INITIAL DECISION RELEASE NO. 690
ADMINISTRATIVE PROCEEDING
FILE NO. 3-15925

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

In the Matter of MICHAEL S. STEINBERG	INITIAL DECISION October 14, 2014

APPEARANCES: Justin P. Smith and Daniel R. Marcus for the Division of Enforcement, Securities and Exchange Commission

Barry H. Berke, Robin M. Wilcox, and Theodore S. Hertzberg for Michael S. Steinberg

BEFORE: Brenda P. Murray, Chief Administrative Law Judge

Background

The Securities and Exchange Commission (Commission) issued an Order Instituting Proceedings (OIP) on June 11, 2014, alleging that Michael S. Steinberg (Steinberg) was convicted of one count of conspiracy to commit securities fraud and four counts of securities fraud in *United States v. Steinberg*,[1] No. 1:12-cr-121 (S.D.N.Y. Dec. 18, 2013) (*Steinberg*). The OIP alleges further that Steinberg was sentenced to a prison term of forty-two months, followed by three years of supervised release, and was ordered to pay a fine of $2 million and $365,142.30 in criminal forfeiture. The Commission's Rules of Practice (Rules) require Steinberg to answer the allegations in the OIP within twenty days of service of the OIP. OIP at 3; 17 C.F.R. § 201.220. Steinberg was served with the OIP on June 16, 2014. *See* 17 C.F.R. § 201.141.

[1] The underlying district court case, docket number 1:12-cr-121, involved multiple defendants—Todd Newman, Anthony Chiasson, Jon Horvath, Danny Kuo, Hyung G. Lim, and Steinberg. The indictment for Steinberg was filed separately from the indictment for the other defendants. To be consistent with the caption used in the OIP and the parties' own characterization of the case in their filings, I refer to different captions throughout Initial Decision to reflect the defendant at issue (*e.g.*, "*United States v. Newman*," "*United States v. Steinberg*," "*United States v. Kuo*").

At a prehearing conference on June 26, 2014, Steinberg's counsel requested that this proceeding be adjourned for ninety days to allow for what he believes will be a favorable ruling from the U.S. Court of Appeals for the Second Circuit that would affect Steinberg's appeal of his criminal conviction. Counsel offered many reasons why, in these circumstances, delay would be the proper course of action, including the Division of Enforcement's (Division) endorsement of a stay in a related civil action, *SEC v. Steinberg*, No. 13-cv-2082 (S.D.N.Y.) (injunctive action), pending the Second Circuit appeal.[2] Tr. 5-8.[3] The Division expressed opposition to any delay in this proceeding, disagreed on the likely outcome and timing of a decision by the Second Circuit, and requested leave to file a motion for summary disposition pursuant to Rule 250. *See* 17 C.F.R. § 201.250. The Division agreed to waive the requirement that Steinberg answer the OIP. OIP at 3; 17 C.F.R. § 201.220.

On June 30, 2014, I issued an Order that refused to postpone the proceedings, granted the Division leave to file a motion for summary disposition pursuant to Rule 250, and set a procedural schedule. *Michael S. Steinberg*, Admin. Proc. Rulings Release No. 1575, 2014 SEC LEXIS 2335.

In accord with the procedural schedule, the Division filed a Motion for Summary Disposition (Motion) on July 25, 2014. The Motion includes the declaration of Justin P. Smith (Smith Decl.) with six attachments.[4] On August 20, 2014, Steinberg filed a Memorandum of Points and Authorities in Opposition to the Division's Motion (Opposition). The Opposition includes the declaration of Barry H. Berke (Berke Decl.) with Exhibits A-N,[5] which was filed on

[2] In *SEC v. Steinberg*, initiated on March 29, 2013, the Commission has charged Steinberg with violations of Section 17(a) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934 (Exchange Act), and Exchange Act Rule 10b-5. Motion at 4 n.1.

[3] Citation is to the transcript of the prehearing conference on June 26, 2014.

