

**UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK**

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

v.

EDWIN BUCHANAN LYON, IV,
GRYPHON MASTER FUND, L.P.,
GRYPHON PARTNERS, L.P.,
GRYPHON PARTNERS (QP), L.P.,
GRYPHON OFFSHORE FUND, LTD.,
GRYPHON MANAGEMENT PARTNERS, L.P.,
GRYPHON MANAGEMENT PARTNERS III, L.P., and
GRYPHON ADVISORS, L.L.C.

Defendants.

Civil Action No.

COMPLAINT

Plaintiff, the Securities and Exchange Commission (“Commission”), alleges as follows:

SUMMARY OF ALLEGATIONS

1. Defendants perpetrated an illegal trading scheme to evade the registration requirements of the federal securities laws in connection with at least thirty-five unregistered securities offerings, which are commonly referred to as “PIPEs” (Private Investments in Public Equities). Defendant Edwin Buchanan Lyon, IV (“Lyon”) serves as managing partner and chief investment officer of defendant entities Gryphon Master

Fund, L.P., Gryphon Partners, L.P., Gryphon Partners (QP), L.P., Gryphon Offshore Fund, Ltd., Gryphon Management Partners, L.P., Gryphon Management Partners III, L.P., and Gryphon Advisors, L.L.C. (collectively, "Gryphon Partners") (Lyon and Gryphon Partners collectively, "Defendants"). From 2001 to 2004, Gryphon Partners realized more than \$6.5 million in ill-gotten gains as a result of the unlawful trading scheme, which violated the antifraud and registration provisions of the federal securities laws.

2. Typically, after agreeing to invest in a PIPE transaction, Defendants sold short the issuer's stock, frequently through "naked" short sales in Canada. Later, once the Commission declared the resale registration statement effective, Defendants used the PIPE shares to cover the short positions — a practice prohibited by the registration provisions of the federal securities laws. To avoid detection and regulatory scrutiny, Defendants employed a variety of deceptive trading techniques, including wash sales, matched orders, and pre-arranged trades, to make it appear that they were covering their short sales with open market shares, when, in fact, Defendants were on both sides of the transactions and were covering with their PIPE shares.

3. "Selling short" is a technique used by investors to, among other things, take advantage of an anticipated decline in the price of a stock. In general, a "short seller" sells shares of stock that he or she does not own, ultimately "covering" the sale with shares that the seller purchases at a later date. The hope is that the stock price will fall so the short seller can purchase the stock to cover the short sale at a lower price.

4. Defendants' unlawful PIPE investment strategy and deceptive trading scheme involved at least thirty-five issuers that sought PIPE financing (collectively, "the PIPE Issuers"). During the relevant period, the common stock of each PIPE Issuer was registered with the Commission pursuant to either Section 12(b) or Section 12(g) of the Securities Exchange Act of 1934 ("Exchange Act") and was quoted on the NASDAQ National Market, or traded on the New York Stock Exchange or the Over-The-Counter Bulletin Board.

5. In each of the transactions, Defendants also made materially false representations to the PIPE Issuers to induce them to sell securities to Gryphon Partners. As a precondition of participation in a PIPE, Defendants had to represent that they would not sell, transfer or dispose of the PIPE shares other than in compliance with the registration provisions of the Securities Act of 1933 ("Securities Act"). At the time Defendants signed the securities purchase agreements, however, they intended to distribute the restricted PIPE securities in violation of the registration provisions of the Securities Act.

6. On at least four occasions, Defendants also engaged in illegal insider trading by using material nonpublic information and selling short the securities of certain PIPE Issuers. Defendants engaged in this conduct notwithstanding their agreement to keep information about the PIPE confidential and/or to refrain from trading prior to the public announcement of the PIPE.

