

INITIAL DECISION RELEASE NO. 1054
ADMINISTRATIVE PROCEEDING
FILE NO. 3-16949

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

In the Matter of

SANDIP SHAH : INITIAL DECISION
: September 8, 2015

APPEARANCES: Martin F. Healey for the Division of Enforcement,
Securities and Exchange Commission

Sandip Shah, *pro se*

BEFORE: Carol Fox Foelak, Administrative Law Judge

SUMMARY

This Initial Decision (ID) concludes that Respondent Sandip Shah violated the antifraud provisions of the federal securities laws. The ID orders him to cease and desist from further violations and imposes a penny stock bar with the right to reapply in five years.

I. INTRODUCTION

A. Procedural Background

The Securities and Exchange Commission instituted this proceeding with an Order Instituting Administrative and Cease-and-Desist Proceedings (OIP) on November 9, 2015, pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 (Exchange Act).

In accordance with leave granted, the Division of Enforcement filed a motion for summary disposition, pursuant to 17 C.F.R. § 201.250(a); Shah, an opposition; and the Division, a reply. The filings mostly relate to sanctions – the Division requests a cease-and-desist order and a penny stock bar, and Shah argues that a penny stock bar should not be imposed. A telephone conference was held on August 3, 2016, at which the parties advanced arguments in support of their filings and in reference to the OIP.¹ Shah affirmed that he does not dispute that he violated Exchange Act Section 10(b) and Rule 10b-5(a) and that his state of mind during the events in question eventually became reckless in that he overlooked indications that he was involved in an illegal kickback scheme. Tr. 63, 72. He also advised that he is not defending against the imposition of a cease-and-desist order. Tr. 73-74, 81. Official notice pursuant to 17 C.F.R. § 201.323 is taken of the docket report, the court's orders, and other

¹ Citations to the transcript of the August 3, 2016, conference will be noted as "Tr. ___."

documents in *United States v. Shah*, No. 14-cr-10135 (D. Mass.), which involved the same events at issue in the instant proceeding, and of stock information on OTC Pink and the Commission's public official records contained in EDGAR concerning the three companies at issue in *United States v. Shah* and in this proceeding. The findings and conclusions in this ID are based on the foregoing. All arguments and proposed findings and conclusions that are inconsistent with this ID were considered and rejected.

B. Allegations and Arguments of the Parties

The events at issue arise from a fraudulent scheme in which insiders of publicly traded penny stock companies paid secret kickbacks to a purported corrupt hedge fund manager, who was actually an undercover Federal Bureau of Investigation agent, in exchange for the agent's purchase of restricted stock of penny stock companies on behalf of his purported (and nonexistent) hedge fund. The OIP alleges that Shah was involved in this scheme and that he was convicted after a jury trial of nine counts of wire fraud in *United States v. Shah*.

II. FINDINGS OF FACT

Shah was convicted after a jury trial of nine counts of wire fraud, in violation of 18 U.S.C. § 1343. *United States v. Shah*, ECF Nos. 114, 131. He was sentenced to twenty-seven months of imprisonment, followed by two years of supervised release,² and ordered to pay a \$9,000 fine. *Id.*, ECF No. 131. He was also ordered to forfeit \$5,750. *Id.*, ECF No. 136. The violations occurred during 2011. *Id.*, ECF No. 114. Additionally, with reference to the allegations in the instant proceeding, Shah affirmed, on the record, that he does not dispute that he violated Exchange Act Section 10(b) and Rule 10b-5(a) and that his state of mind during the events in question eventually became reckless in that he overlooked indications that he was involved in an illegal kickback scheme. Tr. 63, 72. Concerning sanctions, he is not defending against the imposition of a cease-and-desist order. Tr. 73-74, 81.