[4] Exhibit 1 is the Sealed Superseding Indictment in *Steinberg*, unsealed on March 29, 2013. Exhibits 2-4 are Government Exhibits 625, 634, and 636 in *Steinberg*, received in evidence on December 2, 2013. Exhibit 5 is the judgment in *Steinberg*, entered on May 16, 2014. Exhibit 6 is the Complaint in *SEC v. Steinberg* filed on March 29, 2013.

[5] Exhibit A is the August 28, 2012, Superseding Indictment in *United States v. Newman*, No. 1:12-cr-121 (S.D.N.Y). Exhibit B comprises excerpts from the trial transcript in *United States v. Newman*, No. 1:12-cr-121 (S.D.N.Y.). Exhibit C comprises excerpts from the trial transcript in *United States v. Martoma*, No. 1:12-cr-973 (S.D.N.Y.). Exhibit D is comprised of relevant pages from the Government's Request to Charge, filed May 5, 2014, in *United States v. Rajaratnam*, No. 1:13-cr-211, (S.D.N.Y.) (*Rajaratnam*). Exhibit E is an unofficial transcript of oral argument held by the Second Circuit in *United States v. Newman*, No. 13-1837 and *United States v. Newman (Chiasson)*, No. 13-1917 (collectively, *Newman/Chiasson* appeal). Exhibit F is a copy of portions of the Proposed Request to Charge, filed November 6, 2013, in *Steinberg*. Exhibit G is a copy of portions of the *Steinberg* trial transcript. Exhibit H is a copy of the May 16, 2014, sentencing transcript in *Steinberg*. Exhibit I is a copy of "the endorsed May 8, 2014 letter" from Barry H. Berke requesting a stay in *SEC v. Steinberg*. Exhibit J is a copy of the Order Following

August 21, 2014. On August 27, 2014, the Division filed a Reply Memorandum of Points and Authorities in Further Support of the Division's Motion (Reply). The Division's Reply includes the Declaration of Justin P. Smith with four attachments.[6]

The Parties' Arguments

Motion

The Motion argues that the evidence adduced in the criminal trial in *Steinberg* established that in 2008 and 2009, while a portfolio manager of a hedge fund affiliate, Steinberg traded in the securities of two publicly traded companies based on information that he knew had been disclosed by employees in violation of the duty of trust and confidence they owed their employer. Motion at 2. The Motion notes that on the facts presented at a five week trial, Steinberg was found guilty of one count of conspiracy to commit securities fraud and four counts of securities fraud, and that he was sentenced to forty-two months of incarceration followed by three years of supervised release and ordered to pay a fine of $2 million and $365,142.30 in criminal forfeiture. *Id.* at 1, 4; Smith Decl., Ex. 5.

The Motion argues that there is considerable precedent for granting summary disposition pursuant to Rule 250(b) where the respondent, affiliated with an investment adviser, has been criminally convicted, and the only issue in the administrative proceeding is the appropriate sanction. Motion at 5. The Division cites case law for the proposition that the pendency of an appeal of the conviction does not preclude the Commission from acting, based on the district court's judgment. *Id.*

The Division argues that it is in the public interest for the Commission to impose a collateral bar on Steinberg as allowed by Section 203(f) of the Investment Advisers Act of 1940 (Advisers Act) because Steinberg was convicted of a felony involving the purchase or sale of securities while he was associated with an investment adviser. *Id.* at 5-6. Considering the *Steadman* factors seriatim, the Division maintains that Steinberg's criminal conviction shows

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Prehearing Conference in this administrative proceeding. Exhibit K is a copy of the United States Court of Appeals for the Second Circuit Order issued August 6, 2014, granting Steinberg's motion to hold his appeal in abeyance pending disposition of the *Newman/Chiasson* appeal. Exhibit L comprises excerpts from the transcript of a conference held in *United States v. Kuo*, No. 1:12-cr-121 (S.D.N.Y.). Exhibit M comprises excerpts from the transcript of the May 30, 2014, conference held in *Rajaratnam*. Exhibit N is a copy of a May 28, 2014, letter to me from Assistant United States Attorneys requesting continuation of a stay in *Steven A. Cohen*, Admin. Proc. No. 3-15382.

