpublic portfolio holdings to the broker-dealer that executed Canary's trades.

- Stephen J. Treadway, age 56, of New York, N.Y., the CEO of PAFM and PAD as well as the chairman of the board of trustees for the PIMCO Funds: Multi-Manager Series,

approved the market timing arrangement in approximately January 2002 but did not disclose his knowledge of the arrangement to the board of trustees until approximately September 2003.

- Kenneth W. Corba, age 51, of Greenwich, Conn., the former CEO of PEA, negotiated and approved the timing and sticky asset arrangement with Canary. He was the portfolio manager for the PIMCO Growth Fund, which provided Canary with $30 million in market timing capacity, and for the PIMCO Select Growth Fund, which received $25 million in sticky assets from Canary.

PAFM, PEA, PAD, Treadway, and Corba are charged with violating, or aiding and abetting violations of, the antifraud provisions of the federal securities laws. PAFM, PEA, Treadway, and Corba are further charged with violations of the Investment Company Act of 1940's provision against making false and misleading portfolio disclosures. PAFM, PEA, and PAD are also charged with participating in joint transactions raising a conflict of interest. Finally, PAFM and PEA are charged with violations of the Advisers Act for failing to have written policies to prevent the disclosure of nonpublic portfolio holdings to Canary's brokers and others.

The SEC sought injunctive relief, disgorgement, monetary penalties, and an order pursuant to Section 36(a) of the Investment Company Act preventing the defendants from serving as investment advisers, principal underwriters, officers, directors, or members of any advisory boards to any registered investment company.

Subsequently, on September 13, 2004, the Commission announced that PAFM, PEA, and PAD (collectively, the PIMCO Entities) agreed to a settlement of charges that they defrauded investors in the PIMCO Funds: Multi-Manager Series in connection with an undisclosed market timing arrangement. Under the settlement, the PIMCO Entities have been ordered to pay $50 million, consisting of $10 million in disgorgement and a civil penalty of $40 million. Without admitting or denying the Commission's findings, the PIMCO Entities also consented to cease-and-desist orders, censures, and to undertake certain compliance and mutual fund governance reforms.

The Commission's litigation in federal court continues against Stephen J. Treadway, the former chairman of the board of trustees of the PIMCO Funds and former CEO of PAFM and PAD, and Kenneth W. Corba, the former CEO of PEA.

9. In the Matter of Putnam Investment Management, LLC. Administrative Proceeding File No. 3-11317 (April 8, 2004). *http://www.sec.gov/litigation/admin/ia-2226.htm*

In April 2004, the Commission settled an enforcement action against Putnam Investment Management LLC (Putnam), pursuant to which the Commission ordered Putnam to pay a $50 million civil penalty and $5 million in disgorgement for violating federal securities laws by failing to disclose improper market timing trading by Putnam portfolio managers. All of the money obtained by the Commission will be distributed to investors harmed by the market timing trading.

The current Order supplements a Commission Order entered on Nov. 13, 2003 (November 13 Order), pursuant to which Putnam agreed to undertake significant and far-reaching corporate governance, compliance, and ethics reforms. In the November 13 Order, the Commission found that, beginning as early as 1998, at least six Putnam investment management professionals engaged in excessive short-term trading of Putnam mutual funds in their personal accounts. Four of those employees engaged in such trading in funds over which they had investment decision-making responsibility. The November 13 Order further found that although Putnam became aware in 2000 that several investment management employees were engaging in potentially self-dealing short-term trading of mutual fund shares, Putnam failed to disclose this potentially self-dealing securities trading to the boards of the mutual funds it managed and the funds' shareholders. The November 13 Order censured Putnam and ordered it to cease and desist from violations of the antifraud provisions of the Investment Advisers Act of 1940 and other provisions of the federal securities laws. The November 13 Order left open the amount of civil penalty and other monetary relief Putnam would be required to pay.

The Commission's Order calls for the appointment of an Independent Distribution Consultant who is charged with developing a plan for distributing the $55 million in disgorgement and penalties to harmed investors. The $55 million will be distributed to investors in order of priority: first, as compensation to investors for losses attributable to excessive short-term trading and market timing trading activity by Putnam employees and, second, as compensation for advisory fees paid by mutual fund clients who suffered such losses.

The Commission's previously filed civil injunctive action charging two Putnam employees, portfolio managers Justin M. Scott and Omid Kamshad, with securities fraud for engaging in excessive short-term trading of Putnam funds in their personal accounts, is pending.

The Securities Division for the Commonwealth of Massachusetts have also settled related charges against Putnam calling for the payment of an additional $55 million.

The Commission's investigation is continuing.

10. **In the Matter of Massachusetts Financial Services Company.** Administrative Proceeding File No. 3-11450 (March 31, 2004). *http://www.sec.gov/litigation/admin/ia-2224.htm*

The Commission has settled an enforcement action against Massachusetts Financial Services Company (MFS) related to the company's use of mutual fund assets - namely, brokerage commissions on mutual fund transactions - to pay for the marketing and distribution of mutual funds in the MFS Fund Complex (MFS Funds). The Commission issued an order that found MFS failed to adequately disclose to the Boards of Trustees and to shareholders of the MFS Funds the specifics of its "shelf-space" arrangements with brokerage firms and the conflicts created by those arrangements. As part of the settlement, MFS agreed to a series of compliance reforms and to pay a penalty of $50 million, which will be distributed to the MFS Funds.

The Commission's charges stem from an ongoing industry-wide investigation of mutual fund sales practices begun by the SEC in the Spring of 2003. That investigation previously led to a $50 million settlement with Morgan Stanley DW Inc. in November for that firm's failure to adequately disclose to its customers its receipt of such shelf-space payments from mutual funds.

The Commission found that from at least Jan. 1, 2000, through Nov. 7, 2003, MFS negotiated bilateral arrangements, known as "Strategic Alliances," with approximately 100 broker-dealers. Under these arrangements, MFS directed brokerage commissions on fund portfolio transactions to the brokerage firms in exchange for heightened visibility within the brokerage firms' distribution networks.

Based upon negotiated formulas, MFS paid brokerage firms anywhere from 15 to 25 basis points (bps) on mutual fund gross sales and/or 3 to 20 bps on assets held over one year. MFS satisfied the Strategic Alliances in two ways: by paying cash, or "hard dollars," and by directing brokerage commissions. When MFS satisfied the Strategic Alliances with brokerage commissions, it paid 1.5 times (or some other negotiated multiple) the amount it would have paid in hard dollars. MFS did not adequately disclose to the funds' Boards and shareholders the quid pro quo nature of these arrangements and the attendant conflicts of interest they created.

MFS agreed to settle this matter, without admitting or denying the Commission's findings. The Commission's Order censures MFS and orders it to cease-and-desist from providing false reports and records and from engaging in prohibited transactions.

MFS has permanently discontinued its use of fund brokerage commissions to pay for the Strategic Alliances. MFS has also undertaken to direct an independent consultant to conduct a review of, and to provide recommendations concerning, MFS's policies and procedures with respect to its Strategic Alliances including its disclosures to the Boards and shareholders, and to adopt the recommendations of the independent consultant. Finally, MFS will make a nominal disgorgement payment and will pay $50 million in civil penalties.

Pursuant to the Fair Funds provision of the Sarbanes-Oxley Act of 2002, MFS will distribute the penalty to the MFS Funds in accordance with a distribution plan approved by the Commission.

11. In the Matter of Massachusetts Financial Services Co., John W. Ballen, and Kevin R. Parke, Investment Advisers Act of 1940 Release No. 2213 (Feb. 5, 2004). *http://www.sec.gov/litigation/admin/ia-2213.htm*

The Commission settled an enforcement action against Massachusetts Financial Services Co. (MFS), its chief executive officer John W. Ballen, and its president and chief equity officer Kevin R. Parke, for violating federal securities laws by allowing widespread market timing trading in certain MFS mutual funds in contravention of those funds' public disclosures.

The Commission censured MFS and ordered it to pay $225 million, consisting of $175 million in disgorgement and $50 million in penalties. The Commission's Order further requires MFS to undertake certain compliance and mutual fund governance reforms designed to enhance the independence of mutual fund boards of trustees and strengthen oversight of MFS's compliance with the federal securities laws.