7. The Commission requests that: (a) each defendant be enjoined from engaging in future violations of the antifraud and other provisions of the federal securities laws as

alleged herein; (b) Gryphon Partners, disgorge, with prejudgment interest, the illegal profits and proceeds obtained as a result of the actions described herein; (c) Gryphon Partners pay a civil monetary penalty pursuant to Section 20(d) of the Securities Act [15 U.S.C. § 77t(d)] and Section 21(d)(3) of the Exchange Act [15 U.S.C. § 78u(d)(3)]; (d) Lyon disgorge, with prejudgment interest, the illegal profits and proceeds he obtained as a result of the actions described herein; and (e) Lyon pay a civil monetary penalty pursuant to Section 20(d) of the Securities Act [15 U.S.C. § 77t(d)] and Section 21(d)(3) of the Exchange Act [15 U.S.C. § 78u(d)(3)].

JURISDICTION AND VENUE

8. The Commission brings this action pursuant to Sections 20(b) and 20(d) of the Securities Act [15 U.S.C. §§ 77t(b) and 77t(d)] and Section 21(d) of the Exchange Act [15 U.S.C. § 78u(d)].

9. This Court has jurisdiction over this action pursuant to Sections 20(b), 20(d), and 22(a) of the Securities Act [15 U.S.C. §§ 77t(b), 77t(d), and 77v(a)] and Sections 21(d), 21(e), and 27 of the Exchange Act [15 U.S.C. §§ 78u(d), 78u(e), and 78aa].

10. The Defendants, directly or indirectly, made use of the means or instruments of transportation or communication in, or the instrumentalities of, interstate commerce, or of the mails, or of the facilities of a national securities exchange in connection with the transactions, acts, practices, and courses of business alleged herein.

11. Venue is proper because certain of the transactions, acts, practices, and courses of business occurred within the Southern District of New York. Among other things, Defendants placed numerous securities transactions that were either executed or

cleared through broker-dealers located in New York. Defendants transacted business with, and paid compensation to, an entity located in New York for being the source of various PIPE offerings. Certain PIPE Issuers are headquartered in New York. In addition, there is a material witness who resides, and has his place of business, in New York.

12. The Defendants, directly or indirectly, have engaged in, and unless restrained and enjoined by this Court will continue to engage in, transactions, acts, practices, and courses of business that violate Section 10(b) of the Exchange Act [15 U.S.C. § 78j(b)] and Rule 10b-5 promulgated thereunder [17 C.F.R. § 240.10b-5], Section 17(a) of the Securities Act [15 U.S.C. § 77q(a)], and Sections 5(a), 5(b), and 5(c) of the Securities Act [15 U.S.C. §§ 77e(a), 77e(b), and 77e(c)].

DEFENDANTS

13. **Edwin “Bucky” Buchanan Lyon, IV**, age 40, resides in Dallas, Texas. During the relevant period, Lyon was, and continues to be, the managing partner and chief investment officer of Gryphon Management Partners, L.P.

14. **Gryphon Master Fund, L.P.**, a Bermuda limited partnership, is the master hedge fund for the Gryphon-related entities. All investments are held and made in Gryphon Master Fund, L.P. and three separate funds feed into this master fund.

15. **Gryphon Partners, L.P.**, a Texas limited partnership, is an onshore hedge fund that feeds into Gryphon Master Fund, L.P. Gryphon Partners, L.P. is a general partner of Gryphon Master Fund, L.P.

16. **Gryphon Partners (QP), L.P.**, a Texas limited partnership, is an onshore hedge fund that feeds into Gryphon Master Fund, L.P. Gryphon Partners (QP), L.P. is a general partner of Gryphon Master Fund, L.P.

17. **Gryphon Offshore Fund, Ltd.**, a Bermuda exempted mutual fund company, is an offshore hedge fund that feeds into Gryphon Master Fund, L.P. Gryphon Offshore Fund, Ltd. is a general partner of Gryphon Master Fund, L.P.

18. **Gryphon Management Partners, L.P.**, a Texas limited partnership, is the general partner and investment manager of Gryphon Partners, L.P., Gryphon Partners (QP), L.P., and Gryphon Offshore Fund, Ltd. All employees are employed by Gryphon Management Partners, L.P. The general partners of Gryphon Management Partners, L.P. are Lyon, Edwin Buchanan Lyon, III (Lyon's father), and Lee Lyon (sister of Lyon and daughter of Lyon, III). Gryphon Management Partners, L.P. is registered with Commission as an investment advisor with approximately \$200 million in assets under management.

