

# SEC Update

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**July 7, 2008 – July 11, 2008**

**This Week at the SEC**

## **ENFORCEMENT PROCEEDINGS**

### **In the Matter of Phillip W. Offill, Jr., Esq.**

On July 7th, the Commission issued an Order suspending Phillip W. Offill, Jr., Esq. from appearing or practicing before the Commission, based on the Texas State Bar's judgment (i) suspending him from practicing law for 36 months, and (ii) placing him on a period of probated suspension for an additional 24 months. The Commission's order finds that on March 13, 2008, a judgment was entered by the Texas State Bar, concluding that Offill, who has regularly appeared and practiced before the Commission, had committed multiple violations of the Texas Disciplinary Rules of Professional Conduct. Those violations included intending to destroy or conceal client documents when Offill knew that his former client was about to commence litigation against him, making misrepresentations to a federal judge in Florida, and misrepresenting in litigation pleadings his and his client's relationship to certain individuals. (Rel. [34-58105](#); File No. 3-13087)

### **Alex Rabinovich Pleaded Guilty to Criminal Securities Fraud Charges**

The Commission announced that on June 10, 2008, the Honorable Gerard E. Lynch, United States District Judge for the Southern District of New York, entered a Judgment of Permanent Injunction against Alex Rabinovich, permanently enjoining Rabinovich from violating the registration and antifraud provisions of the federal securities laws. The judgment further orders Rabinovich to disgorge ill-gotten gains, together with prejudgment interest, and pay a civil penalty, but defers the Court's determination of the amount of

disgorgement and penalty to be paid until a later date, pending a motion by the Commission. Rabinovich consented to entry of the judgment without admitting or denying the allegations in the Commission's complaint.

The Commission's complaint, filed on Nov. 26, 2007, alleged that defendants Rabinovich, Rabinovich & Associates, LP, an unregistered investment company and broker-dealer managed by Rabinovich, and Joseph Lovaglio, operating out of a storefront boiler room in Brooklyn, sold limited partnership interests in Rabinovich & Associates (sometimes referred to hereafter as the Fund or the firm) and other securities to investors, including senior citizens and retirees. The complaint further alleged that the defendants obtained investments in the Fund by cold-calling and making fraudulent statements to investors and prospective investors in the Fund, including: (1) false claims that the Fund had been extraordinarily profitable whereas the Fund's actual performance had been dismal; and (2) false representations that Rabinovich & Associates was a Wall Street firm and a member of the NASD, the New York Stock Exchange, and the Securities Investor Protection Corporation. The defendants allegedly also failed to disclose to investors that Rabinovich had been barred by the NASD from associating with any broker or dealer and that there was a pending action by the Financial Industry Regulatory Authority, Inc. seeking to bar Lovaglio from associating with any broker or dealer.

The complaint charged that the defendants defrauded Fund investors and prospective investors, unlawfully operated as unregistered broker-dealers and offered and sold securities in an unregistered offering; and that defendant Rabinovich & Associates unlawfully operated as an unregistered investment company. When it filed the complaint, the Commission also sought emergency and preliminary relief.

On Nov. 26, 2007, Judge Lynch entered an order temporarily restraining Rabinovich, Rabinovich & Associates, and Lovaglio from violating the statutes and rules charged in the complaint. The court also ordered that the defendants' assets be frozen, ordered the defendants to promptly provide sworn accountings, ordered that discovery be accelerated and that defendants be prohibited from destroying documents, and scheduled a preliminary injunction hearing. On Jan. 15, 2008, Judge Lynch entered a preliminarily injunction against Rabinovich, Rabinovich & Associates, and Lovaglio pending a final disposition of the action, and continued the emergency relief the court had ordered on Nov. 26, 2007.

Rabinovich has also been criminally charged, and pleaded guilty to a single count criminal information, in connection with the conduct alleged in the Commission's complaint. *United States v. Alex Rabinovich*, Crim. Information No. 1:08-Cr-220 (S.D.N.Y.) (DC).