For their roles in the misconduct, the Commission prohibited MFS CEO Ballen and president Parke from serving as an officer or director of any investment adviser and from serving as an employee, officer, or trustee of any registered investment company for three years. In addition, the Commission's order places certain restrictions on the duties Ballen and Parke can

perform during that period. The Commission also suspended Ballen and Parke from association with any investment adviser or registered investment company for nine months and six months, respectively, and ordered each to pay a penalty of $250,000 and disgorge over $50,000 in ill-gotten gains derived from MFS's market timing practices. All of the money paid by MFS, Ballen, and Parke will be distributed to harmed shareholders.

According to the Commission Order, beginning in late 1999, MFS began including disclosures in its retail mutual fund prospectuses that prohibited market timing trading in those funds. Contrary to those disclosures, MFS internally categorized certain of its retail funds as "Unrestricted Funds" with respect to market timing, and knowingly permitted widespread market timing in these funds. Ballen and Parke implemented MFS's undisclosed policy permitting market timing trading in its Unrestricted Funds during the same period that they signed registration statements for these funds that stated they prohibited market timing.

The Commission's Order finds that MFS, Ballen, and Parke engaged in prohibited transactions, provided false documents and records, and requires them to cease and desist from violating these provisions. MFS, Ballen, and Parke consented to entry of the Commission's Order without admitting or denying the findings.

12. In the Matter of Paul A. Flynn, Administrative Proceeding File No. 3-11390 (Feb. 3, 2004). *http://www.sec.gov/litigation/admin/33-8360.htm.*

The Commission instituted enforcement proceedings against Paul A. Flynn, a former managing director of Canadian Imperial Bank of Commerce (CIBC), for his role in providing financing to hedge funds he knew were engaged in unlawful market timing and late trading of mutual funds.

The Division of Enforcement alleges that from 2001 to 2003, Flynn arranged for certain hedge fund clients, including Canary Capital Partners, LLC, to receive financing from a CIBC subsidiary. Flynn negotiated and structured swaps and loan agreements that provided these hedge fund clients with leverage to trade in mutual fund shares. The Division alleges that this conduct was fraudulent because Flynn was aware that these hedge fund clients were engaged in unlawful mutual fund trading through an electronic trading platform operated by Security Trust Company, N.A. (STC). The Division alleges, Flynn was aware that by trading through STC, the hedge funds, and others were able to engage in late trading and to use deceptive means to evade the mutual funds' efforts to detect and prevent market timing.

The specific charges against Flynn are that he willfully aided and abetted and caused violations of the anti fraud provisions under the 1933 and 1934 acts. The Division is seeking civil penalties, disgorgement and other relief, which may include permanently barring Flynn from the securities industry.

13. In the Matter of Alliance Capital Management, L.P., Administrative Proceeding File No.3-11359 (December 18, 2003). *http://www.sec.gov/litigation/admin/ia-2205.htm*

On December 18, 2003, the Commission settled an enforcement action against Alliance Capital Management L.P. (Alliance Capital) for defrauding mutual fund investors by allowing

market timing in certain of its mutual funds in exchange for fee-generating investments in other Alliance Capital investment vehicles.

The Commission ordered Alliance Capital to pay $250 million, consisting of $150 million in disgorgement and $100 million in penalties. All of the money will be distributed to the shareholders harmed by Alliance Capital's market timing arrangements. The Commission also ordered Alliance Capital to undertake certain compliance and fund governance reforms designed to prevent a recurrence of the kind of conduct described in the Commission's Order. The reforms will enhance the independence of the mutual funds' boards and strengthen oversight of Alliance Capital's compliance with the federal securities laws.

The Commission's Order finds that Alliance Capital entered into arrangements permitting market timing (short-term trading to exploit pricing inefficiencies), in certain of its mutual funds. In exchange, Alliance Capital solicited from these market timers long-term investments, so-called "sticky assets" or "legit assets," in its hedge funds and mutual funds. By virtue of these arrangements, Alliance Capital reaped additional management fees, but exposed its mutual funds to what it recognized as potential adverse effects of market timers. Alliance Capital breached its fiduciary duty to those funds and misled those who invested in them.

The Commission's Order finds that Alliance Capital violated provisions prohibiting the misuse of nonpublic information, engaging in prohibited transactions, providing false records and documents, and the misuse of a proxy. The Order also requires Alliance Capital to cease and desist from further violating these provisions. Alliance Capital consented to entry of the Commission's Order without admitting or denying the findings.

In accepting the settlement, the Commission considered Alliance Capital's cooperation in this investigation, including reporting its discovery of possible misconduct to the Commission promptly, conducting a thorough and independent internal investigation, sharing the results of that investigation with the staff, obtaining the resignations of certain supervisory personnel and others, and implementing certain remedial actions.

14. **In the Matter of Robert T. Littell and Wilfred Meckel,** Investment Advisers Act of 1940 Release No. 2203 (December 15, 2003), *http://www.sec.gov/litigation/admin/ia-2203.htm*

On December 15, 2003, the Commission brought the first "failure to supervise" enforcement action against the principal of an unregistered investment adviser to a hedge fund. Previous failure to supervise actions against investment advisers had been brought only against registered advisers. In the same action, the Commission charged the adviser's director of investments with fraud.

The Commission charged Wilfred Meckel, principal, and Robert T. Littell, director of investments, of Marque Millennium Group, Inc. (MMG), an unregistered investment adviser to three hedge funds called Marque Partners I (MPI), Marque Partners II and Marque Fund II Limited. The Commission charged Littell with defrauding investors in the hedge funds and Meckel with failing reasonably to supervise Littell with a view to preventing violations of the federal securities laws while Littell was subject to his supervision. Littell and Meckel each settled the actions without admitting or denying the Commission's findings.

The Commission's administrative order makes the following findings. From December 1998 through March 2000, MMG, through Littell, defrauded hedge fund investors and potential investors by: (1) communicating materially inaccurate performance information; (2) misrepresenting the hedge funds' management structure, retention of an accountant and auditor, and risk management techniques; and (3) improperly redeeming the full amount of investments by two large investors at a time when the hedge funds had incurred substantial undisclosed losses. Littell also concealed and attempted to conceal the hedge funds' losses from investors and from Meckel.

The Commission's order also finds that Meckel failed to take reasonable supervisory actions, which could include maintaining accurate records of investments into and distributions from the hedge funds, review of daily trading activity, valuation of the hedge funds' positions, and separation of the hedge funds' trading and back office functions. Instead, Meckel relied on Littell's reporting and did not independently verify the performance information and other representations made by Littell. This delayed Meckel's discovery of Littell's misconduct and enabled Littell to continue his fraudulent activities.

The Commission barred Littell from association with any investment adviser and ordered him to cease and desist from violating the antifraud provisions of the Securities Act of 1933 or the Securities Exchange Act of 1934, and from engaging in any prohibited transactions under the Investment Advisers Act of 1940, and ordered him to pay a civil money penalty of $15,000. The Commission suspended Meckel from association in any supervisory capacity with any investment adviser for a period of six months and censured him. In determining appropriate sanctions, the Commission considered a financial statement submitted by Littell as well as remedial acts (including Meckel's payment of approximately $600,000 to reimburse Hedge Fund investors for losses) promptly undertaken by Meckel and the cooperation he afforded the Commission staff.

15. **In the Matter of Jon D. Hammes, Albert Gary Shilling, Allan H. Stefl, and Linda F. Stephenson**, Securities Act of 1933 Release No. 8346 (December 11, 2003). *http://www.sec.gov/litigation/admin/33-8346.htm;* **In the Matter of FT Interactive Data, f/k/a Interactive Data Corporation,** Investment Advisers Act of 1940 Release No. 2201 (December 11, 2003). *http://www.sec.gov/litigation/admin/ia-2201.htm;*

    SEC v. Heartland Advisors et al., Litigation Release No. 18505 (December 12, 2003). *http://www.sec.gov/litigation/litreleases/lr18505.htm*

On December 11, 2003, the Commission filed civil fraud charges against Heartland Advisors, Inc., its CEO, two portfolio managers, four officers, five directors, a pricing service and one individual for misrepresentations, mispricing and insider trading in two Heartland Group high yield bond funds.

