

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF PENNSYLVANIA

SECURITIES AND EXCHANGE COMMISSION,	:	
	:	
Plaintiff,	:	
	:	
v.	:	Civil Action No.
	:	
DAVID S. DAVIDSON,	:	05-cv742 BMS
LLOYD S. BEIRNE and	:	
BRANDON T. BUSH,	:	
	:	
Defendants.	:	

COMPLAINT

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

SUMMARY

1. This matter involves a fraudulent short selling scheme conducted by defendants David S. Davidson, former chairman and chief executive officer of D.L. Cromwell Investments, Inc. (“Cromwell”), a defunct broker-dealer, Lloyd S. Beirne, Cromwell’s former president, and Brandon T. Bush, a former Cromwell trader.

2. From late October 2002 through March 2003, defendants fraudulently used non-existent trades to hide a burgeoning short position in the stock of Expedia, Inc. (“Expedia”), held in Cromwell’s proprietary account at its clearing broker. Davidson, Beirne, and Bush used the access that Cromwell, as an introducing broker, had to the clearing broker’s system to falsely place Expedia buy orders, which they knew they

would cancel the next day, claiming the orders were placed in error. Defendants entered and cancelled these fictitious buys almost daily for five months, concealing the size of the short position from the clearing broker, and avoiding serious financial consequences.

3. The scheme unraveled on March 19, 2003, when the announcement of a tender offer for Expedia by its majority shareholder lifted Expedia's price from \$38 per share to more than \$47. Cromwell could not cover its short position in Expedia which had grown to approximately 660,000 shares, and the clearing broker was forced to pay \$18 million to cover the position.

4. By knowingly or recklessly engaging in the conduct described in this Complaint, defendants Davidson, Beirne and Bush violated, and unless restrained and enjoined will continue to violate, Section 17(a) of the Securities Act of 1933 ("Securities Act") [15 U.S.C. § 77q(a)], 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], thereunder.

JURISDICTION AND VENUE

5. The Commission brings this action pursuant to Section 20(b) of the Securities Act [15 U.S.C. § 77t(b)], and Section 21(d) of the Exchange Act [15 U.S.C. § 78u(d)] to enjoin such acts, transactions, practices, and courses of business, obtain disgorgement and civil penalties, and for other appropriate relief.

6. This Court has jurisdiction over this action pursuant to Section 22(a) of the Securities Act [15 U.S.C. § 77v(a)] and Section 27 of the Exchange Act [15 U.S.C. § 78aa].

7. Certain of the acts, transactions, practices, and courses of business constituting the violations alleged herein occurred within the Eastern District of Pennsylvania and elsewhere, and were effected, directly or indirectly, by making use of the means and instruments of transportation or communication in interstate commerce, or the means and instrumentalities of interstate commerce, or the mails, or the facilities of a national securities exchange.

DEFENDANTS

8. David S. Davidson, age 44, resides in Boca Raton, Florida. He is the former chairman and chief executive officer of Cromwell, a defunct broker-dealer.

9. Lloyd S. Beirne, age 39, resides in Boca Raton, Florida. He is the former president of Cromwell.

10. Brandon T. Bush, age 29, resides in Boca Raton, Florida. He was formerly employed as a trader at Cromwell.

11. As the senior officers at Cromwell, Davidson and Beirne made the firm's investment decisions, including those described in this Complaint. Davidson, Beirne and Bush implemented those decisions, with full knowledge of the consequences of their fraudulent acts.

FACTS

Defendants' Fraudulent Short Selling Scheme

12. D.L. Cromwell Investments, Inc., formerly located in Boca Raton, Florida, was a broker-dealer registered with the Commission from July 1999 through March 2003. As an introducing broker, Cromwell cleared its securities transactions through a clearing broker located in Philadelphia, Pennsylvania. Cromwell engaged primarily in proprietary

trading, or trading for its own accounts, using short selling as one of its investment strategies.

13. A short sale is the sale of a security that the seller does not own. In order to deliver the security to the purchaser, the short seller will borrow the security, typically from a broker-dealer on margin. The short seller later closes out the position by purchasing equivalent securities on the open market, or by using a security it already owns, and returning the security to the lender. In general, short selling is used to profit from an expected downward price movement, or to hedge the risk of a long position in the same or a related security.

14. During the fall of 2002, Davidson, Beirne and Bush caused Cromwell to develop a short position in Expedia. Contrary to their expectations, instead of falling, Expedia's stock price either stayed flat or increased during much of this period. Rather than take an immediate loss, the defendants continuously increased Cromwell's short position in Expedia over time. As a result, the value of Cromwell's margin account at the clearing broker rapidly decreased to levels below minimum equity requirements which, but for the fraudulent purchase orders described below, would have triggered numerous margin calls.

