UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933

SECURITIES EXCHANGE ACT OF 1934

ADMINISTRATIVE PROCEEDING
File No. 3-12898

In the Matter of
Michael K. Smith,
Respondent.

ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS, MAKING FINDINGS AND A CEASE-AND-DESIST ORDER PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933 AND SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934

I.

The Securities and Exchange Commission (“Commission”) deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 (“Securities Act”) and Section 21C of the Securities Exchange Act of 1934 (“Exchange Act”), against Michael K. Smith (“Smith” or “Respondent”).

II.

In anticipation of the institution of these proceedings Respondent has submitted an Offer of Settlement (the “Offer”) which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission’s jurisdiction over him and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Cease-and-Desist Proceedings, Making Findings, and Imposing a Cease-and-Desist Order Pursuant to Section 8A of the Securities Act of 1933 and Section 21C of the Securities Exchange Act of 1934 (“Order”), as set forth below.
III.

On the basis of this Order and Respondent’s Offer, the Commission finds¹ that:

**RESPONDENT**

**Smith** age 47 is a resident of St. Michaels, Maryland and was Chief Financial Officer of Pegasus from September 1999 until March of 2002. By March 2002, in addition to being CFO, Mr. Smith was Treasurer and Executive Vice President of Finance and Information Technology. Smith is an inactive Certified Public Account licensed in California.

**RELEVANT ENTITIES**

**Pegasus Communications Corporation** (“Pegasus”) was a Delaware corporation based in Bala Cynwyd, Pennsylvania, which, pursuant to a corporate re-organization in February of 2001, became the parent company of various operating subsidiaries including Pegasus Satellite Communications and Pegasus Media & Communications.² Pegasus’ common stock was registered with the Commission pursuant to Section 12(g) of the Exchange Act. On January 4, 2007, Pegasus filed a Form 15 to terminate its registration and reporting status following a going-private transaction, which took it below the 300 record holder threshold set forth under Exchange Act Rules 12g-4(a)(1) and 12h-3(b)(1)(i). Pegasus and its subsidiaries followed a calendar year reporting cycle.

**Pegasus Satellite Communications, Inc.** (“PSC”), during all relevant times, was a Delaware corporation based in Bala Cynwyd, Pennsylvania. PSC filed annual and quarterly reports with the Commission on Forms 10-K and 10-Q commencing in November of 1996. During the period 1998 to 2001, PSC issued stock, options, warrants, and debt securities in public and private offerings. On February 22, 2001, PSC became a wholly-owned subsidiary of Pegasus. On June 2, 2004, PSC filed for bankruptcy. On August 2, 2004, PSC filed a Form 15 to terminate its duty to file reports with the Commission. On May 5, 2005, PSC ceased being a subsidiary of Pegasus when a plan of reorganization became effective that provided for a Liquidating Trustee overseeing the disposition of PSC’s assets.

**Pegasus Media & Communications, Inc.** (“PM&C”), a Delaware corporation based in Bala Cynwyd, Pennsylvania during all relevant times, was a diversified media and communications company, which together with its subsidiaries, owned and operated broadcast television systems and provided direct broadcast satellite television services to customers in certain rural areas of the United States. PM&C was a direct subsidiary of PSC. PM&C also filed annual and quarterly reports with the Commission commencing in May 1996. On September 3, 2003, it filed a Form 15 to terminate its reporting duties. On June 2, 2004, PM&C filed for bankruptcy. On May 5, 2005, PM&C ceased being an indirect subsidiary of Pegasus when a

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¹ The findings herein are made pursuant to Respondent’s Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

² Prior to the re-organization, Smith served as Chief Financial Officer of the operating subsidiaries.
plan of reorganization became effective that provided for a Liquidating Trustee overseeing the disposition of PM&C’s assets.3

SUMMARY

During the period from 1999 through 2001, Pegasus, a satellite television provider, engaged in a number of actions designed to increase the number of its active satellite subscribers. First, Pegasus extended the period of time that customers who had failed to pay their bills could be considered active and, therefore, part of the subscriber count. At Pegasus, these delinquent accounts whose status was extended were called “re-aged” accounts. Second, in 2001, Pegasus re-activated the accounts of certain customers who had voluntarily disconnected their service by reclassifying the accounts from disconnect to suspend status and by assigning one-cent credits to the customers’ accounts, thus causing the billing system to restore those subscriber accounts to active status. At Pegasus, these accounts that were reactivated by one-cent credits were called “penny-suspends” or “Penny-credits.” As a result of these actions, the number of subscribers who were not generating revenue or receiving services from Pegasus grew substantially. Without these actions, Pegasus would have had nominal growth in its subscriber base for the year 2001. Up until April of 2002, when Pegasus disclosed an adjusted subscriber count, investors had no way of knowing that a significant number of Pegasus’ subscribers had been retained by using the tactics described above. The Commission has previously addressed PSC and PM&C’s violations of the federal securities laws arising out of these programs. See In the Matter of Pegasus Satellite Communications, Inc., et al., File No. 3-12146 (January 11, 2006). This Order addresses the role of Smith.