The SEC charged the following entities and individuals: Heartland Adivsors, Inc.; William Nasgovitz, its President and CEO; Paul Beste, its COO; Jilaine Bauer, its General Counsel; Kevin Clark, its Senior Vice President of Trading; Kenneth Della, its Treasurer; Thomas Conlin and Greg Winston, former portfolio managers; Hugh Denison, an associated Director; John Hammes, Dr. Gary Shilling, Allen Stefl, and Linda Stephenson, all Independent

Directors; FT Interactive Data Corp., an independent pricing service, and Raymond Krueger, a friend and client of Nasgovitz.

Heartland Advisors (Heartland), a Milwaukee investment adviser, manages the Heartland Group complex of mutual funds. The Commission's actions alleged violations in three primary areas -- fund pricing, insider trading, and disclosure -- and relate to two high-yield municipal bond funds managed by Heartland (the Funds). The value of the Funds, and a smaller related fund, dropped by approximately $93 million between Sept. 28 and Oct. 13, 2000, when Heartland sought to correct months of deliberate mispricing.

In its complaint, the Commission charged Heartland, Nasgovitz, Beste, Bauer, Clark, Conlin, and Della with fraudulently pricing bonds in the Funds. The Commission further alleged that the Funds' directors caused certain of Heartlands' pricing violations when they failed to adequately follow up and resolve concerns about pricing issues that came to their attention. The Commission charged FT Interactive with aiding and abetting and causing certain Heartland pricing violations.

The Commission also charged that Nasgovitz, Bauer, Winston, Della and Krueger engaged in insider trading in the shares of the Funds when they sold their shares, and/or tipped others to do so, while aware that the Funds had liquidity and pricing problems.

In the disclosure area, the Commission charged that Heartland, through Nasgovitz, Beste, Bauer, Clark, Conlin and Winston, misrepresented and omitted material facts in the offer and sale of shares in the Funds. The misrepresentations and omissions related to the risks of investing in the Funds, the credit research on the bonds purchased and held by the Funds, the credit quality of the bonds held in the Funds and the liquidity of the Funds.

In the federal district court action, Heartland, Nasgovitz, Beste, Bauer, Clark, Conlin, Winston and Della are charged with violating or aiding and abetting violations of the antifraud provisions of the Securities Act of 1933, the Securities Exchange Act of 1934, the Investment Advisers Act of 1940 and the Investment Company Act of 1940. They are also charged with breaching their fiduciary duties under the Investment Company Act, and all but Della are charged with misrepresentations or omissions in certain records required under the Investment Company Act. Denison is charged with violations of the antifraud provisions of the Securities Act and for breaching his fiduciary duties under the Investment Company Act for failing to adequately monitor the liquidity of the Funds and to take adequate steps to address the Funds' pricing deficiencies. The Commission is seeking permanent injunctions against these defendants as well as disgorgement, pre-judgment interest and civil penalties.

In separate administrative proceedings, FT Interactive consented to the issuance of an order by the Commission finding that it caused and willfully aided and abetted Heartland Advisors' violations of the antifraud provisions of the Investment Advisers Act and the fund pricing provision of the Investment Company Act. In that order, the Commission also censured FT Interactive, ordered it to cease and desist from committing or causing the above violations, ordered it to pay a $125,000 civil penalty and ordered it to comply with certain undertakings

regarding the pricing of securities for which market quotations are not readily available. FT Interactive neither admitted nor denied the Commission's findings.

In another administrative proceeding, the Commission issued an order, also by consent, requiring Hammes, Shilling, Stefl and Stephenson to cease and desist from committing or causing violations of the antifraud provisions of the Securities Act and the fund pricing provision of the Investment Company Act, for their negligent failure to adequately monitor the liquidity of the Funds and to take adequate steps to address the Funds' pricing deficiencies. Hammes, Shilling, Stefl and Stephenson neither admitted nor denied the Commission's findings. In accepting the Independent Directors' offer of settlement, the Commission considered the facts that the respondents were lied to by the Funds' adviser regarding the status of the Funds, hired experts to assist them in performing their duties and engaged in subsequent remedial actions. Nevertheless, though the directors inquired about the pricing and liquidity issues that came to their attention, they did not go far enough in following through and resolving those issues as required by their duties arising under the Investment Company Act.

16. **SEC v. Invesco Funds Group, Inc., and Raymond R. Cunningham**, Litigation Release No. 18482 (December 2, 2003).
http://www.sec.gov/litigation/litreleases/lr18482.htm

On December 2, 2003, the Commission filed suit in the United States District Court for the District of Colorado against Invesco Funds Group, Inc., and Raymond R. Cunningham.

The Commission alleged that from at least July 2001 until October 2003, the defendants fraudulently accepted investments by market timers in Invesco mutual funds to enhance the management fees earned by IFG. The complaint alleges that market timing is the practice of frequent short term buying and selling of mutual funds shares, and that IFG entered into specific arrangements with particular investors under which these investors were allowed to market-time Invesco funds. The complaint further alleges that the defendants accepted these investments knowing that doing so would be detrimental to long-term shareholders in the mutual funds. In addition, the complaint alleges that accepting these investments was fraudulent because it was contrary to disclosures made in the prospectuses for the mutual funds. These disclosures stated that exchanges between funds by investors would be limited to four yearly and that changes in this policy would only be allowed if it was in the best interests of the funds.

The complaint further alleges that the defendants had a fiduciary duty to act at all times in the best interests of the Invesco mutual funds. Accordingly, the defendants had an affirmative obligation to act in the utmost good faith, and to provide full and fair disclosure of all material facts to investors. The complaint alleges that, despite this duty, the defendants never disclosed to shareholders in the funds or to the independent directors or trustees of the funds that particular investors were being allowed to market-time the funds or that IFG had a conflict of interest because the market timing arrangements served to increase its management fees.

The complaint alleges that, based on the foregoing, IFG and Cunningham violated the securities antifraud provisions and also violated Section 34(b) of the Investment Company Act for filing materially false and misleading registration statements with the Commission. In

addition, the complaint alleges that Cunningham aided and abetted IFG's violations of the Investment Advisers Act of 1940 set forth in Sections prohibiting certain transactions by investment advisors. Last, the complaint seeks relief against IFG and Cunningham under Investment Company Act for breach of fiduciary duty. This provision allows the Commission to seek injunctive relief against, among others, any investment adviser to or director of an investment company based on a breach of fiduciary duty involving personal misconduct.

The Commission's action seeks permanent injunctions, disgorgement of the defendants' ill-gotten gains plus prejudgment interest, and civil penalties against both defendants.

17. **SEC v. Security Trust Company, N.A., Grant D. Seeger, William A. Kenyon and Nicole McDermott**, Press Release 2003-165; *see also* Litigation Release No. 18479 (November 25, 2003). *http://www.sec.gov/news/press/2003-165.htm.*

On November 25, 2003, the Office of the Comptroller of the Currency, the Commission, and the New York Attorney General jointly filed a series of actions against Phoenix, Arizona-based Security Trust Company, N.A. (STC) and three former executives, arising from their participation in mutual fund late trading and market timing schemes.

The NYAG announced criminal actions against STC's former chief executive officer, Grant D. Seeger; its former president, William A. Kenyon; and its former senior vice president for corporate services, Nicole McDermott. The SEC announced the filing of civil fraud charges against STC, Seeger, Kenyon, and McDermott.

The OCC announced that STC will begin a process that will result in an orderly dissolution of the bank by March, 31, 2004. An order signed by the OCC, which is the bank's primary regulator, requires the bank to take steps to ensure that the trust accounts and investment plans it administers experience the minimum disruption possible. The OCC also took an enforcement action against STC last month requiring the bank's controlling shareholder, Capital Management Investors Holdings, Inc. (CMIH), Chicago, Illinois, to provide a substantial capital infusion and make a general pledge of its assets that ensures the bank will have sufficient funds available for an orderly dissolution.

The Labor Department's Employee Benefits Security Administration, which enforces provisions of the Employee Retirement Income Security Act that are designed to protect retirement and employee benefit plans, also participated in the OCC investigation.

An investigation by the New York Attorney General's office implicated Security Trust in certain improper and illegal activities, including late trading and market timing, and triggered an investigation by the other agencies.

On March 31, 2004, the United States District Court for the District of Arizona entered a final judgment against Security Trust Company, N.A. (STC). In accordance with the final judgment, STC paid $1 million in disgorgement on March 31, 2004, when STC was shut down pursuant to orders from its primary regulator, the Office of the Comptroller of the Currency. STC

consented to the entry of the judgment without admitting or denying the allegations in the Commission's complaint.