The Commission's litigation is continuing against defendants Rabinovich & Associates and Lovaglio, and is also continuing against Rabinovich for purposes of determining penalties and disgorgement. For further information see Litigation Release No. 20372 (Nov. 27, 2007). [*SEC v. Rabinovich & Associates, LP, Alex Rabinovich and Joseph Lovaglio*, 07 Civ. 10547 (S.D.N.Y.) (GEL)] ([LR-20637](#))

### **SEC Charges Broker and Former Officer of VMT Scientific, Inc. in "Pump-And-Dump" Scheme and Suspends Trading in VMT Scientific Stock**

The Securities and Exchange Commission filed a complaint against a registered stockbroker, and the former Chief Technology Officer of VMT Scientific, Inc., a purported medical device manufacturer in Las Vegas, NV. The complaint alleges that the two defendants pumped VMT stock by issuing false press releases about VMT and then the stockbroker sold, or dumped, over 9.5 million shares for almost \$1 million.

The Commission's complaint, filed in federal district court in Las Vegas, alleges that in mid-2005, Stephen H. Roebuck and Daniel Kaiser purportedly took control of VMT, a public shell company under court custodianship, and issued 120 million shares of VMT to Roebuck. Roebuck immediately transferred the shares to offshore brokerage accounts in the Cayman Islands, Turks and Caicos, and Panama.

The complaint further alleges that between November and December 2005, Roebuck and Kaiser created a website and issued a series of press releases that falsely touted the company's financial viability and its "breakthrough" product that would help patients with peripheral vascular disease. As alleged in the complaint, the website and press releases failed to state the company was under court custodianship, had no operations or revenues, and that Roebuck's stock sales were the company's only funding. After Roebuck and Kaiser issued the press releases, Roebuck sold 9,539,350 shares, resulting in proceeds

over \$990,000. Roebuck transferred approximately \$300,000 to the company, and Kaiser took approximately \$81,491 for himself.

The complaint charges the defendants with violating fraudulent interstate transactions, deceptive trade practices and anti-fraud provisions. Roebuck settled to a permanent injunction, disgorgement and a civil penalty to be determined by the court, and a permanent bar from participating in an offering of penny-stock. The Commission is seeking from Kaiser an injunction, disgorgement, civil penalty, a penny-stock bar, and a permanent officer and director bar. [SEC v. Daniel Kaiser and Stephen H. Roebuck, Civil Action No. 2:08-cv-00888-JCM-LRL (D. Nev.)] ([LR-20639](#))

## **SEC Charges Sycamore Networks and Former Executives in Stock Options Backdating Case**

On July 9, the Commission announced the filing of a settled civil injunctive action against Sycamore Networks, Inc., an optical networking company based in Chelmsford, Massachusetts, as well as its former Chief Financial Officer Frances M. Jewels, former Director of Financial Operations Cheryl E. Kalinen, and former Director of Human Resources Robin A. Friedman, in connection with the backdating of stock options to employees over several years.

The Commission's complaint, filed in federal court in Boston, alleges that Sycamore's unreported options-related expenses totaled nearly \$250 million during the period from 2000 through 2005. According to the complaint, Jewels and Kalinen repeatedly backdated options grants between October 1999 and July 2002 to prices at or near monthly or quarterly low points for the company's stock, and they falsified or caused others to falsify various company documents concerning these grants. The Commission further alleges that Jewels and Kalinen personally benefited from backdated options grants. The complaint also alleges that Friedman was aware of a plan by Jewels and Kalinen to backdate options to five company employees without informing the company's auditors, and that, in connection with the plan, Friedman altered or created, or caused others to alter or create, company personnel and payroll records so that they would reflect incorrect information.

All parties have agreed to settle the Commission's charges without admitting or denying the allegations in the complaint. The company and the former executives will be subject to permanent injunctions prohibiting them from future violations of various provisions of the

federal securities laws, and the former executives have agreed to pay more than \$650,000 combined in disgorgement, interest, and penalties. Jewels also will be barred from serving as an officer or director of a public company for five years.

**[SEC v. Sycamore Networks, Inc. et al., Civil Action No. 1:08-CV-11166 (D. Mass.)] ([LR-20638](#); AAE Rel. 2843)**

### **In the Matter of Pritchard Capital Partners, LLP**

An Administrative Law Judge has issued an Initial Decision in Pritchard Capital Partners, LLP, Administrative Proceeding No. 3-12753. The Initial Decision finds that Joseph John VanCook, while associated with the broker-dealer Pritchard Capital Partners, LLP, engaged in a fraudulent mutual fund late trading scheme. VanCook enabled, and solicited, the mutual fund late trading business executed by his clients.