19. **Gryphon Management Partners III, L.P.**, a Texas limited partnership, is the investment manager of Gryphon Offshore Fund, Ltd. Gryphon Management Partners III, L.P., however, assigned its management responsibilities to Gryphon Management Partners, L.P. The general partners of Gryphon Management Partners III, L.P. are Lyon, Edwin Buchanan Lyon, III, and Lee Lyon.

20. **Gryphon Advisors, L.L.C.**, a Texas limited liability company, is the general partner of Gryphon Management Partners, L.P. and Gryphon Management Partners III, L.P. Gryphon Advisors is owned 100% by Lyon.

STATEMENT OF FACTS

I. PIPEs Background

21. Issuers utilize the PIPEs market when more traditional means of financing, such as a registered repeat offering, are for various reasons impractical. PIPE securities are generally issued pursuant to Section 4(2) of the Securities Act or Regulation D under the Securities Act, which provide an exemption from registration for a nonpublic offering by an issuer. Because PIPEs are unregistered offerings, PIPE investors receive restricted securities when a transaction closes. Before investors can publicly trade those restricted securities, the issuer must file, and the Commission must declare effective, a resale registration statement, a process that may take 60 to 120 days to complete. PIPE investors therefore must wait a certain period of time before they can publicly trade the securities that they received in the PIPE. To compensate investors for this temporary illiquidity, PIPE issuers customarily offer the restricted securities at a discount to market price.

22. Many PIPE investors “hedge” their investment by selling short the PIPE issuer’s securities before the resale registration statement is declared effective. The size of the “hedge” is limited by the investor’s ability to locate shares of the PIPE issuer’s securities to borrow in order to sell short. A PIPE investor that wishes to fully “hedge” its investment therefore typically wants to purchase in the offering only as many shares as it knows it can locate to borrow. In thinly-traded securities, where locating shares can be difficult, investors wishing to “hedge” must limit their investment, which correspondingly limits their ability to profit from the PIPE transaction.

23. Defendants violated Sections 5(a), 5(b), and 5(c) of the Securities Act by covering their pre-effective date short positions with the actual shares received in the PIPE. This is because shares used to cover a short sale are deemed to have been sold when the short sale was made.

24. Lyon knew the lawful way to cover those short positions that were established to “hedge” PIPE investments, but he chose instead to cover his pre-effective date short positions with PIPE shares in order to avoid exposing the trades to market risk. This unlawful trading scheme permitted Defendants to profit from PIPE offerings without incurring corresponding market risk.

II. The Unlawful Trading Scheme and Unregistered Sale of Shares

25. During the period 2001 through 2004, Lyon implemented the unlawful trading scheme that enabled Gryphon Partners to invest in PIPE offerings without incurring market risk. His strategy was simple: to sell short as much as possible (up to the amount of Gryphon Partners’ restricted PIPE allocation) prior to the Commission declaring the resale registration statement effective and then to cover those short positions using the PIPE shares.

26. In each of the thirty-six transactions listed below (except Manufacturers’ Services Limited, in which Defendants engaged only in illegal insider trading), Defendants employed an unlawful trading strategy in violation of the antifraud and registration provisions of the federal securities laws:

	PIPE Issuer	Closing Date
1	PhotoMedex, Inc.	3/27/2001
2	Guilford Pharmaceuticals, Inc.	6/8/2001
3	Generex Biotechnology Corp.	7/30/2001
4	HealthExtras, Inc.	9/25/2001
5	MGI Pharma, Inc.	10/31/2001
6	Alloy, Inc.	11/1/2001
7	Gentner Communications Corp.	11/15/2001
8	IntelliData Technologies Corp.	11/28/2001
9	Viisage Technology, Inc.	12/14/2001
10	RailAmerica, Inc.	12/18/2001
11	Impco Technologies, Inc.	1/11/2002
12	Siga Technologies, Inc.	12/31/2002
13	Stonepath Group, Inc.	2/26/2003
14	Datatec Systems, Inc.	4/22/2003
15	Generex Biotechnology Corp.	5/29/2003
16	CytRx Corp.	5/29/2003
17	Vion Pharmaceuticals, Inc.	6/19/2003
18	Hollis-Eden Pharmaceuticals, Inc.	6/19/2003
19	Aastrom Biosciences, Inc.	7/10/2003
20	Insmmed, Inc.	7/11/2003
21	Celsion Corp.	7/23/2003
22	GTC Biotherapeutics, Inc.	7/30/2003
23	Socket Communications, Inc.	8/5/2003
24	Cardima, Inc.	8/13/2003
25	Heartland Oil & Gas Corp.	8/20/2003
26	Lifestream Technologies, Inc.	9/10/2003
27	Genome Therapeutics Corp.	9/29/2003
28	Verticalnet, Inc.	10/9/2003
29	Immune Response Corp.	10/10/2003
30	Keryx Biopharmaceuticals, Inc.	11/12/2003
31	Sorrento Networks Corp.	12/23/2003
32	V.I. Technologies, Inc.	1/13/2004
33	Medis Technologies Ltd.	1/13/2004
34	Verticalnet, Inc.	1/22/2004
35	AuthentiDate Holding Corp.	1/28/2004
36	Manufacturers' Services Limited (Insider Trading Only)	3/13/2002

27. Defendants engaged in the illegal trading scheme in connection with each of the PIPE offerings (except for Manufacturers' Services Limited), garnering a total of approximately \$6.5 million in ill-gotten gains for Gryphon Partners. These ill-gotten gains inflated Gryphon Partners' assets under management and performance, which consequently led Lyon to receive improper performance fees and compensation.

28. Defendants employed several different methods — often used in combination for the same PIPE — to establish their short positions. Because Defendants were sometimes unable to borrow the number of shares necessary to hedge their entire PIPE allocation, they often executed pre-effective date short sales through a Canadian broker-dealer.

29. Using their Canadian broker-dealer, Defendants executed “naked” short sales by selling short without borrowing unrestricted shares to deliver. Because “naked” short selling was permissible in Canada during the relevant period, Defendants had no borrowing limitations, and because they knew that they would be using their PIPE shares illegally to cover their pre-effective date short positions, Defendants were able to make larger PIPE investments than other investors and, as a result, were able to earn larger profits. In addition to their “naked” Canadian short selling, Defendants also engaged in short selling in the United States through domestic broker-dealers or by executing short sales through electronic communications networks (“ECNs”).

30. When Defendants sold short the PIPE Issuers' securities, there was not a resale registration statement in effect for the PIPE shares and no exemption from registration applied to the sales of those shares.

31. Once Defendants had established their short positions, they waited until the Commission declared effective the resale registration statement and then began to use their PIPE shares to cover the short positions in violation of Sections 5(a), 5(b), and 5(c) of the Securities Act.

32. To cover Canadian short positions, Defendants either directly delivered their PIPE shares to their Canadian account or engaged in deceptive trading techniques – wash sales and matched orders – through their Canadian broker-dealer. Specifically, Lyon would enter a limit order on an ECN to sell a specific number of Gryphon Partners’ PIPE shares from its domestic prime brokerage account. He would also place a limit order with the Canadian broker to buy the same number of shares for Gryphon Partners’ Canadian account. The limit order to sell the PIPE shares and the limit order to buy the PIPE shares would be placed simultaneously, or nearly simultaneously. These buy and sell orders would match on the ECN and the Canadian broker-dealer would use the PIPE shares that Gryphon Partners had just purchased from its domestic account to cover Gryphon Partners’ Canadian short positions.

33. By placing his limit order to sell the same amount of PIPE shares simultaneously, or nearly simultaneously, with his buy limit order to cover Gryphon Partners’ short position, Lyon knew there was a high likelihood that the two orders would match, and thus, eliminate Gryphon Partners’ exposure to the market moving against one side of the trade.