In addition to STC, the Commission's complaint, filed on November 25, 2003, charged STC's former chief executive, Grant D. Seeger, 40, of Phoenix; its former president, William A. Kenyon, 57, of Phoenix; and its former senior vice president, Nicole McDermott, 34, who resides near Phoenix. McDermott consented to the entry of a final judgment that was entered on February 23, 2004. The case is pending against Seeger and Kenyon.

18. SEC v. Gary L. Pilgrim, Harold J. Baxter, and Pilgrim Baxter & Associates, Ltd. SEC Press Release 2003-161 (November 20, 2003). *http://www.sec.gov/news/press/2003-161.htm*

On November 20, 2003, the Commission filed a civil injunctive action in the United States District Court for the Eastern District of Pennsylvania against Gary L. Pilgrim, Harold J. Baxter, and Pilgrim Baxter & Associates, Ltd. (Pilgrim Baxter), a registered investment adviser, charging them with fraud and breach of fiduciary duty in connection with market timing of the PBHG Funds. Pilgrim was the President, Chief Investment Officer and Director of Pilgrim Baxter & Associates, and the President of the PBHG Funds. Baxter was the CEO and Chairman of Pilgrim Baxter & Associates, and the Chairman and trustee of the PBHG Funds and the PBHG Insurance Series Fund. Both Pilgrim and Baxter resigned from each of these positions on Nov. 13, 2003.

The Commission's complaint alleges that the defendants permitted a hedge fund in which Pilgrim and his wife had a substantial interest, Appalachian Trails, to engage in market timing of the high profile Growth Fund that Pilgrim himself managed. The complaint also alleges that Baxter provided non-public PBHG Fund portfolio information to a close friend at Wall Street Discount Corporation, who then passed this information to Wall Street Discount customers who used the portfolio information to market time the PBHG funds and to exercise hedging strategies through other financial and brokerage institutions.

According to the complaint, the defendants were aware of the impact of excessive short-term trading on a portfolio manager's ability to effectively manage the assets of the funds and adopted and published a limitation of shareholder exchanges out of PBHG funds and into its cash management fund to four exchanges per year. Notwithstanding the published limitation of four exchanges per year, Appalachian Trails and Wall Street Discount, along with more than two dozen others, are alleged to have engaged in extensive exchanges in and out of the PBHG funds with the defendants' knowledge and consent. This large-scale abuse peaked with timing assets of close to $600 million, and continued into the Summer of 2001. At that point, the defendants halted trading by all of the timers save Appalachian and Wall Street Discount, and redeemed their shares. These latter two were permitted to continue their trading through the end of 2001. Neither Pilgrim nor Baxter disclosed to the Board of Pilgrim Baxter, the Board of Trustees of the funds, or fund shareholders, that Pilgrim had an extensive financial interest in Appalachian and that Appalachian had been permitted to implement its trading strategy in PBHG funds. In 2000

and 2001, Appalachian profited by more than $13 million from its trading, $3.9 million of which was Pilgrim's share.

The complaint seeks permanent injunctive relief, disgorgement, prejudgment interest and civil penalties, and also seeks that Pilgrim and Baxter be permanently enjoined from acting in certain enumerated positions with an investment company pursuant to Section 36(a) of the Investment Company Act of 1940. The Commission's action was brought contemporaneously with an action in New York State Supreme Court by the New York Attorney General, with whom the Commission has coordinated its efforts in this matter.

19. **In the Matter of Morgan Stanley DW Inc.**, Securities Act of 1933 Release No. 8339 (November 17, 2003). *http://www.sec.gov/litigation/admin/33-8339.htm*

During November of 2003, the Commission instituted and simultaneously settled enforcement action against Morgan Stanley DW Inc. for failing to provide customers important information relating to their purchases of mutual fund shares. As part of the settlement, Morgan Stanley will pay $50 million in disgorgement and penalties, all of which will be placed in a Fair Fund for distribution to certain Morgan Stanley customers.

Stemming from the SEC's ongoing industry-wide investigation of mutual fund sales practices, this inquiry uncovered two distinct, firm-wide disclosure failures by Morgan Stanley. The first relates to Morgan Stanley's "Partners Program" and its predecessor, in which a select group of mutual fund complexes paid Morgan Stanley substantial fees for preferred marketing of their funds. To incentivize its sales force to recommend the purchase of shares in these "preferred" funds, Morgan Stanley paid increased compensation to individual registered representatives and branch managers on sales of those funds' shares. The fund complexes paid these fees in cash or in the form of portfolio brokerage commissions.

Morgan Stanley also failed to adequately disclose at the point of sale the higher fees associated with large ($100,000 or greater) purchases of Class B shares of certain of its proprietary mutual funds. In connection with its recommendation to customers to purchase certain Class B shares, Morgan Stanley did not adequately inform customers at the point of sale that large purchases of such shares were subject to higher fees. Significantly, Morgan Stanley also failed to explain to customers that those fees could have a negative impact on customers' investment returns. As with the sales of funds in the "preferred" programs, Morgan Stanley's sales force stood to earn more on sales of Class B shares of its proprietary funds than on sales of Class A shares.

Morgan Stanley has agreed to settle this matter, without admitting or denying the findings in the Commission's Order. As part of the settlement, Morgan Stanley will pay $25 million in disgorgement and prejudgment interest. In addition, Morgan Stanley will pay civil penalties totaling $25 million. The entire $50 million payment will be placed in a Fair Fund for distribution to customers who purchased "preferred" fund shares from January 1, 2000 through the present. In addition, investors who bought class B shares of Morgan-run funds in amounts of more than $100,000 could have their shares converted to A shares. Morgan Stanley also agreed

to improve its disclosures and to retain an independent consultant to review Morgan Stanely's procedures.

The Commission's Order censures Morgan Stanley and orders it to cease-and-desist from committing or causing any violations of the antifraud provisions under the Securities Act of 1933 or under the Securities Exchange Act of 1934.

20. SEC v. Martin J. Druffner, Justin F. Ficken, Skifter Ajro, John S. Peffer, and Marc J. Bilotti, SEC Release 2003-149 (November 4, 2003). *http://www.sec.gov/news/press/2003-149.htm*

On November 4, 2003, the Commission instituted a civil fraud action against five brokers and one branch manager formerly employed by Prudential Securities, Inc., in connection with their market timing trades in numerous mutual funds. The Commission alleges in its complaint that, from at least 2001 through September 2003, former brokers Martin J. Druffner, Justin F. Ficken, Skifter Ajro, John S. Peffer, and Marc J. Bilotti defrauded mutual funds and their shareholders by misrepresenting their identities or the identities of their customers in connection with thousands of market timing trades after the mutual funds had restricted or blocked the defendants or their customers from further trading. According to the Commission's complaint, former branch manager Robert Shannon substantially assisted the brokers in their violations by, among other things, approving their market timing trades. Until September 2003, the defendants worked at a Prudential Securities branch in Boston, Massachusetts.

According to the Commission's complaint, filed in federal district court in Boston, from at least 2001 through September 2003, numerous mutual fund companies blocked the defendants or their brokerage customers from further trading in their funds after the mutual fund companies detected market timing activity by the defendants. To evade these blocks, the defendants concealed their own identities by using multiple broker identification numbers or concealed the identities of their brokerage customers by establishing additional brokerage accounts at Prudential Securities on behalf of the customers.

The Commission is seeking injunctive relief, disgorgement, penalties, and such equitable relief as the court deems appropriate.

The Commission filed an amended complaint on July 14, 2004, against five brokers and one branch manager formerly employed by Prudential Securities, Inc.'s Boston branch office in connection with their market timing trades in dozens of mutual funds. The Commission alleges in its amended complaint that, from at least January 2001 through September 2003, former brokers Martin J. Druffner, Justin F. Ficken, Skifter Ajro, John S. Peffer, and Marc J. Bilotti defrauded more than fifty mutual fund companies and the funds' shareholders by placing thousands of market timing trades worth more than one billion dollars. According to the Commission's amended complaint, former branch manager Robert Shannon aided and abetted the brokers' fraudulent scheme by, among other things, approving new broker identification numbers and new customer accounts for the other defendants, whom he supervised. T The amended complaint seeks injunctive relief, disgorgement, penalties, and such equitable relief as the court deems appropriate.