The Initial Decision orders VanCook to cease and desist from committing or causing future violations of the securities laws, bars him from associating with an investment adviser, broker, or dealer, and from working for an investment company, and orders him to disgorge \$538,565.70 in ill-gotten gains (plus prejudgment interest) and to pay a civil penalty of \$100,000. (Initial Decision No. [350](#); File No. 3-12753)

### **Richard F. Selden, Former CEO of a Massachusetts Biotechnology Company, Settles SEC Fraud Action**

On July 10, 2008, the Commission announced a final judgment by consent was entered on July 9, 2008 by the United States District Court Judge for the District of Massachusetts against Richard F. Selden of Lincoln Massachusetts. Selden, age 49, was the former CEO of Transkaryotic Therapies (TKT), a biotechnology company that was headquartered in Cambridge, Massachusetts, and was publicly-traded until it was acquired in July 2005.

Selden was the only defendant in a civil injunctive action filed in September 2005, alleging that he made materially misleading statements between October 2000 and October 2002 concerning results of TKT's clinical trials and its U.S. Food and Drug

Administration (FDA) application for its flagship drug, Replagal. The Commission's complaint alleged that, during the relevant time period, Selden and, at his direction, TKT, made positive statements concerning Replagal's clinical benefits, describing its clinical trials as a success, and made positive statements about Replagal's chance of being approved by FDA. However, the complaint alleged that Selden knew, but failed to disclose, material negative information, including that Replagal's clinical trial failed to meet its primary objective and FDA had told TKT on several occasions that it was a failed study and had recommended additional clinical trials. The complaint further alleged that Selden benefited by selling 90,000 shares of TKT stock between May 2001 and February 2002, prior to TKT's disclosure of some negative information about Replagal on October 2, 2002, which caused TKT's stock price to fall.

The final judgment against Selden, to which he consented without admitting or denying the Commission's allegations, permanently enjoins him from violating the antifraud and other provisions of the federal securities laws, and orders Selden to pay a \$125,000 civil penalty and \$1,041,417 in disgorgement and prejudgment interest related to his sales of TKT stock during the period of the alleged fraud. The Court will determine whether a bar from serving as an officer or director of any public company is warranted against Selden at a later date. [SEC v. Richard F. Selden, Civil Action No. 05-11805, USDC, D. Mass.] ([LR-20640](#))

## **Delinquent Filers' Stock Registrations Revoked**

The registrations of the stock of Baroque Corp., Mother Lode Gold Mines Consolidated, and Solvis Group, Inc., have been revoked. Each had repeatedly failed to file annual and quarterly reports with the Securities and Exchange Commission in compliance with the requirements of the Securities Exchange Act of 1934. Thus, each violated a crucial provision of the federal securities laws that requires public corporations to publicly disclose current, accurate financial information so that investors may make informed decisions. The revocations were ordered in an administrative proceeding before an administrative law judge. (Rel. [34-58120](#); File No. 3-13077)

On July 10, 2008, the Commission revoked the registration of each class of registered securities of Harbour Intermodal, Ltd. (Harbour) for failure to make required periodic filings with the Commission. Without admitting or denying the findings in the order, except as to jurisdiction, which it admitted, Harbour consented to the entry of an Order Making Findings and Revoking Registration of Securities as to Harbour Intermodal, Ltd. finding that it had failed to comply with

reporting requirements and revoking the registration of each class of Harbour's securities pursuant to Section 12(j) of the Exchange Act. This order settled the charges brought against Harbour in *In the Matter of American Ship Building Co., et al.*, Administrative Proceeding File No. 3-13065.

For further information see Order Instituting Administrative Proceedings and Notice of Hearing Pursuant to Section 12(j) of the Securities Exchange Act of 1934, *In the Matter of American Ship Building Co., et al.*, Administrative Proceeding File No. 3-13065, Exchange Act Release No. 57956 (June 12, 2008). (Rel. [34-58132](#); File No. 3-13065)

On July 10, 2008, the Commission revoked the registration of each class of registered securities of Uniroyal Technology Corp. for failure to make required periodic filings with the Commission.