[6] Exhibit 1 is the prehearing conference transcript in this administrative proceeding. Exhibit 2 is the initial page of a motion to dismiss in *Evelyn Litwok*, Admin. Proc. No. 3-14190, filed June 12, 2012. Exhibit 3 is an Application to Vacate Order Making Findings and Imposing Remedial Sanctions in *Jimmy Dale Swink, Jr.*, Admin. Proc. No. 3-8129, filed July 20, 1995. Exhibit 4 is a Motion to Vacate the Commission's Order of Debarment in *David G. Ghysels*, Admin. Proc. No. 3-13481, filed May 15, 2013.

that his illegal conduct was egregious and involved a high degree of scienter. *Id.* at 7; *Steadman v. SEC*, 603 F.2d 1126, 1140 (5th Cir. 1979), *aff'd on other grounds*, 450 U.S. 91 (1981). The Division, in addition, points to the fact that Steinberg received material nonpublic information on numerous occasions in 2008-2009 and his illegal conduct occurred on two separate occasions from at least August 2008 through May 2009. Motion at 7. It also points to the fact that Steinberg has not acknowledged that his conduct was wrong, shown any remorse, or provided any assurance that he would not engage in similar violations in the future. The Division concludes that a full collateral bar is the prospective measure needed to protect the public. *Id.* at 8; *see Christopher A. Lowry*, Investment Company Act of 1940 Release No. 2052, 2002 SEC LEXIS 2346 (Aug. 30, 2002).

Opposition

Steinberg advances several arguments, which focus on the Division's timing in initiating and resolving this administrative proceeding.

On December 17, 2012, a jury found defendants Newman and Chiasson guilty on all counts of conspiring to commit securities fraud and securities fraud in *United States v. Newman, Chiasson*, No. 1:12-cr-121 (S.D.N.Y.) (*Newman/Chiasson* trial). Opposition at 4. The Opposition presents a detailed description of events in the *Newman/Chiasson* trial, as well as the oral argument before the Second Circuit of their appeal on the "knowledge of benefit issue" in *United States v. Newman*, No. 13-1837, and *United States v. Newman (Chiasson)*, No. 13-1917 (collectively, *Newman/Chiasson* appeal). *Id.* at 2-4, 6. According to Steinberg, the presiding judge in the joint *Newman/Chiasson* trial, who also presided at his trial, erroneously concluded in both trials that a tippee need not have known that the tipper received a benefit to support insider trading liability. *Id.* at 3, 5; Berke Decl., Ex. B at 3594-605. Steinberg, like Newman and Chiasson, was refused a jury instruction that "to find him guilty of insider trading the prosecution had to prove that he knew that an insider breached a duty of trust or confidence 'in exchange for a personal benefit to the insider.'" Opposition at 5.

Steinberg claims that there has been an extraordinary reaction to the oral argument in the *Newman/Chiasson* appeal and that reversal would impact insider trading litigation in the Second Circuit and require reversal of his conviction. *Id.* at 8-9. The Opposition lists several matters impacted by the appeal.[7] *Id.* at 9. Steinberg believes that his conviction is tenuous, and that a

[7] On August 6, 2014, the Court of Appeals for the Second Circuit granted Steinberg's motion and held his appeal in abeyance until the disposition of the *Newman/Chiasson* appeal. Berke Decl., Ex. K. On July 1, 2014, sentencing was deferred in *United States v. Kuo*, No. 1:12-cr-121 (S.D.N.Y.), for the same reason. Berke Decl., Ex. L. The Commission has not acted on an Initial Decision that would bar Chiasson from the securities industry. *See Anthony Chiasson*, Initial Decision Release No. 589, 2014 SEC LEXIS 1366 (Apr. 18, 2014). The Commission has also issued an Order Granting Petition for Review and Scheduling Briefs. *See Anthony Chiasson*, Advisers Act Release No. 3841, 2014 SEC LEXIS 1853 (May 30, 2014). In *Rajaratnam*, Judge Buchwald referred to the *Newman/Chiasson* oral argument when discussing the charge she would give. Berke Decl., Ex. M. On May 28, 2014, the United States Attorney requested a continuation of the stay in *Steven A. Cohen*, Admin. Proc. No. 3-15382, until the

decision on the Motion should be deferred until after the Second Circuit rules on the appeal. *Id.* at 10.