The Commission's investigation is continuing.

21. **SEC v. Edward J. Strafaci**, Litigation Release No. 18432 (October 29, 2003). *http://www.sec.gov/litigation/litreleases/lr18432.htm*

On October 29, 2003, the Commission instituted fraud charges against Edward J. Strafaci, the former portfolio manager of the Lipper convertible hedge funds, for overstating the value of the funds. Simultaneously, the Office of the United States Attorney for the Southern District of New York announced Strafaci's indictment on criminal charges arising from the same conduct.

The Commission's complaint alleges that from at least 1998 until January 2002, Strafaci knowingly and recklessly overstated the value of convertible bonds and preferred stock held by the funds, resulting in the dissemination of materially false and misleading fund valuations and performance figures to investors and prospective investors, and the filing of false reports with the Commission.

Each of the funds was managed by Lipper & Company, L.P., an investment adviser registered with the Commission, or an affiliate (collectively, the Managing Entities); three of the funds were registered with the Commission as broker-dealers. During the relevant period, Strafaci was the portfolio manager for each of the funds and was an executive vice-president and the Director of Fixed Income Money Management for the Managing Entities. Strafaci resigned these positions in January 2002, and is now the majority shareholder of, and portfolio manager for, a hedge fund holding company.

The complaint charges Strafaci with violating or aiding and abetting violations of certain antifraud provisions of the federal securities laws and with aiding and abetting various books-and-records and reporting provisions applicable to registered investment advisers and broker-dealers. The complaint seeks a permanent injunction, disgorgement, and civil money penalties. The litigation is pending.

22. **In the Matter of Putnam Investment Management LLC**, Investment Advisers Act of 1940, Release No. 2192 (November 13, 2003). *http://www.sec.gov/litigation/admin/ia-2192.htm;* **SEC v. Justin M. Scott and Omid Kamshad**, SEC Release 2003-156 (November 13, 2003). *http://www.sec.gov/news/press/2003-156.htm*

On October 28, 2003, the Commission instituted actions against Putnam Investment Management LLC (Putnam) and two former Putnam Managing Directors and portfolio

managers, Justin M. Scott and Omid Kamshad, in connection with the personal trading by those Managing Directors in Putnam mutual funds.

The Commission filed a civil injunctive action in federal district court in Boston against Justin M. Scott and Omid Kamshad charging each of them with securities fraud. The complaint alleges that Scott and Kamshad, for their own personal accounts, engaged in excessive short-term trading of Putnam mutual funds for which they were portfolio managers. According to the complaint, Scott and Kamshad's investment decision-making responsibility for those funds afforded them access to non-public information about the funds, including current portfolio holdings, valuations and transactions. The complaint further alleges that Scott and Kamshad's short-term trading violated their responsibilities to other fund shareholders, that Scott and Kamshad failed to disclose their trading and that, by their trading, they potentially harmed other fund shareholders.

The Commission's civil injunctive action against Scott and Kamshad is pending.

The Commission also issued an administrative order instituting proceedings against Putnam in which the Division of Enforcement alleges that Putnam engaged in securities fraud by failing to disclose to the funds or to the fund boards the potentially self-dealing transactions in fund shares by Scott, Kamshad and other employees. The Division further alleges that Putnam failed to supervise Scott, Kamshad and other employees, that it failed to have policies and procedures reasonably designed to prevent the misuse of non-public information and that it failed adequately to enforce its code of ethics.

On November 13, 2003 the Commission announced that Putnam agreed to entry of the order in the Commission's administrative proceeding. In the Order, Putnam has agreed to undertake significant and far-reaching corporate governance, compliance, and ethics reforms. Putnam has also agreed to a process for calculating and paying restitution for losses attributable to excessive short-term and market timing trading by its employees. The amount of civil penalty and other monetary relief to be paid by Putnam remains open and will be determined at a later date.

The Commission found that Putnam committed securities fraud by failing to disclose potentially self-dealing securities trading by several of its employees. The Commission also found that Putnam failed to take adequate steps to detect and deter such trading activity through its own internal controls and its supervision of investment management professionals. By virtue of this conduct, Putnam breached its fiduciary duties in violation of, among other things, the antifraud provisions of the Advisers Act. Putnam consented to the entry of the Commission's order without admitting or denying its findings, but has agreed not to contest the findings in connection with the later determination of a penalty and other monetary relief. The Commission's investigation is continuing.

23. **<u>In the Matter of James Patrick Connelly, Jr</u>**., Securities Act Release No. 8304 (October 16, 2003). *http://www.sec.gov/litigation/admin/33-8304.htm*

During October of 2003, the Commission setteled administrative proceeding against James P. Connelly, Jr., former Vice Chairman and Chief Mutual Fund Officer of Fred Alger & Company, Inc., a prominent mutual fund firm.

Connelly, separately, in a matter brought by the New York Attorney General, pled guilty to the crime of Tampering with Physical Evidence, a class E felony punishable by up to four years in state prison. The charges against Connelly stem from his repeated efforts to tamper with an ongoing investigation of illegal trading practices in the mutual funds industry.

In its administrative order, the SEC found that Connelly approved agreements that permitted select investors to "time" certain mutual funds managed by Alger, a practice that violates an adviser's fiduciary duties and adversely affects the value of the fund being timed. In this case, the timing arrangements were also inconsistent with Alger's public disclosures in prospectuses and statements of additional information filed with the SEC. Connelly is the first fund executive charged for permitting market timing.

According to the felony complaint, Connelly took a series of steps to thwart the investigation. Beginning Sept. 3, 2003, Connelly began deceiving his own firm's lawyers to prevent them from identifying and producing documents responsive to a subpoena from the Attorney General's office. Specifically, Connelly tried to conceal trading arrangements between Alger and Veras Investment Partners, LLP, a Texas hedge fund company.

The illegal conduct alleged in the complaint began September 3rd, following the Attorney General's announcement of a settlement and cooperation agreement with Canary Capital Partners and an expanding investigation. The next day, Connelly directed subordinates to delete e-mails called for by the subpoena. Later, he coached them to falsely report facts relevant to the investigation and his own culpability.

According to the Commission's order, Connelly was involved in timing arrangements at Alger from the mid-1990s until 2003. By early 2003, Connelly was requiring that investors seeking timing capacity agree to maintain at least 20% of their investment at Alger in buy-and-hold positions, sometimes referred to as "sticky assets."

In settling this matter, Connelly neither admitted nor denied the SEC findings. The Commission's order directs Connelly to cease and desist from future violations of various provisions of the federal securities laws; bars him from association with any broker, dealer or investment adviser; bars him from serving in various capacities with respect to any registered investment company; and imposes a $400,000 civil penalty.

On December 17, 2003, James P. Connelly Jr. was sentenced to 1 to 3 years in prison for tampering with evidence.

24. **In re Stephen B. Markovitz (“Millenium Partners”)**, SEC Press Release 2003-132 (October 2, 2003). *http://www.sec.gov/news/press/2003-132.htm*

The Commission and New York Attorney General Eliot Spitzer announced civil and criminal actions against Steven B. Markovitz, formerly an executive and senior trader with the prominent hedge fund firm Millennium Partners, L.P.

The SEC's administrative order finds that Markovitz committed securities fraud. In partial settlement of that action, Markovitz has agreed to a lifetime bar from association with an investment adviser or mutual fund. In the criminal case, Markovitz pleaded guilty to a felony violation of New York's Martin Act.

According to the criminal charges and the SEC findings, Markovitz engaged in "late" trading of mutual fund shares on behalf of Millennium, one of the nation's largest hedge fund operators, with more than $4 billion under management. With the assistance of certain registered broker-dealers, Markovitz placed mutual fund orders after 4:00 p.m. ET, but obtained the prices that had been set as of 4:00 p.m. ET. By SEC rule, Markovitz's post-4:00 p.m. orders should have received the prices set on the following day. This illegal trading allowed Millenium to take advantage of events that occurred after the markets closed.