Shah was in the business of consulting for companies, including corporate development, corporate finance, public relations, and capital raising. Opp. at 1. The companies included Advanced Defense Technologies, Inc. (ADTI), Sohm, Inc. (SHMN), and Costas, Inc. (CSSI).³ His

² The conditions of supervised release include terms related to Shah's financial and business activities:

3. The defendant is prohibited from incurring new credit charges or opening additional lines of credit without the approval of the Probation Office while any financial obligations remain outstanding.

4. The defendant is to provide the Probation Office access to any requested financial information, which may be shared with the Financial Litigation Unit of the U.S. Attorney's Office.

United States v. Shah, ECF No. 131 at 4.

³ EDGAR does not contain records concerning SHMN. SHMN is shown as dark or defunct on OTC Pink. <http://www.otcmarkets.com/stock/SHMN/profile> (last visited Sept. 6, 2016). EDGAR does not contain records concerning CSSI. During 2011 CSSI traded between \$12 and \$14 on OTC

involvement in the FBI sting was as follows: Shah learned of a [purported] hedge fund, called Seafin Capital, through counsel for the three companies, and he and ADTI's CEO went to Boston in March 2011 to meet the potential source of funding. *Id.* After hearing ADTI's presentation, the [purported] fund's manager agreed to proceed with tranches of investment. *Id.* The procedures laid out by the fund manager did not raise any red flags; similar to existing practices in the small cap/microcap industry, they agreed to pay finder's fees for the capital. *Id.* In April 2011, Shah and SHMN's CEO went to Boston and met with the fund manager in search of funding for SHMN. *Id.* Again, after listening the SHMN's presentation, the fund manager agreed to proceed with funding and laid out the procedures. *Id.* After the meeting the fund manager told Shah privately that Shah would receive a finder's fee of 10% of the fund's investment in SHMN and that this arrangement would apply retroactively to ADTI and prospectively to any future company that Shah introduced to the fund manager. Opp. at 2. This was the first time that Shah's receiving any proceeds from the funding was mentioned. *Id.* CSSI had the same CEO as SHMN, and within the next few weeks, following a telephone conference with the fund manager, the fund invested in CSSI. *Id.* The CEOs of ADTI, SHMN, and CSSI, not Shah, made the final decisions to proceed with the funding. Opp. at 1-2, 4-5. In accordance with the fund manager's instructions, the CEOs returned approximately 50% of the funding they received to a nominee company, totaling approximately \$87,500. Opp. at 2. The fund manager then sent a total of \$5,750 (much less than the 10% promised) to Shah. Opp. at 2-3.

Shah acknowledges that he got involved in what turned out to be an illegal kickback scheme. Opp. at 6. He and the CEOs did not intentionally seek to get involved in the fraudulent scheme but, rather, passively followed the plan laid out by the fund manager. Opp. at 3. The word "kickback" was never used. Opp. at 4. Shah and the CEOs were blinded by the funding opportunity. Opp. at 3. Nonetheless, Shah's state of mind during the events in question eventually became reckless in that he overlooked indications that he was involved in an illegal kickback scheme. Tr. 63, 72; Opp. at 6. Shah has paid a heavy price: he was sentenced to twenty-seven months in prison, and he has lost his status in society, his business relationships, and his family. Opp. at 6. He has resolved to be more careful and to seek more transparency to ensure that he will not in the future be involved in anything illegal. *Id.*

III. CONCLUSIONS OF LAW

Shah has admitted to liability for the legal violations alleged in the OIP: that he willfully violated Exchange Act Section 10(b) and Rule 10b-5(a), which prohibit fraudulent conduct in connection with the purchase or sale of securities. Thus, it is concluded that Shah willfully violated Exchange Act Section 10(b) and Rule 10b-5(a).⁴

Pink. <http://www.otcmarkets.com/stock/CSSI/chart> (last visited Sept. 6, 2016). Neither EDGAR nor OTC Pink has records concerning ADTI.