Steinberg contends that the Division took a contrary position on the need for expedition where it represented to the district court that its injunctive action against Steinberg should be stayed following oral argument in the *Newman/Chiasson* appeal. *Id.* at 1, 7. Steinberg also represents that he has agreed to absent himself from the securities industry until all cases against him are concluded, and given pending litigation before the Second Circuit which might well be successful, Steinberg would be significantly prejudiced if he were barred on the basis of innocent conduct. *Id.* at 2.

Steinberg argues that the cases cited by the Division are inapplicable and deferring action under Rule 250(b) would be in line with what other forums have done in these circumstances. *Id*. at 10-12. Finally, Steinberg argues that he would be unfairly prejudiced by an industry bar given that eight district courts have held that to support a conviction, a tippee must know that the insider received a personal benefit in exchange for disclosing the information, and if a bar were imposed and his conviction were reversed, it would be months before he could get his right to associate restored. *Id.* at 14

The Second Circuit heard oral argument on the *Newman/Chiasson* appeal on April 22, 2014. If the Second Circuit has not ruled by January 12, 2015, my calculation for the Initial Decision due date, Steinberg would ask that I request an extension in the due date for the Initial Decision in this administrative proceeding. *Id.* at 15.

Reply

The Reply insists that I should act without delay, that there are grounds for summary disposition, and Section 203(f) of the Advisers Act specifies that the Commission shall impose a collateral industry bar on a person, who like Steinberg, has been convicted of a crime within the preceding ten years involving the purchase or sale of securities where the person was associated with an investment adviser at the time of the of the misconduct. Reply at 2-9. The Division finds no basis for either delaying a ruling on the Motion under Rule 250(b) or for requesting an extension under Rule 360(a)(3) in the 210-day deadline for an Initial Decision.

Summary Disposition

Summary disposition is permissible here pursuant to the Commission Rules of Practice. 17 C.F.R. § 201.250(a). I waived Steinberg's requirement to answer and granted leave to the Division to file the Motion. The application of summary disposition often occurs where an administrative proceeding is based on the fact of a prior criminal conviction or a civil injunction. In this situation, the applicable statutory provision is Section 203(f) of the Advisers Act. Courts have upheld the Commission's application of summary disposition in follow-on proceedings like

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Second Circuit issues a decision in the *Newman/Chiasson* appeal. Berke Decl., Ex. N. Lastly, Steinberg was granted bail pending appeal on May 16, 2014, based on the *Newman/Chiasson* appeal. Berke Decl., Ex. H.

this one. *See Gary M. Kornman*, Exchange Act Release No. 59403, 2009 SEC LEXIS 367, at *22 (Feb. 13, 2009), *pet. denied*, 592 F.3d 173 (D.C. Cir. 2010); *Jeffrey L. Gibson*, Exchange Act Release No. 57266, 2008 SEC LEXIS 236, at *19-21 & n.21-24 (Feb. 4, 2008) (collecting cases), *pet. denied*, 561 F.3d 548 (6th Cir. 2009). Neither party objected to resolving the allegations through summary disposition at the prehearing conference on June 26, 2014.

Rule 250(b) specifies that a motion for summary disposition shall be promptly granted or denied or decision on the motion shall be deferred. 17 C.F.R. § 201.250(b). Motions may be granted if there is no genuine issue with regard to any material fact and the party making the motion is entitled to summary disposition as a matter of law. *Id.* In deciding a motion for summary disposition, the facts offered by the party against whom a motion is made shall be taken as true. 17 C.F.R. § 201.250(a).