The SEC's administrative order finds that Markovitz willfully violated the anti-fraud provisions of the securities laws and willfully aided and abetted and caused violations of the market timing regulations udner the Investment Company Act of 1940. Without admitting or denying the SEC's findings, Markovitz consented to cease and desist from violations of those provisions, and to be permanently barred from associating with an investment adviser or from working in any capacity with or for a registered investment company. The SEC also is seeking disgorgement and civil penalties in amounts to be determined later. The investigations are continuing.

25. **In re Theodore Charles Sihpol III**, Securities Act Release No. 8288 (September 16, 2003). *http://www.sec.gov/litigation/admin/33-8288.htm*

The Commission instituted an administrative order instituting proceedings in which the Division of Enforcement alleges that Sihpol played a key role in enabling certain hedge fund customers of BOA to engage in late trading in shares of mutual funds offered by Bank of America, including the Nations Funds family of funds and other mutual funds. Based on the conduct alleged in the Order, the Division alleges that Sihpol violated, and aided and abetted and caused violations of, the antifraud, mutual fund pricing and broker-dealer record-keeping provisions of the federal securities laws. In its action, the Division is seeking civil penalties, disgorgement and other relief, which may include permanently barring Sihpol from the securities industry. If convicted in the criminal action, Sihpol could face a mandatory term in prison.

Sihpol was a broker responsible for executing trades of BOA's Nations Fund Trust for Canary Capital Partners, LLC. Canary was named in a civil complaint filed by Spitzer's office on September 3 detailing illegal trading in the mutual fund industry.

The specific civil charges against Sihpol are that he willfully violated and/or aided and abetted and caused violations rules promulgated under the Securities Act, the Exchange Act, and the Investment Company Act by "late trading." Late trading is prohibited because it allows a

favored investor to take advantage of post-market-closing events not reflected in the share price set at the close of the market. The New York Attorney General's and SEC's investigations are continuing.

26. **SEC v. Prudential Securities, Inc., et al.,** Press Release 2003-82 (July 10, 2003). *http://www.sec.gov/news/press/2003-82.htm*

On July 10, 2003 the Commission announced two enforcement actions - one settled and one unsettled - involving sales of mutual fund shares by Prudential Securities, Inc. (Prudential).

In the settled action, the Commission found that from 1998 to 2000 Prudential, a registered broker-dealer, had inadequate systems in place to effectively monitor and enforce its policies and procedures relating to sales of different classes of mutual funds. In resolving the matter, Prudential agreed, without admitting or denying the Commission's findings, to pay disgorgement and prejudgment interest totaling $82,000, which will be returned to investors harmed by the conduct described in the actions, and a civil penalty in the amount of $300,000. The respondents in the unsettled action are two former employees of Prudential.

In multi-class mutual funds, the primary differences among the classes of shares are the type and amount of fees charged to investors. In the actions, the SEC's Division of Enforcement alleges that a former Prudential registered representative sold Class "B" shares to his customers, while failing to disclose that if they purchased Class "A" shares, they were eligible for breakpoint discounts based on the size of their mutual fund purchases. The Division further alleges that the respondents stood to make more money through sales of Class B shares than they would from sales of Class A shares. Mutual fund breakpoints are sales charge discounts available to customers who purchase large amounts of certain classes of shares in mutual funds that charge commissions.

In the unsettled action, the Commission issued an administrative order instituting proceedings against Robert Ostrowski, a former Prudential registered representative, and Rees T. Harris, a former Prudential branch office manager.

In the settled action, the Commission's order found that, although Prudential had policies and procedures prohibiting the type of sales practices that Ostrowski utilized, it did not have any systems in place to effectively monitor and enforce those policies and procedures above the branch office manager's level. As a result, when Harris failed in his supervisory responsibilities, Prudential had inadequate means to detect Harris' failure. The Commission found that, as a result, Prudential failed reasonably to supervise Ostrowski with a view to preventing his violations.

In July 2001, following completion of an internal review, Prudential revised and enhanced its mutual fund policies and procedures, including those related to the sales of Class B mutual fund shares, and implemented systems to monitor compliance with them.

In addition to paying $82,000 in disgorgement and prejudgment interest and a $300,000 civil penalty, the Commission ordered that Prudential be censured and that it comply with its

undertakings to, among other things, maintain the revised policies, procedures and systems that it has implemented.

VI. INSIDER TRADING

1. **SEC v. Guillermo Garcia Simon, et al.**, Litigation Release No. 18763 (June 24, 2004). *http://www.sec.gov/litigation/litreleases/lr18763.htm*

A Massachusetts federal court has entered a final judgment against Guillermo Garcia Simon, a former FleetBoston Financial Group employee residing in Buenes Aires, Argentina, in connection with his trading in the securities of FleetBoston in advance of the announcement of its acquisition by Bank of America Corporation. Under the terms of the final judgment, entered by consent, Simon was ordered to pay approximately $525,000 in disgorgement, interest, and a penalty. He was also enjoined from further violations of Section 10(b) of the Securities Exchange Act of 1934, and Rule 10b-5 thereunder.

The Commission filed an emergency enforcement action against Simon on Monday, October 28, 2003, only hours after Bank of America announced its acquisition of FleetBoston, and less than three days after Simon purchased FleetBoston securities. In its complaint, filed in the United States District Court for the District of Massachusetts, the Commission alleged that Simon engaged in illegal insider trading when he bought FleetBoston securities late on Friday, October 24, while in possession of material, non-public information about the acquisition that was announced the next trading day. The day it filed its complaint, the Commission also sought a temporary restraining order and asset freeze against Simon. Judge Nancy Gertner granted the order freezing Simon's trading account and prohibiting him from transferring or disposing of the securities or any trading proceeds. The Commission obtained the order before the transaction was concluded and as a result, was able to freeze the account before any profits could be removed or dissipated.

Specifically, the Commission's complaint alleged that Simon, a former employee at FleetBoston's Buenos Aires office, purchased 1100 November FleetBoston call options during the last hours of trading on Friday, October 24, 2003, at a cost of about $11,000. The complaint alleged that Simon's options purchase represented over 50% of the total trading volume in that series of call options that day. The complaint alleged that before the market opened on Monday, October 27, FleetBoston's acquisition was announced. In the wake of the announcement, the price of FleetBoston's stock and call options rose dramatically, with Simon's call options increasing in value by $473,000 as of the close of the day. The complaint alleged that Simon's conduct violated Section 10(b) of the Securities Exchange Act and Rule 10b-5.

Without admitting or denying the allegations in the Commission's complaint, Simon consented to the final judgment entered by the court on June 9 in this matter. The judgment permanently enjoined him from future violations of the antifraud provisions of the Securities Exchange Act of 1934. Simon was also ordered to pay disgorgement of $473,000, prejudgment interest of $1,576.67, and a civil penalty of $51,842.36, representing the entire proceeds frozen by the court.

In its complaint, the Commission had also named Simon's wife and brother, who shared the account through which Simon traded, as co-defendants. The Commission dismissed the claims against them with prejudice.

2. **SEC v. Peter J. Davis, Jr., John M. Youngdahl, and Steven E. Nothern**, Litigation Release No. 18322 (September 4, 2003). *http://www.sec.gov/litigation/litreleases/lr18322.htm*

The Commission brought three related enforcement actions arising from trading in U.S. Treasury 30-year bonds minutes before the Treasury Department announcement's on October 31, 2001 that it would no longer issue such bonds. The Treasury Department's announcement had a dramatic market impact, causing the largest one-day price movement in the 30-year bond since October 1987. Goldman Sachs & Company, Massachusetts Financial Services Company ("MFS"), and Peter J. Davis, Jr., the individual who misappropriated the Treasury Department information that was subject to a news embargo, will pay a total of over $10.3 million to settle the Commission's actions.

The Commission's complaint against Davis, John M. Youngdahl and Steven E. Nothern alleges that Davis marketed himself to Wall Street clients by claiming special access that enabled him "to get Washington information ahead of the media," and by promising clients "the first call on investment issues they care about." MFS retained Davis as a consultant sometime between 1995-1997, and Goldman Sachs retained Davis beginning in the spring of 2001. Youngdahl, who advised Treasury Desk traders on economic and political developments, was Davis' primary contact at Goldman Sachs. Nothern, who managed seven fixed income mutual funds for MFS, was Davis' primary contact at MFS.

