

**IN THE UNITED STATES DISTRICT COURT  
FOR THE NORTHERN DISTRICT OF OHIO  
EASTERN DIVISION**

---

**UNITED STATES  
SECURITIES AND EXCHANGE  
COMMISSION,**

**Plaintiff,**

v.

**LNB BANCORP, INC., GARY C. SMITH,  
THOMAS P. RYAN, GERALD S. FALCON,  
and THOMAS H. ESCHKE,**

**Defendants.**

---

**CIVIL ACTION  
FILE NO. 04 CV 0933**

**COMPLAINT**

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

**NATURE OF THE CASE**

1. Beginning as early as February 11, 2000 and continuing through July 16, 2001, LNB Bancorp, Inc. (“LNB Bancorp”), through, Gary C. Smith (“Smith”), Thomas P. Ryan

(“Ryan”), Gerald S. Falcon (“Falcon”) and Thomas H. Eschke (“Eschke”) (hereinafter collectively referred to as the “Defendants”) perpetrated a market manipulation scheme to artificially increase and stabilize the price of LNB Bancorp common stock on the Nasdaq National Market (“Nasdaq”). Specifically, on 285 separate days, at or near the close of the trading day, Defendants Ryan, Falcon and Eschke placed purchase orders for 100 or 200 shares of LNB Bancorp common stock during the last half-hour of the trading day for the Lorain National Bank employee benefit plans in an attempt to mark the close of trading in the stock with a purchase order. Of these 285 purchases, Ryan, Falcon and Eschke succeeded in placing the last trade of the day for LNB Bancorp stock on 232 days. This manipulative trading practice is known as “marking the close”. Defendant Smith maintained supervisory roles over Ryan, Falcon and Eschke and knew, or was reckless in not knowing of the marking the close scheme and failed to take timely action to stop the scheme. By marking the close, the Defendants artificially supported the price of LNB Bancorp common stock on Nasdaq. As a result, the Defendants fraudulently manipulated the closing price of LNB Bancorp common stock.

2. By engaging in this scheme, the Defendants, directly and indirectly, have engaged in and, unless enjoined, will continue to engage in acts, practices and courses of business which constitute and will constitute violations of Section 10(b) of the Securities Exchange Act of 1934 (“Exchange Act”) [15 U.S.C. § 78j(b)] and Rule 10b-5 [17 C.F.R. § 240.10b-5] promulgated thereunder.

3. The Commission brings this action to enjoin such acts, practices and courses of business pursuant to Sections 21(d) and 21(e) of the Exchange Act [15 U.S.C. §§ 78u(d) and 78u-1(a)].

### **JURISDICTION**

4. The Court has jurisdiction over this action pursuant to Sections 21 and 27 of the Exchange Act [15 U.S.C. §§ 78u and 78aa]. Venue is also proper in this court pursuant to Section 27 of the Exchange Act [15 U.S.C. §78aa].

5. The acts, practices and courses of business constituting the violations herein occurred within the jurisdiction of the United States District Court for the Northern District of Ohio and elsewhere.

6. The Defendants will, directly and indirectly, unless enjoined, have the opportunity to engage in the acts, practices and courses of business set forth in this Complaint and in acts, practices and courses of business of similar purport and object.

7. The Defendants, directly and indirectly, have made use of the mails and of the means and instrumentalities of interstate commerce in connection with the acts, practices and courses of business alleged herein in the Northern District of Ohio and elsewhere.

### **THE DEFENDANTS**

8. LNB Bancorp is a \$715 million financial holding company with its headquarters located in Lorain, Ohio. LNB Bancorp, incorporated on October 11, 1983, has two wholly owned subsidiaries: Charleston Insurance Agency, Inc. and Lorain National Bank. Lorain National Bank is the primary subsidiary of LNB Bancorp. The common stock of LNB Bancorp is listed on the Nasdaq and registered with the Commission pursuant to Section 12(g) of the Exchange Act [15 U.S.C. §78l].

9. Smith, age 56, is a resident of Avon Lake, Ohio. During the time period at issue, Smith was the President and Chief Executive Officer (“CEO”) of LNB Bancorp, President and CEO of Lorain National Bank, and a Director of LNB Bancorp. Smith was also the Plan Administrator for the various Lorain National Bank employee benefit plans. Smith resigned

from LNB Bancorp and Lorain National Bank on December 10, 2003, after approximately five years of employment. His retirement from LNB Bancorp and Lorain National Bank became effective on March 10, 2004. During the relevant periods at issue, Smith owned approximately 3,600 shares of LNB Bancorp common stock.