I applied preponderance of the evidence as the standard of proof. *See Steadman v. SEC*, 450 U.S. 91, 101-04 (1981). I admit into evidence the exhibits attached to the parties' pleadings which are described in this Initial Decision and take official notice of the official record of related judicial proceedings pursuant to 17 C.F.R. § 201.323. The findings and conclusions herein are based on the entire record. I have considered and rejected all arguments and proposed findings and conclusions that are inconsistent with this Initial Decision.

Findings of Fact

On December 18, 2013, the *Steinberg* jury found Steinberg guilty of four counts of securities fraud for offenses in violation of Section 10(b) of the Exchange Act and Exchange Rule 10b-5 that ended on June 1, 2009. *Steinberg*; Opposition at 6, Ex. 5. On May 16, 2014, Steinberg was sentenced to serve forty-two months in prison and three years of supervised release, and ordered to pay $2 million in penalties and $365,142.30 in forfeitures. Smith Decl., Ex. 5. From in or about late 2007 through in or about 2009, Steinberg, while a portfolio manager with a hedge fund located in New York, New York:

> obtained material, nonpublic information ("Inside Information") from his analyst, [Jon] Horvath. Horvath, in turn, obtained the Inside Information directly and indirectly from employees of certain publicly traded technology companies ("Technology Companies"), including information relating to the Technology Companies' earnings, revenues, gross margins, and other confidential and material financial information of the Technology Companies. Specifically, Horvath obtained Inside Information from his own sources at companies, as well as from analysts who worked at different hedge funds and investment firms in New York, New York and elsewhere (the "Analysts Conspirators"), who, in turn, obtained the Inside Information directly or indirectly from employees of the Technology Companies. Steinberg executed and caused to be executed securities transactions in certain of the Technology Companies based in whole or in part on the Inside Information Horvath provided to him, earning substantial sums in unlawful profits for the benefit of Hedge Fund A.

> The Inside Information received by . . . Steinberg, . . . was obtained in violation of: (i) fiduciary and other duties of trust and confidence owed by the employees of the Technology Companies to their employers; (ii) expectations of confidentiality held by the Technology Companies; (iii) written policies of the Technology Companies regarding the use and safekeeping of confidential business information; and (iv) agreements between the Technology Companies and their employees to maintain information in confidence.
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> . . .
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> Steinberg executed and caused others to execute securities transactions . . . based in whole or in part on the Inside Information provided by Horvath, knowing that the Inside Information had been disclosed by public company employees in violation of duties of trust and confidence owed to their employers.

Smith Decl., Ex. 1 at 2-3, 12-13.

Steinberg has appealed his conviction to the Second Circuit on an issue that is also before that court in the *Newman/Chiasson* appeal, among other issues. Tr. 7. Steinberg's counsel is confident based on his interpretation of the legal issue involved, the oral argument before the Second Circuit in *Newman/Chiasson*, and events and comments which have transpired since the oral argument, that Steinberg's conviction will be reversed. Based on the same information, the Division believes the conviction will be upheld.

Conclusions of Law

Section 203(f) of the Advisers Act states that the Commission shall impose sanctions where a person has been convicted of a violation specified in Advisers Act Section 203(e) and at the time of the violations the person was associated with an investment adviser, and the public interest supports imposition of sanctions. 15 U.S.C. § 80b-3(e), (f). Possible sanctions include censure, limiting his activities in the securities industry, suspension for up to twelve months, and a bar from association with an investment adviser, broker, dealer, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization (collateral or industry wide bar). 15 U.S.C. § 80b-3(f).