34. “Wash sales” are transactions involving no change in beneficial ownership. “Matched orders” are orders for the purchase or sale of a security that are entered with

the knowledge that orders of substantially the same size, at substantially the same time and price, have been or will be entered by the same or different persons.

35. A “limit order” is an order to buy or sell a security at a specific price. A buy limit order can only be executed at the limit price or lower, and a sell limit order can only be executed at the limit price or higher.

36. When Defendants established short positions in their domestic prime brokerage account, they used the following deceptive trading techniques to cover those short positions: “closing the box” and pre-arranged trades. To “close the box,” Defendants simply directed their prime broker to journal their PIPE shares from their cash account to their short account with instructions to cover the short position using the PIPE shares.

37. For the pre-arranged trades, Defendants sold their PIPE shares to certain brokers, which then sold the same shares back to Defendants. Once Defendants received their PIPE shares back from the brokers, they used those PIPE shares to cover their domestic short positions.

38. Although the manner of establishing and covering the short positions differed from deal to deal, the Medis Technologies Ltd. (“Medis”) PIPE offering that closed on January 13, 2004 illustrates Defendants’ basic trading strategy: Gryphon Partners invested \$1,500,000 in the offering, receiving 150,000 restricted Medis shares at \$10 per share – a discount of approximately 30% from Medis’s then-market price of approximately \$14.48 per share.

39. Defendants, through their Canadian broker, sold short 149,887 shares at prices ranging from \$11.57 to \$14.06 per share, garnering proceeds of approximately \$1,939,000. These short sales were placed prior to the registration statement being declared effective.

40. The Canadian short sales were “naked” short sales, meaning Defendants neither borrowed nor delivered to the purchaser the shares of Medis stock that they sold short.

41. Once the Commission declared the resale registration statement effective, Defendants, as described above, engaged in wash sales and matched orders with their Canadian broker, and used their PIPE shares to cover the 149,887 share short position. Gryphon Partners’ profit was therefore locked in at the moment its short sales were executed: the \$1,939,000 short sale proceeds minus the \$1,500,000 investment, for a net profit of approximately \$439,000.

42. An example of directly delivering the PIPE shares to cover occurred in the October 2003 Immune Response Corporation (“IMNR”) PIPE offering. As part of that PIPE offering, Gryphon Partners purchased 371,287 restricted PIPE shares and sold short, through its Canadian broker, 344,969 shares of IMNR prior to the registration statement being declared effective.

43. The Canadian short sales were “naked” short sales, meaning Defendants neither borrowed nor delivered to the purchaser the shares of IMNR stock that they sold short.

44. On December 17, 2003, subsequent to the IMNR registration statement being declared effective, Defendants directly delivered all 371,287 PIPE shares to their Canadian broker to cover their short position.

45. By selling short the PIPE Issuers' securities before the effective date of the resale registration statement for the PIPE shares and covering those short positions with the PIPE shares after the resale registration statement became effective, Defendants sold the PIPE shares prior to their effective registration.

III. Defendants Made Materially False Representations to the PIPE Issuers

46. As a necessary part of the unlawful trading scheme, Lyon, or those directed by Lyon, intentionally made materially false representations to the PIPE Issuers to induce them to sell their securities to Gryphon Partners. Each securities purchase agreement between the PIPE Issuers and Gryphon Partners contained a provision in which Gryphon Partners represented that it was purchasing the PIPE securities in compliance with Section 5 of the Securities Act. In each offering, Gryphon Partners represented, among other things, that it was purchasing the securities for its own account and without any present intention of distributing the securities.

47. This representation was material to the PIPE Issuers, who, as the stock purchase agreements made clear, relied on the investors' representations in order to qualify for an exemption from the registration requirements for their private offering. Without securing such representations, the PIPE Issuers could not have permitted Defendants to participate in the offering because the PIPE Issuers would not have qualified for a registration exemption.