The complaint alleges that, since 1994, Davis had attended the Treasury Department's quarterly refunding press conferences under an explicit agreement that he would honor the news embargo that Treasury imposed until the designated public announcement time. At these press conferences, the Treasury Department announced the Federal Government's financing requirements for the coming quarter. Notwithstanding his agreement to abide by the news embargo, the complaint alleges that, in July 2001, Davis and Youngdahl agreed in a series of e-mails that Davis would provide Youngdahl with confidential information from the Treasury Department's quarterly refunding press conferences prior to the expiration of the embargo. Davis had previously conveyed confidential refunding information to Youngdahl in May 2001, and, pursuant to their July agreement, did so again in August 2001.

At the refunding press conference on October 31, 2001, Treasury Department officials announced three times that the information being made available was embargoed until 10:00 a.m. The press conference ended at approximately 9:25 a.m. Then, Davis, despite the officials' warnings, and in violation of his prior explicit agreement to abide by the embargo, placed a series of cell phone calls to his clients, including Youngdahl and Nothern, beginning at 9:28 a.m., and told them that the Treasury Department was suspending future long bond issuances. The complaint alleges that Youngdahl knew that Davis, pursuant to their July agreement, was tipping him with confidential Treasury Department information before the information was

released to the public. The complaint also alleges that Nothern knew, from a voice mail which Davis left him and which he listened to, that Davis had learned about the suspension of 30-year bond issuances directly from the Treasury Department, and that the news was embargoed until a scheduled 10:00 a.m. press announcement.

The Commission's complaint charges Davis, Youngdahl, and Nothern with violations of the antifraud provisions of the federal securities laws and seeks injunctions, disgorgement, and civil money penalties. Prior to the filing of the action, Davis consented, without admitting or denying the allegations of the complaint, to the entry of a permanent injunction from future violations of the federal antifraud securities laws, to a court order that he disgorge $29,598, which represents the amount of consulting fees he received from Goldman Sachs and MFS plus prejudgment interest, and to pay a penalty of $120,000.

The Commission's administrative order against Goldman Sachs finds that, because of Youngdahl's conduct and the trading that ensued, Goldman Sachs willfully violated the provisions that prohibit fraud by broker-dealers and government securities dealers. The order also finds that Goldman Sachs willfully violated the Exchange Act because did not have written policies and procedures reasonably designed to prevent the misuse of material nonpublic information that expressly addressed the use of such consultants and handling of information in their control.

Goldman Sachs consented to the Commission's order without admitting or denying the Commission's findings. The order censures Goldman Sachs, orders the firm to cease and desist from committing or causing future violations, and orders Goldman Sachs to disgorge $1,742,642 in bond trading profits and prejudgment interest, and to pay a penalty of $5,000,000. In addition Goldman Sachs is undertaking to disgorge $2,562,740 in bond futures trading profits and prejudgment interest. The Commission's order also requires Goldman Sachs' Legal Department to do a review of the firm's policies and procedures and to implement corrective measures to prevent any possible future abuse of material nonpublic information with respect to the use of consultants.

The Commission's Order against MFS finds that MFS willfully violated Section 204A of the Investment Advisers Act of 1940 because it lacked adequate safeguards to prevent the misuse of material nonpublic information with respect to information obtained from consultants. Without admitting or denying the Commission's findings, MFS consented to the entry of the Commission's order, which censures MFS, requires MFS to cease and desist from committing or causing future violations, and orders MFS to pay a penalty of $200,000. The order also requires MFS' General Counsel's office to implement corrective measures to prevent any possible future abuse of material nonpublic information with respect to the use of consultants. In addition, MFS is undertaking to reimburse the broker-dealer that sold MFS the 30-year bonds $717,858, representing losses by the broker-dealer from selling 30-year bonds to MFS on October 31, 2001, and prejudgment interest on that amount.

On November 12, 2003, the Commission announced that Youngdahl, has agreed to settle the Commission's pending insider trading charges against him. If the federal district court in Manhattan hearing the SEC's civil action approves the settlement, Youngdahl will be

permanently enjoined from committing securities fraud and will pay a civil penalty of $240,000. In separate proceedings regarding the same conduct, Youngdahl pled guilty to criminal securities fraud charges brought by the United States Attorney's Office for the Southern District of New York. Litigation Release 18453, (Nov. 20, 2003). h*ttp://www.sec.gov/litigation/litreleases/lr18453.htm.*

3. **SEC v. Martha Stewart and Peter Bacanovic,** Litigation Release No. 18169 (June 4, 2003). *http://www.sec.gov/news/press/2003-69.htm.*

On June 4, 2003, the Commission filed charges against Martha Stewart, Chairman and CEO of Martha Stewart Living Omnimedia, Inc., and Peter Bacanovic, a former registered representative associated with Merrill Lynch, Pierce, Fenner, and Smith Incorporated, for illegal insider trading. The Commission's Complaint, filed in the United States District Court for the Southern District of New York, alleges that Stewart sold stock in a biopharmaceutical company, ImClone Systems, Inc., on December 27, 2001, after learning material, nonpublic information communicated from Bacanovic, who was Stewart's stockbroker at the time. Bacanovic's tip was that then-ImClone CEO Samuel Waksal and his daughter had instructed Merrill Lynch to sell all of their ImClone stock held at Merrill Lynch. At the time, according to the Complaint, ImClone and the market were awaiting an imminent decision from the U.S. Food and Drug Administration on one of ImClone's key products, a cancer treatment called "Erbitux." The Commission alleges that information about the Waksals' efforts to sell signaled insider pessimism about the FDA decision, the prospects for Erbitux, and the future of ImClone. The Commission alleges that, based on this conduct, Stewart and Bacanovic violated the securities antifraud provisions.

In its lawsuit, the Commission seeks an order requiring that Stewart and Bacanovic, jointly and severally, disgorge $45,673, representing the losses avoided by Stewart's sale of ImClone securities, and that they pay civil penalties. The Commission also seeks an order permanently enjoining Stewart and Bacanovic from violating the securities laws, and barring Stewart from acting as a director of, and limiting her activities as an officer of, a public company.

Martha Stewart was convicted during March of 2004 on charges of obstructing justice, conspiracy and making false statements in connection with suspicious trades. During June of 2004, Martha Stewart was sentenced to serve five months in prison, five months of house arrest and two years of probation, and given a $30,000 fine.

4. **SEC v. Samuel D. Waksal**, Litigation Release No. 18026 (March 11, 2003). *http://www.sec.gov/litigation/litreleases/lr18026.htm*

Samuel Waksal, the former CEO of ImClone Systems Inc., has agreed to a partial resolution of the insider trading case brought against him by the SEC on June 12, 2002. *See* SEC v. Samuel D. Waksal, Lit. Rel. 17559 (June 12, 2002). In documents filed with the federal court in Manhattan on March 11, 2003, Waksal, without admitting or denying the allegations, consented to pay more than $800,000 from the unlawful sales including prejudgment interest, be barred from acting as an officer or director for public companies, and accept other relief. This

partial final judgment resolved many of the insider trading charges alleged in the Commission's complaint, including new charges that Waksal unlawfully bought ImClone put options through a Swiss account in December 2001.

In its amended complaint, the Commission alleges that in late December 2001, Waksal received disappointing news that the U.S. Food and Drug Administration was expected to soon issue a decision rejecting for review ImClone's pending application to market its cancer treatment drug, Erbitux. With that inside information in hand, and before ImClone publicly announced the FDA's decision on Dec. 28, 2001, Waksal: Unlawfully tried to sell shares of ImClone worth nearly $5 million between Dec. 26 and 28; Directed his daughter, Aliza, to sell all of her ImClone stock on Dec. 27; Purchased 210 ImClone put option contracts through a Swiss account on Dec. 28; and Tipped a family member, who sold his own ImClone stock as well as ImClone stock of another Waksal family member on Dec. 27 and 28.

The partial resolution covers Waksal's attempted trades, the trades of his daughter, Aliza, and Waksal's purchase of ImClone puts. Waksal has consented to (a) injunctions against violating antifraud and other provisions of the federal securities laws; (b) pay $804,367, representing the losses avoided by the sales of ImClone stock in Aliza Waksal's account and Waksal's profits from his options transactions ($760,425), plus prejudgment interest ($43,942); and (c) a permanent bar from serving as an officer or director of a public company.