Without admitting or denying the findings in the order, except as to jurisdiction, which it admitted, Uniroyal consented to the entry of an Order Revoking Registration as to Uniroyal Technology Corp. finding that it had failed to comply with reporting requirements and revoking the registration of each class of Uniroyal's securities. This order settled the charges brought against Uniroyal in *In the Matter of Benguet Corp., et al.*, Administrative Proceeding File No. 3-13079.

For further information see Order Instituting Administrative Proceedings and Notice of Hearing Pursuant to Section 12(j) of the Securities Exchange Act of 1934, *In the Matter of Benguet Corp., et al.*, Administrative Proceeding File No. 3-13079, Exchange Act Release No. 57999 (June 23, 2008). (Rel. [34-58133](#); File No. 3-13079)

## **INVESTMENT COMPANY ACT RELEASES**

### **ING Clarion Real Estate Income Fund, et al.**

A notice has been issued giving interested persons until Aug. 4, 2008, to request a hearing on an application filed by ING Clarion Real Estate Income Fund, et al., under Section 6(c) of the Investment Company Act of 1940 (Act) for an exemption from Section 19 (b) of the Act, and Rule 19b-1 under the Act. The order would permit certain registered closed-end management investment companies to make periodic distributions of long-term capital gains (i)with respect to their common stock as part of a managed distribution plan as

frequently as twelve times each year, and (ii) with respect to their preferred stock as frequently as required by the terms of such preferred stock. (Rel. [IC-28329](#) - July 8)

## **COMMISSION ANNOUNCEMENTS**

### **SEC, FRB Sign Agreement to Enhance Collaboration, Coordination and Information Sharing**

Securities and Exchange Commission Chairman Christopher Cox and Board of Governors of the Federal Reserve System Chairman Ben Bernanke signed a memorandum of understanding (MOU) between the two agencies that will deepen their information sharing and cooperation, permitting both agencies to better perform their responsibilities.

Under the MOU between the two agencies, the SEC and the Board would share information and cooperate across a number of important areas of common interest including anti-money laundering, bank brokerage activities under the Gramm-Leach-Bliley Act, clearance and settlement in the banking and securities industries, and the regulation of transfer agents. The MOU specifically covers bank holding companies and so-called Consolidated Supervised Entities that own securities firms. It builds on and formalizes the long-standing cooperative arrangements between the SEC and the Board, as well as the more recent cooperation on matters including banking and investment banking capital and liquidity following the Board's emergency opening of credit facilities to primary dealers.

"I am pleased with this agreement," said Federal Reserve Board Chairman Ben Bernanke. "It formalizes and strengthens the ongoing cooperation between our two agencies to enhance the stability of the financial system. I look forward to continuing this productive collaboration with Chairman Cox and his staff."

SEC Chairman Christopher Cox said, "This agreement represents a valuable coordination of the roles of the SEC and the Fed in our capital markets. Years ago, when the dividing lines between commercial and investment banking were bright, the high level of coordination we are establishing was not a priority for the U.S. government. But, the interconnectedness of mortgage and lending

markets, credit derivatives, securitizations, and counterparty relationships requires the U.S. government to adopt a more coherent and coordinated approach. Just as with our similar arrangement with the CFTC, this agreement will permit the expanded sharing of information on a confidential basis, and help ensure that regulated entities receive a coherent message from Uncle Sam. This is smart government. We look forward to enhancing our collaborative relationship with the Fed within the formal framework covered by the agreement."

The MOU will improve the ability of the SEC to perform its role as primary supervisor of Consolidated Supervised Entities and Primary Dealers, and improve the ability of the Federal Reserve to perform its role in overseeing the stability of the financial system. The importance of this deepened cooperation is highlighted by the recent stress in the financial markets affecting commercial and investment banks, as well as many other market participants.

The SEC recently entered into a similar MOU with the Commodity Futures Trading Commission. An agreement between the SEC and the Department of Labor is anticipated later this summer. (Press Rel. [2008-134](#))

## **SEC Examinations Find Shortcomings in Credit Rating Agencies' Practices and Disclosure to Investors**

On July 8, the Securities and Exchange Commission released findings from extensive 10-month examinations of three major credit rating agencies that uncovered significant weaknesses in ratings practices and the need for remedial action by the firms to provide meaningful ratings and the necessary levels of disclosure to investors.