⁴ The scienter requirement of those provisions can be satisfied by recklessness. *See SEC v. Steadman*, 967 F.2d 636, 641-42 (D.C. Cir. 1992); *David Disner*, Exchange Act Release No. 38234, 1997 SEC LEXIS 258, at *15 & n.20 (Feb. 4, 1997). Shah has acknowledged that his state of mind during the events in question eventually became reckless in that he overlooked indications that he was involved in an illegal kickback scheme.

IV. SANCTIONS

The Division requests: a cease-and-desist order pursuant to Section 21C(a) of the Exchange Act, 15 U.S.C. § 78u-3(a); and a penny stock bar pursuant to Section 15(b)(6) of the Exchange Act, 15 U.S.C. § 78o(b)(6). Shah has consented to a cease-and-desist order; accordingly, he will be ordered to cease and desist from violations of the antifraud provisions. Additionally, as discussed below, a penny stock bar with the right to reapply in five years will be imposed.

A. Sanction Considerations

In determining sanctions, the Commission considers such factors as:

the egregiousness of the defendant's actions, the isolated or recurrent nature of the infraction, the degree of scienter involved, the sincerity of the defendant's assurances against future violations, the defendant's recognition of the wrongful nature of his conduct, and the likelihood that the defendant's occupation will present opportunities for future violations.

Steadman v. SEC, 603 F.2d 1126, 1140 (5th Cir. 1979) (quoting *SEC v. Blatt*, 583 F.2d 1325, 1334 n.29 (5th Cir. 1978)), *aff'd on other grounds*, 450 U.S. 91 (1981). The Commission also considers the age of the violation and the degree of harm to investors and the marketplace resulting from the violation. *Marshall E. Melton*, Exchange Act Release No. 48228, 2003 SEC LEXIS 1767, at *4-5 (July 25, 2003). Additionally, the Commission considers the extent to which the sanction will have a deterrent effect. *Schild Mgmt. Co.*, Exchange Act Release No. 53201, 2006 SEC LEXIS 195, at *35-36 & n.46 (Jan. 31, 2006). As the Commission has often emphasized, the public interest determination extends to the public-at-large, the welfare of investors as a class, and standards of conduct in the securities business generally. See *Christopher A. Lowry*, Investment Company Act of 1940 Release No. 2052, 2002 SEC LEXIS 2346, at *20 (Aug. 30, 2002), *aff'd*, 340 F.3d 501 (8th Cir. 2003); *Arthur Lipper Corp.*, Exchange Act Release No. 11773, 1975 SEC LEXIS 527, at *52 (Oct. 24, 1975). The amount of a sanction depends on the facts of each case and the value of the sanction in preventing a recurrence. See *Berko v. SEC*, 316 F.2d 137, 141 (2d Cir. 1963); *Leo Glassman*, Exchange Act Release No. 11929, 1975 SEC LEXIS 111, at *7 (Dec. 16, 1975).

B. Sanctions

Section 15(b)(6) of the Exchange Act authorizes the Commission to issue a penny stock bar against a person who, as here, violated the federal securities laws and was participating in an offering of penny stock⁵ at the time of misconduct, if a bar is in the public interest. The *Steadman* factors are used to assess the public interest. *Vladlen "Larry" Vindman*, Securities Act of 1933 Release No. 8679, 2006 WL 985308, at *11 (Apr. 14, 2006)

⁵ The term "person participating in an offering of penny stock" includes any person acting as a promoter, finder, consultant, agent, or other person who engages in activities with an issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock. *Harold F. Harris*, Exchange Act Release No. 53122-A, 2006 WL 89510, at *4 (Jan. 13, 2006). Exchange Act Rule 3a51-1 defines "penny stock." Shah does not dispute that the securities of the companies at issue were penny stocks.