10. Ryan, age 65, is a resident of Vermilion, Ohio. During the time period at issue, Ryan was the Executive Vice President, Secretary and Treasurer of LNB Bancorp and the Executive Vice President and Secretary of Lorain National Bank and a Director of LNB Bancorp. Ryan retired from LNB Bancorp and Lorain National on December 31, 2001, after approximately forty years of employment. During the time period at issue, Ryan owned approximately 37,000 shares of LNB Bancorp common stock.

11. Falcon, age 54, is a resident of Solon, Ohio. Falcon has been employed at Lorain National Bank for approximately twelve years. Falcon was the Vice President of the Operations Unit of the Investment and Trust Services Division of Lorain National Bank until approximately June 2000, when he was promoted to Senior Employees Benefits Officer of the Investment and Trust Services Division of Lorain National Bank.

12. Eschke, age 41, is a resident of Elyria, Ohio. Eschke has been employed at Lorain National Bank for approximately twelve years. Eschke was Falcon's assistant until approximately June 2000 when he replaced Falcon as the Assistant Vice President and Trust Operations Officer of the Operations Unit of the Investment and Trust Services Division of Lorain National Bank.

### **FACTS**

13. Prior to the commencement of the Defendants' marking the close scheme, the Lorain National Bank Investment and Trust Services Division had the responsibility of

purchasing stock for the individual accounts that it managed, such as self-directed and managed trust accounts, agency accounts and individual retirement plans, as well as for the Lorain National Bank employee benefit plans. As part of this process, Lorain National Bank was responsible for purchasing a variety of securities for these accounts, including LNB Bancorp common stock. Lorain National Bank established an internal procedure so as to place its daily securities trades with brokerage firms at approximately 11:00 a.m. and at 3:00 p.m. Eastern Standard Time.

14. During the relevant periods, Smith was the Plan Administrator of the Lorain National Bank employee benefit plans. Smith delegated the operational duties of these plans to Ryan, who in turn, delegated the day-to-day operations to Falcon and Eschke. Smith retained supervisory authority over Ryan, Falcon and Eschke.

15. Prior to LNB Bancorp's listing on Nasdaq, purchases of LNB Bancorp common stock for the Lorain National employee benefit plans were restricted by the availability of the stock on the OTC Bulletin Board.

16. During the time that LNB Bancorp was being considered for listing on Nasdaq, Smith and Ryan made numerous presentations to investment groups to promote LNB Bancorp common stock. On February 9, 2000, LNB Bancorp common stock became listed on Nasdaq. At that time, LNB Bancorp common stock was a thinly traded stock. Smith and Ryan decided that it would be beneficial for LNB Bancorp common stock to gain a "regular presence" on Nasdaq. To achieve this regular presence, Smith and Ryan decided to make a daily purchase of 200 shares of LNB Bancorp common stock for the Lorain National Bank employee benefit plans (the "Regular Presence Plan").

17. Smith, Plan Administrator of the Lorain National bank employee benefit plans, gave Ryan the authority to determine the timing of the daily purchase of 200 shares of LNB Bancorp common stock in furtherance of the regular presence plan.

18. Shortly after LNB Bancorp common stock became listed on Nasdaq, Smith and Ryan became aware that LNB Bancorp common stock was being sold late in the trading day. Ryan believed that an individual who was attempting to gain control over LNB Bancorp was driving down the closing price for LNB Bancorp common stock by selling LNB Bancorp common stock late in the day and then capitalizing on the lower closing price by making early morning purchases of LNB Bancorp common stock the next day.

19. Ryan informed Falcon of his concerns about the late day sales and early morning purchases of LNB Bancorp common stock. Falcon and Ryan decided to make the daily purchase of 200 shares of LNB Bancorp common stock for the Lorain National Bank employee benefit plans at or near the close of the trading day in order to counteract the effect of the late day sales on LNB Bancorp's stock price. Based on Falcon's suggestion, Ryan directed Falcon to deviate from Lorain National Bank's internal procedure of placing its securities trades with brokerage firms and to place the daily purchases of 200 shares of LNB Bancorp common stock for the Lorain National Bank employee benefit plans at or near the close of the trading day.