In a separate criminal proceeding, Waksal has pleaded guilty to a variety of charges, including criminal charges arising out of his attempted sales of ImClone stock on Dec. 26-28, 2001, and sales of ImClone stock from the account of his daughter on Dec. 27, 2001. On June 11, 2003 he was sentenced to seven years and three months in prison for these convictions.

On October 10, 2003, the Commission filed a second amended complaint, naming Jack Waksal as a defendant and Patti Waksal as a relief defendant. In its second amended complaint, the Commission charges, among other things, that in late December 2001, Sam Waksal, the then CEO of ImClone Systems, Inc. (IMCL), tipped his father, Jack Waksal, with the disappointing news about ImClone. Before this news became public, Jack Waksal sold his own ImClone stock and ImClone stock owned by Patti Waksal, who is Jack Waksal's daughter and Sam Waksal's sister.

In its second amended complaint, <u>SEC v. Samuel D. Waksal, Jack Waksal and Patti Waksal,</u> the Commission seeks to resolve the remaining issues in the case, including (a) Sam Waksal's and Jack Waksal's liability for Jack Waksal's sales of ImClone stock on December 27 and 28, 2001, and (b) civil penalties concerning the totality of the Commission's allegations against Sam Waksal and Jack Waksal.

VII. CASES INVOLVING SECURITIES OFFERINGS

1. **SEC v. Craig J. Shaber, Stephen R. Wright, and Bonaventure Capital, Ltd., et al.**, Litigation Release No. 18381 (September 30, 2003). *http://www.sec.gov/litigation/litreleases/lr18381.htm*

On September 30, 2003, the SEC filed a lawsuit in the United States District Court for the Northern District of Texas against Craig J. Shaber, a California-licensed attorney and Stephen R. Wright, an accountant. According to the complaint, from 1998 to 2002, Shaber and Wright engaged in an elaborate scheme to manufacture and sell 18 public shell companies, from which they derived at least $7.5 million in ill-gotten gains. To carry out the "shell factory" scheme, Shaber and Wright installed nominee officers and directors in dormant corporations that they controlled and caused these companies to submit false registration statements and reports to the SEC and the NASD, Inc. These false documents gave the bogus companies the appearance of legitimacy and permitted their securities to be eligible for quotation on the OTC Bulletin Board.

Among other things, the false registration statements and reports contained phony business plans, misrepresented the identity of the companies' true officers and directors, and contained false shareholder lists. In reality, Shaber and Wright owned virtually all of the companies' stock, and the individual shareholders listed in the documents were merely nominees for Shaber and Wright. In addition, Shaber and Wright served as the de facto officers and directors of the companies and intended not to pursue the stated business plans, but rather, to sell their controlling blocks of shares-and thus control of the shell companies-to stock promoters and other buyers for substantial profits. Shaber and Wright sold one of these fraudulently manufactured companies, Moranzo, Inc., for approximately $600,000 to certain 2DoTrade defendants, who then used it to create 2DoTrade and carry out that scheme.

The other defendant in this case is Bonaventure Capital, Ltd., which are controlled by Shaber and Wright. Shaber and Wright maintained a bank account and a brokerage account at Bonaventure through which they sold the securities at issue. The relief defendants are two corporations, Wright & Geis, Inc. and Aspen International Marketing, Inc., which are owned by Wright and Shaber respectively. Both entities received proceeds in the fraudulent scheme.

The complaint alleges that Shaber, Wright, and Bonaventure Capital violated the securities-registration, anti-fraud, beneficial-ownership, and principal-shareholder reporting provisions of the federal securities laws. The SEC seeks disgorgement with prejudgment interest from each defendant and relief defendant and further seeks permanent injunctions, an accounting, and officer-and-director bars against defendants Shaber and Wright.

2. **SEC v. Terry Richard Martin, Silver Legacy Corporation, et. al.**, Litigation Release No. 18314 (August 28, 2003). *http://www.sec.gov/litigation/litreleases/lr18314.htm*

The Commission filed civil charges relating to the fraudulent sale of $20 million in municipal bonds for the Holmes Harbor Sewer District, a small sewer district located on Whidbey Island, Washington. The bonds were intended to finance the building of certain public purpose portions of a private office-building complex. However, the developer and others lied to investors about how bond proceeds would be used to acquire land for the project; falsely claimed that a prominent investment bank was involved in providing additional private financing for the project; falsely claimed that the project was already fully leased to a "Triple A" credit-rated company; and failed to disclose kickbacks to several of the offering participants.

Currently, the bonds are in default and no substantial work has taken place on the project. When the bonds were sold to investors in October 2000, approximately half of the proceeds were used to acquire land and for professional fees. The balance of the proceeds remains in escrow.

According to the complaint, the bonds were sold to investors in October 2000 based on information contained in an Official Statement, a written offering document that explains key features and risks for a bond offering, that the developer, attorneys and underwriter each either drafted or reviewed. The Official Statement contained several material misrepresentations and omissions. One misrepresentation stated that $6.2 million in bond proceeds would be used to acquire 15 acres of land for public purposes when, in actuality, the developer used the bond proceeds to acquire nearly 40 acres of land for both public and private portions of the project.

The Official Statement also misrepresented that Goldman/Sig LLC, the proposed mortgage lender for the project, was formed in part by Goldman Sachs. Goldman Sachs had nothing to do with Goldman/Sig LLC. In addition, the Official Statement misrepresented that financing would be provided by Goldman/Sig, when Goldman/Sig had no ability to provide the $65 million financing.

Furthermore, the information contained in the Official Statement declared that the developer had entered into a lease agreement with a single corporate tenant that would give the project a value of $90 million. In fact, the agreement could be cancelled at any time by the lessee and was not with a corporation, but with a small firm with annual revenues of $600,000. The statement also failed to disclose additional payments to law firms, the underwriter, and the defendant who was supposed to obtain financing for the project.

The Commission's complaint charges the defendants with violating the antifraud provisions of the securities laws. The Commission seeks permanent injunctions prohibiting future violations against each defendant, as well as the return of all monies received as a result of the fraud plus pre-judgment interest, and civil money penalties.

In a separate action, the Office of the U.S. Attorney for the Western District of Washington also announced the filing of criminal charges against Terry Martin, Smith, White and Tezak for their roles in the bond offering.

VIII. SELF REGULATORY ORGANIZATIONS

In re Chicago Stock Exchange, Exchange Act Release No. 48566 / September 30, 2003, *http://www.sec.gov/litigation/admin/34-48566.htm*

On September 30, 2003, the Commission instituted and simultaneously settled an administrative enforcement action against the Chicago Stock Exchange, finding that the Exchange failed to enforce certain of its trading rules. The Exchange consented to the entry of an order imposing a censure and requiring the Exchange to cease and desist from further violations of the federal securities laws and to comply with significant undertakings designed to enhance the Exchange's oversight of order handling by its members.

The Commission's order includes findings that the Exchange neither admits nor denies. Specifically, the Commission found that the Exchange's surveillance program failed adequately to detect violations by its members of the firm quote rule, trading ahead prohibitions and the limit order display rule from 1998 through 2001. For instance, until early 2001, the Exchange's surveillance for intermarket firm quote rule violations was ineffective because it relied solely on telephone complaints alleging such violations. In another instance, from approximately June 1998 through August 2001, the Exchange failed to conduct any surveillance for intra-day trading ahead violations.

In addition, the Commission found that even when the Exchange detected such violations, it often failed to take appropriate disciplinary actions against the individuals and/or firms that committed the violations. These deficiencies were first detected by an inspection by the staff of the Commission's Office of Compliance Inspections and Examinations. The Commission found that the Exchange violated Section 19(g) of the Securities Exchange Act of 1934, which requires exchanges to enforce compliance by its members with the provisions and rules of the Exchange Act and with the exchanges' own rules.

Among the undertakings required by the settlement are: (i) the creation by the Exchange of a Regulatory Oversight Committee comprised almost exclusively of individuals with no material business relationship with the Exchange, which Committee will regularly advise the Exchange's Board of Governors about regulatory, compliance and enforcement matters and assist the Board in monitoring the design, implementation and effectiveness of the Exchange's compliance programs; (ii) the engagement of an Independent Consultant to conduct a comprehensive review of the Exchange's trading floor surveillance and enforcement programs and provide recommendations to the Exchange; and (iii) the filing of various certifications by the Exchange's officials confirming its ongoing compliance with its statutory obligations.