Shah's conduct was egregious since it violated the antifraud provisions. The violations were relatively recent, in 2011. The conduct was recurrent, as to a total of three companies, and involved a reckless degree of scienter. Shah recognizes the wrongful nature of the conduct and intends to be more careful and to avoid involvement in illegal activities in the future. While his assurance against future violations is sincere, it is somewhat undercut by his failure to recognize contemporaneously the illegality of the scheme in which he became entangled. For example, his reference to not having heard the term "kickback" in the funding discussions suggests that he did not recognize the conduct as such and might be at risk for a repetition. While Shah has suffered consequences such as imprisonment and loss of his status in society, business relationships, and family, the Commission has ruled that "the collateral consequences of misconduct, including the loss of employment, reputation, and income, are not mitigating." *Thomas C. Gonnella*, Securities Act Release No. 10119, 2016 SEC LEXIS 2786, at *51 & n.61 (Aug. 10, 2016). Since the conduct occurred within an FBI sting operation, no actual harm to investors and the markets occurred, but such conduct in market transactions would harm the marketplace because of its dishonest nature.⁶

Shah's business is consulting, including corporate development, corporate finance, public relations, and capital raising, for penny stock companies such as ADTI, SHMN, and CSSI. This occupation presents opportunities for future illegal conduct in the securities industry, and weighs in favor of a penny stock bar. Such a sanction is also required in light of the need to deter others from misconduct. In view of Shah's unequivocal recognition of the wrongful nature of his conduct and the sincerity of his assurance against future violations, the bar will be imposed with the right to reapply in five years. He is, and will be, limited in engaging in business activities, such as consulting for penny stock companies, during his twenty-seven month term of imprisonment and two year term of supervised release.

In sum, combined with a cease-and-desist order, a penny stock bar, with the right to reapply in five years, is in the public interest and an appropriate deterrent. The violations involved penny stocks,⁷ with Shah acting as a consultant to penny stock issuers.

V. ORDER

Based on the findings and conclusions set forth above:

IT IS ORDERED that, pursuant to Section 21C of the Securities Exchange Act of 1934, SANDIP SHAH CEASE AND DESIST from committing or causing any violations or future violations of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5(a) thereunder.

⁶ The foregoing evaluation of Shah's conduct also supports the imposition of a cease-and-desist order, to which he has consented.

⁷ Shah's conviction for wire fraud is itself a basis for a penny stock bar. Respondent has been convicted "within 10 years of the commencement of [this proceeding]" of a felony that involves 18 U.S.C. § 1343 within the meaning of Sections 15(b)(4)(B)(iv) and 15(b)(6)(A)(ii) of the Exchange Act.

IT IS FURTHER ORDERED that, pursuant to Section 15(b) of the Securities Exchange Act of 1934, SANDIP SHAH is BARRED from participating in an offering of penny stock, with the right to reapply in five years.⁸

This Initial Decision shall become effective in accordance with and subject to the provisions of Rule 360 of the Commission's Rules of Practice, 17 C.F.R. § 201.360. Pursuant to that Rule, a party may file a petition for review of this Initial Decision within twenty-one days after service of the Initial Decision. A party may also file a motion to correct a manifest error of fact within ten days of the Initial Decision, pursuant to Rule 111 of the Commission's Rules of Practice, 17 C.F.R. § 201.111. If a motion to correct a manifest error of fact is filed by a party, then a party shall have twenty-one days to file a petition for review from the date of the undersigned's order resolving such motion to correct a manifest error of fact. The Initial Decision will not become final until the Commission enters an order of finality. The Commission will enter an order of finality unless a party files a petition for review or a motion to correct a manifest error of fact or the Commission determines on its own initiative to review the Initial Decision as to a party. If any of these events occur, the Initial Decision shall not become final as to that party.

Carol Fox Foelak
Administrative Law Judge

⁸ Thus, he is barred from acting as a promoter, finder, consultant, or agent; or otherwise engaging in activities with a broker, dealer, or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock, pursuant to Section 15(b)(6)(A), (C) of the Securities Exchange Act of 1934.