20. Falcon was responsible for the day-to-day implementation of Ryan's directive to purchase LNB Bancorp common stock at or near the close of the trading day. To ensure that the marking the close scheme was executed, Falcon immediately informed Eschke, his subordinate, about Ryan's directive to purchase the daily 200 shares of LNB Bancorp common stock for the Lorain National Bank employee benefit plans at or near the close of the trading day. Eschke knew that this trading plan was contrary to Lorain National Bank's established internal

procedure of placing securities trades with brokerage firms at approximately 11:00 a.m. and 3:00 p.m., but did not object to the plan.

21. The initial implementation of the Defendants' marking the close scheme resulted in LNB Bancorp stock closing the trading day with a purchase order. By closing the day with a purchase, the Defendants artificially increased the closing price of LNB Bancorp common stock and counteracted any late day sales. For example, on March 13, 2000, at 3:31 p.m. there was a sale of 200 shares of LNB Bancorp common stock. This late day sale resulted in lowering the LNB Bancorp common stock price from \$20.00 per share to \$18.75 per share. To counteract this sale, at 3:36 p.m. on the same day, the Defendants placed a purchase order for 200 shares of LNB Bancorp common stock at a price of \$20.00 per share. This purchase of LNB Bancorp common stock at the close of the trading day increased the bid price of LNB Bancorp common stock to \$20.00 per share.

22. Anticipating a continual need for the marking the close scheme, on or about April 20, 2000, Ryan and Falcon changed the quantity of the daily purchase of LNB Bancorp common stock purchase for the Lorain National Bank employee benefit plans from 200 shares to 100 shares. The Lorain National Bank employee benefit plans had defined amounts of LNB Bancorp common stock that Lorain National Bank was required to purchase for these plans. By purchasing 100 shares a day instead of 200 shares, LNB Bancorp could continue to execute its marking the close scheme for an indefinite period of time.

23. On or about May 2000, Ryan informed Smith that the daily purchases of LNB Bancorp common stock was occurring late in the trading day. At that time, Smith had an understanding of how purchases or sales placed at or near the close of the market impacted the closing price of stock. Ryan also informed Smith that the daily purchase of LNB

Bancorp common stock had changed from 200 shares to 100 shares. Smith acquiesced in Ryan's purchasing plan of LNB Bancorp common stock.

24. On or about June 2000, Falcon was promoted to Senior Employee Benefits Officer and Eschke replaced Falcon as the Assistant Vice President and Trust Operations Officer of Lorain National Bank. At this time, Eschke took over the day-to-day responsibilities of making sure that a daily order to purchase 100 shares of LNB Bancorp common stock for the Lorain National Bank employee benefit plans was placed at or near the close of the of the trading day.

25. On a few occasions, after Eschke and the Lorain National Bank trade clerk forgot to place the daily purchase of 100 shares of LNB Bancorp common stock, Ryan informed Eschke that it was important to place the purchases of LNB Bancorp common stock at or near the close of the day so that the stock would close with a purchase order. Eschke informed Ryan that it appeared that LNB Bancorp was trying to control the price of its own stock by purchasing shares at the end of day. Nevertheless, Ryan directed Eschke and others to continue the purchases of LNB Bancorp common stock at the close of trading each day. Eschke then devised a method to ensure that the daily purchase of LNB Bancorp common stock was executed.

26. Throughout this time period, Ryan maintained regular oversight of the daily purchases of LNB Bancorp common stock by continuously monitoring the LNB Bancorp stock activity and frequently contacting Eschke and the Lorain National Bank trade clerk to verify that the purchases of LNB Bancorp stock were placed at or near the close of the trading day.

27. The Defendants' scheme succeeded in setting the closing price of LNB Bancorp common stock on Nasdaq for 232 different days. All 232 trades placed at or near the close of the day were the last transactions in the trading day for the LNB Bancorp common stock. Of these

232 trades, 42 of the trades were the only trade of the day for LNB Bancorp common stock. As a result, during the time period at issue, numerous purchases of LNB Bancorp common stock placed for the Lorain National Bank employee benefit plans caused the closing price of LNB Bancorp common stock to be higher than what the price would have been without these trades. In fact, the Defendants' trading activity raised the closing price of LNB Bancorp common stock on at least 142 days. On the other 90 days, the Defendant's trading activity stabilized the price of LNB Bancorp common stock.