Under new statutory authority from Congress that enabled the SEC to register and examine credit rating agencies, the agency's staff conducted examinations of Fitch Ratings Ltd., Moody's Investor Services Inc., and Standard & Poor's Ratings Services to evaluate whether they are adhering to their published methodologies for determining ratings and managing conflicts of interest. With the recent subprime market turmoil, the SEC has been particularly interested in the rating agencies' policies and practices in rating mortgage-backed securities and the impartiality of their ratings.

The SEC staff's examinations found that rating agencies struggled significantly with the increase in the number and complexity of

subprime residential mortgage-backed securities (RMBS) and collateralized debt obligations (CDO) deals since 2002. The examinations uncovered that none of the rating agencies examined had specific written comprehensive procedures for rating RMBS and CDOs. Furthermore, significant aspects of the rating process were not always disclosed or even documented by the firms, and conflicts of interest were not always managed appropriately.

"We've uncovered serious shortcomings at these firms, including a lack of disclosure to investors and the public, a lack of policies and procedures to manage the rating process, and insufficient attention to conflicts of interest," said SEC Chairman Christopher Cox. "When the firms didn't have enough staff to do the job right, they often cut corners. That's the bad news. There's also good news. And that's that the problems are being fixed in real time. The recent events affecting our economy and our markets have galvanized regulators around the world to re-examine the regulatory framework governing credit rating agencies, but ultimately the responsibility for providing meaningful ratings to investors begins with the credit rating firms themselves."

Lori Richards, Director of the SEC's Office of Compliance Inspections and Examinations, said, "These examinations found shortcomings in the ratings processes used by each of the firms examined. The firms have all agreed to implement broad reforms to address the letter and the spirit of the findings, to better ensure that investors can have confidence in their ratings."

The Summary Report of Issues Identified in the Commission Staff's Examinations of Select Credit Rating Agencies describes the significant weaknesses in the rating agencies' processes in rating subprime RMBS and CDOs linked to subprime residential mortgage-backed securities from January 2004 to the present.

Specifically, the examinations found:

There was a substantial increase in the number and in the complexity of RMBS and CDO deals since 2002, and some of the rating agencies appear to have struggled with the growth. Significant aspects of the ratings process were not always disclosed.

Policies and procedures for rating RMBS and CDOs can be better documented.

The rating agencies are implementing new practices with respect to the information provided to them.

The rating agencies did not always document significant steps in the ratings process - including the rationale for deviations from

their models and for rating committee actions and decisions - and they did not always document significant participants in the ratings process.

The surveillance processes used by the rating agencies appear to have been less robust than the processes used for initial ratings.

Issues were identified in the management of conflicts of interest and improvements can be made.

The rating agencies' internal audit processes varied significantly.

The examinations were conducted by staff in the SEC's Office of Compliance Inspections and Examinations, Division of Trading and Markets, and Office of Economic Analysis. The report summarizes generally the remedial actions that credit rating agencies are expected to take as a result of the examinations, and includes observations by the SEC's Office of Economic Analysis about conflicts of interest that are unique to these products. A factual summary of the models and methodologies used by the rating agencies is provided in the report to provide transparency to the ratings process and the activities of the rating agencies in connection with the recent subprime mortgage turmoil.

The SEC last month proposed a three-fold set of comprehensive reforms to regulate the conflicts of interests, disclosures, internal policies, and business practices of credit rating agencies. The first portion of rulemaking would address conflicts of interest in the credit ratings industry and require new disclosures designed to increase the transparency and accountability of credit ratings agencies. The second portion would require credit rating agencies to differentiate the ratings they issue on structured products from those they issue on bonds through the use of different symbols or by issuing a report disclosing the differences. The third part of the SEC's proposed rulemaking would clarify for investors the limits and purposes of credit ratings and ensure that the role assigned to ratings in SEC rules is consistent with the objectives of having investors make an independent judgment of credit risks. (Press Rel. [2008-135](#))