15. The clearing broker has an on-line system which provides introducing brokers access to their customer accounts. The clearing broker requires introducing brokers to manually enter into the system any trades executed through a third-party trading platform, such as an electronic communications network, but cleared through the clearing broker.

16. In order to facilitate the clearing process, the clearing broker matches the trades entered through its system with trades reported from the National Securities Clearing Corporation (“NSCC”). Trades entered through the clearing broker’s system that do not match trades reported from the NSCC are considered “trade breaks.”

17. In response to the growing short position, from late October 2002 through March 2003, Davidson, Beirne and Bush used Cromwell’s on-line access to its clearing broker’s system to fraudulently enter and then cancel fictitious Expedia buy orders. They did so almost daily. These “buys” made Cromwell’s short position appear minimal and concealed the margin problems from the clearing broker.

18. Because the NSCC did not reflect any matching sell side for these trades, the false buys appeared as trade breaks to the clearing broker the following day. When contacted by the clearing broker the day after each purported trade for an explanation for the unmatched trade, Bush, with the knowledge of Davidson and Beirne, claimed the buy order was the result of a keypunch error, and cancelled the trade.

19. Each day, the clearing broker identified trade breaks and required introducing brokers to correct them. As part of this process, Cromwell regularly received a trade break report from the clearing broker. Although the defendants knew that the buys were fictitious, and in furtherance of a fraudulent scheme, Bush nonetheless falsely told the clearing broker that the trade breaks were the result of keypunch errors, and cancelled the trades. Bush repeated these false statements several times a week to employees of the clearing broker.

20. The defendants engaged in this pattern of false Expedia purchases and cancellations with the expectation that the stock price would eventually decline, thus

enabling them to earn a profit or cover their short position with minimal losses. This trading pattern continued until the clearing broker discovered the scheme on or about March 20, 2003.

21. The scheme succeeded for months because, as Davidson, Beirne and Bush knew, the clearing broker calculated Cromwell's margin requirement on the basis of its short position on the date that each trade was placed rather than several days later when the trade settled.

22. On March 19, 2003, Expedia's majority shareholder announced a purchase agreement to acquire the remainder of Expedia's shares. As a result, Expedia's price increased from \$38.90 on March 18, 2003 to \$47.13 on March 19, 2003.

23. On March 20, 2003, the clearing broker discovered the defendants' short selling scheme after it issued several margin calls to Cromwell stemming from the sharp increase in Expedia's stock price. The clearing broker discovered that Cromwell had a 660,000 share short position, and ultimately paid \$18 million to cover Cromwell's short position.

CLAIM FOR RELIEF

Violations of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder

24. The Commission realleges and incorporates by reference each and every allegation in paragraphs 1 through 23, inclusive, as if the same were fully set forth herein.

25. From at least October 2002 and continuing through March 2003, as a result of the conduct alleged herein, defendants Davidson, Beirne and Bush, knowingly or recklessly, in connection with the offer, purchase, or sale of securities, directly or indirectly, by the use of the means or instruments of transportation or communication in

interstate commerce, or the means or instrumentalities of interstate commerce, or the mails, or the facilities of a national securities exchange:

(a) employed devices, schemes or artifices to defraud;

(b) obtained money or property by means of, or made, untrue statements of material fact, or omitted to state material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; and

(c) engaged in acts, transactions, practices, or courses of business that operated as a fraud or deceit upon offerees, purchasers, and prospective purchasers of securities.

26. By engaging in the foregoing conduct, Davidson, Beirne and Bush violated Section 17(a) of the Securities Act [15 U.S.C. § 77q(a)], Section 10(b) of the Exchange Act [15 U.S.C. § 78j(b)], and Rule 10b-5 [17 C.F.R. § 240.10b-5], thereunder.

WHEREFORE, the Commission respectfully requests that this Court:

I.

Permanently restrain and enjoin defendants Davidson, Beirne and Bush, and their agents, officers, servants, employees, attorneys, and those persons in active concert or participation with them, directly or indirectly, singly or in concert, from violating Section 17(a) of the Securities Act [15 U.S.C. § 77q(a)], Section 10(b) of the Exchange Act [15 U.S.C. § 78j(b)], and Rule 10b-5 [17 C.F.R. § 240.10b-5], thereunder.

II.

Order defendants Davidson, Beirne and Bush to disgorge any and all ill-gotten gains, together with prejudgment interest, derived from the activities set forth in this

Complaint, in accordance with a plan of disgorgement acceptable to the Court and to the Commission.

III.

Order defendants Davidson, Beirne and Bush to pay civil penalties 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)], as a result of the violations set forth herein.

IV.

Grant such other and further relief as the Court may deem just and appropriate.

Respectfully submitted,

s/

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Attorneys for Plaintiff

**SECURITIES AND EXCHANGE
COMMISSION**

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