28. For instance, on January 16, 2001, the Defendants placed a purchase of 100 shares of LNB Bancorp common stock at \$22.50 per share within fifteen minutes of the market close. Prior to Defendants' trade, the bid price for LNB Bancorp common stock was \$21.50 per share. As a result of Defendants' purchase the closing price for LNB Bancorp common stock increased to \$22.75 per share.

29. As a result of the Defendants' daily purchases of LNB Bancorp common stock at or near the close of the trading day, the closing price of LNB Bancorp common stock was artificially increased or stabilized. As a result of these marking the close activities, the Defendants believed that they successfully fended off a takeover bid of LNB Bancorp and the possible change in control and management that they feared would result. In addition, these marking the close activities had the effect of preserving the value of the personal investments in LNB Bancorp common stock for Ryan and Smith.

## **COUNT I**

### **Violation of Section 10(b) of the Exchange Act [15 U.S.C. § 78j(b)] and Rule 10b-5 [17 C.F.R. § 240.10b-5] Promulgated Thereunder**

30. Paragraphs 1 through 29 are hereby realleged and incorporated by reference herein.

31. On or about February 11, 2000 through July 16, 2001, the Defendants, in connection with the purchase of LNB Bancorp securities, namely common stock, by use of the means and instrumentalities of interstate commerce and of the mails, directly and indirectly: employed devices, schemes and artifices to defraud; made untrue statements of material fact and omitted to state material facts necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; and engaged in acts, practices and courses of business which operated as a fraud and deceit upon purchasers and sellers of such securities.

32. The Defendants knew or were reckless in not knowing the facts and circumstances described in paragraphs 1 through 31 above.

33. By reason of the activities described in paragraphs 1 through 32 above, the Defendants violated Section 10(b) of the Exchange Act [15 U.S.C. § 78j(b)] and Rule 10b-5 [17 C.F.R. § 240.10b-5] promulgated thereunder.

### **PRAYER FOR RELIEF**

**WHEREFORE**, the Commission requests that the Court:

#### **I.**

Find that the Defendants committed the violations alleged above.

## **II.**

Issue an order of permanent injunction, in a form consistent with Rule 65(d) of the Federal Rules of Civil Procedure, enjoining LNB Bancorp, Smith, Ryan, Falcon and Eschke, their officers, agents, servants, employees, attorneys and those persons in active concert or participation with them who receive actual notice of the order of permanent injunction by personal service or otherwise, and each of them, from violating Section 10(b) of the Exchange Act [15 U.S.C. § 78j(b)] and Rule 10b-5 [17 C.F.R. § 240.10b-5] promulgated thereunder, by directly or indirectly, in connection with the purchase or sale of the securities of any issuer, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any national securities exchange from:

- A. employing any device, scheme or artifice to defraud;
- B. making any untrue statement of a material fact or omitting to state a material fact necessary in order to make statements made, in the light of the circumstances under which they were made, not misleading; or
- C. engaging in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person.

## **III.**

Grant an order requiring Defendants to pay civil penalties pursuant to Section 21(d) of the Exchange Act [15 U.S.C. §§ 78u(d)].

## **IV.**

Grant an order permanently prohibiting Ryan from acting as an officer or director of any issuer that has a class of securities registered pursuant to Section 12 of the Exchange Act or that is required to file reports pursuant to Section 15(d) of the Exchange Act pursuant to Section 21(d)(2) of the Exchange Act [15 U.S.C. § 78u(d)(2)] and the Court's equitable jurisdiction.

**V.**

Retain jurisdiction of this action in accordance with the principles of equity and the Federal Rules of Civil Procedure in order to implement and carry out the terms of all orders and decrees that may be entered or to entertain any suitable application or motion for additional relief within the jurisdiction of this Court.

**VI.**

Grant an Order for such further relief as the Court may deem appropriate.

Respectfully submitted,

---

Dee A. O'Hair  
Ohio Bar No. 0063523  
[o'haird@sec.gov](mailto:o'haird@sec.gov)  
Susan M. Weiss  
Illinois Bar No. 6211578  
[weiss@sec.gov](mailto:weiss@sec.gov)  
Attorneys for Plaintiff  
Securities and Exchange Commission  
175 W. Jackson Blvd., Suite 900  
Chicago, Illinois 60604  
Telephone: 312/353-7390  
Facsimile: (312) 353-7398

DATED: May 19, 2004