In making a public interest determination, the Commission considers the so-called *Steadman* factors: the egregiousness of the respondent's actions; the isolated or recurrent nature of the infraction; the degree of scienter involved; the sincerity of the respondent's assurances against future violations; the respondent's recognition of the wrongful nature of his conduct; and the likelihood that the respondent's occupation will present opportunities for future violations. *Steadman v. SEC*, 603 F.2d 1126, 1140 (5th Cir. 1979), *aff'd on other grounds*, 450 U.S. 91 (1981). The Commission also considers the deterrent effect of administrative sanctions. *See Schield Mgmt. Co.*, Exchange Act Release No. 53201, 2006 SEC LEXIS 195, at *35-36 & n.46 (Jan. 31, 2006). The Commission has determined that an administrative law judge should "review each case on its own facts" to make findings before imposing an industry-wide bar. *See Ross Mandell*, Exchange Act Release No. 71668, 2014 SEC LEXIS 849, at *7-8 (Mar. 7, 2014).

Egregiousness and Recurrence

The violations are egregious because they were a willful and knowing betrayal of trust by a person at a very high level in the securities industry, who, realizing the nature of his activities, urged discretion with the material nonpublic information that he received. Smith Decl., Exhibit 3. The violations were also egregious because they resulted in substantial unlawful profits to a hedge fund; the superseding indictment quantifies an amount of $1.4 million dollars. Smith Decl., Ex. 1 at 3, 8, 10-11. The case law considers fraud violations, including insider trading, as serious transgressions. *See Robert Bruce Lohmann*, Exchange Act release No. 48092, 2003 SEC LEXIS 3171, at *16 (June 26, 2003) (upholding a permanent, collateral bar and noting that "[i]nsider trading constitutes clear defiance and betrayal of basic responsibilities of honesty and fairness to the investing public" (internal quotation marks omitted)). Steinberg's activities were not isolated, but occurred from approximately late 2007 through 2009 and resulted in four improper securities transactions in August 2008 and May 2009. Smith Decl., Ex. 1 at 2, 15.

Scienter

The superseding indictment in *Steinberg* on which Steinberg was found guilty stated that his acts were done willfully and knowingly. Smith Decl., Ex. 1 at 11-14. Steinberg was convicted of conspiracy to commit securities fraud and securities fraud, which require a high degree of scienter. *See United States v. Feola*, 420 U.S. 671, 686 (1975) (holding that in order to sustain a judgment of conviction on a charge of conspiracy to violate a federal statute, the government must prove at least the degree of criminal intent necessary for the substantive offense); *United States v. Vilar*, 729 F.3d 62, 88-89 (2d Cir. 2013) (scienter is an element of the government's case for securities fraud under Section 10(b) of the Exchange Act).

Opportunity For Future Violations and Deterrence

The Commission's concern is protecting the public. The fact that Steinberg has voluntarily agreed not to participate in the industry until the litigation is resolved does not adequately protect the public as he could change his mind at any time. The facts that exist at this time, the prevailing case law, and consideration of the *Steadman* factors and the likelihood of deterrence all indicate that Steinberg should receive a collateral bar.

Finally, an appeal is not a basis for delaying a ruling in an administrative proceeding. *See Todd Newman*, Initial Decision Release No. 562, 2014 SEC LEXIS 507 (Feb. 10, 2014), Exchange Act Release No. 71787, 2014 SEC LEXIS 1041 (Mar. 24, 2014); *Ross Mandell*, 2014 SEC LEXIS 849, at *21 n.28; *Jon Edelman*, 52 S.E.C. 789, 790 (1996). Steinberg might well be correct about the outcome of his appeal, but this ruling has to be based on the facts as they exist at the time this Initial Decision is issued, not assumptions on what might happen.

Order

I GRANT, pursuant to Commission Rule of Practice 250(b), the Division's Motion for Summary Disposition, and ORDER, pursuant to Section 203(f) of the Investment Advisers Act of 1940, that Michael S. Steinberg, is barred from association with an investment adviser, broker, dealer, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization.

This Initial Decision shall become effective in accordance with and subject to the provisions of Commission Rule of Practice 360. 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 Commission Rule of Practice 111. 17 C.F.R. § 201.111(h). If a motion to correct a manifest error of fact is filed by a party, then that 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 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. 17 C.F.R. § 201.360(b)(1).

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Brenda P. Murray
Chief Administrative Law Judge