IV.

FACTS

A. Background

Pegasus’ business plan focused on marketing satellite television products and services to rural areas within the United States. At all relevant times, Pegasus included subscriber data in its quarterly and annual reports filed with the Commission, and in quarterly earnings releases and conference calls with securities analysts. Subscriber data was also incorporated into a registration statement on Form S-4, as amended June 15, 2001, filed with the Commission by PSC, covering an exchange offering of securities under the Securities Act.4 Stock analysts

3 Until the completion of a corporate reorganization in 2001, PSC was required to file periodic reports with the Commission under Section 13(a) of the Exchange Act as a result of registering securities pursuant to Section 12(g) of the Exchange Act. During the relevant time, PM&C’s obligation to file periodic reports with the Commission under Section 15(d) of the Exchange Act was suspended, but it did file reports on a voluntary basis.

4 Registration statements were also filed by Pegasus entities, including PSC, at different times. Such filings included, among others, a Form S-4 filed on January 7, 2000 covering an exchange offer for PSC senior notes and a Form S-4 filed on April 6, 2000 covering the issuance of Pegasus Class A common stock. These registration statements either restate subscriber data containing no-core numbers and/or incorporate by reference other filings that do so.
frequently cited subscriber statistics as a metric for measuring the value of satellite and cable television businesses such as Pegasus, and Pegasus monitored the movement of the subscriber base from period to period.

For example, on January 19, 2000, a research report prepared by an independent investment firm had said of Pegasus:

> Despite the run-up in the stock, we argue that Pegasus is attractively valued. Pegasus trades at $3,600 per user, which compares favorably to Echostar’s $6,900 per user. Our view is that a discount is warranted given that Echostar is an integrated provider rather than simply a reseller. A 50% discount, however, fails to reflect the fact that [among other things] Pegasus is growing faster than Echostar—its net subscriber additions jumped by 50% in December versus only 23% for Echostar .... Based on a valuation of $4,000 per estimated end-2000 user.... we increase our price target to $150 from $70.

Pegasus billed customers through a billing system designed and maintained by an independent telecommunications cooperative. The system generated subscriber statistics that Pegasus used to prepare reports. The system used certain criteria to determine which accounts would be considered active and included in the subscriber statistics and which accounts would be considered dropped, or “churned,” and excluded from subscriber statistics. Prior to February 2000, the system automatically cut off and marked as churned accounts that were overdue by 52 days. Such churned accounts were not counted as part of the subscriber base reported by the system. Accounts of customers who voluntarily terminated their relationship with Pegasus were considered inactive and churned immediately unless an account had a credit balance, in which case, it would continue to be counted as active by the billing system maintained by the telecommunications cooperative.

**B. Re-aging Delinquent Subscribers**

From at least the third quarter of 1999 through 2001, Pegasus engaged in activities that had the effect of increasing the number of subscribers reported in its public filings. Specifically, in December of 1999, Pegasus extended the churn parameters for a number of delinquent subscribers from 51 to 60 days, thus allowing those subscribers to be reported as active for a longer period. In June and September 2000, Pegasus made similar extensions for even longer periods, in each instance extending the cut-off parameters from 60 days to 120 days. Many of the delinquent subscribers whose accounts were extended did not ultimately produce revenue for Pegasus, though they continued to receive satellite television services. The stated reason for these parameter extensions was to allow customers the time and incentive to come current in their bills and to maintain or “remarket” them as active subscribers.
C. **The Audit Committee Internal Review**

At or around November 2000, a Pegasus board member learned of an allegation that Pegasus had inflated its subscriber count for the third quarter of 2000. On November 16, 2000, the board member e-mailed the senior managers, asking them to investigate the activity in question. The Audit Committee assigned the director of internal audit to review the allegations, interview the appropriate employees, and draft a report. In January 2001, the Audit Committee, after considering the report, determined that the Company had not intentionally extended parameters at the ends of quarters to manipulate subscriber counts. The Audit Committee expressed a concern that the Company’s actions could be misinterpreted that way, however, and instructed management to set clear definitions and classifications of subscribers and to adhere to them in the future.

D. **Renewed Efforts to Extend Subscriber Churn Dates**

In 2001, Pegasus continued to re-age delinquent subscribers by extending cut-off parameters and, in addition, Pegasus initiated a new penny-suspend policy which targeted customers who had voluntarily disconnected their accounts. In May 2001, Pegasus further extended the churn date for delinquent accounts to 114 days — two months after the service cutoff date for delinquent accounts.

E. **Using Penny-Suspends to Activate Closed Accounts**

In 2000, Pegasus had used penny-suspends as a “work around” to address an anomaly in the billing system concerning the classification of a relatively small number of subscribers. In the spring of 2001, Pegasus began to use a new and different penny-suspend policy on a widespread basis. This penny-suspend policy involved taking accounts of voluntarily disconnected customers (customers who specifically stated they no longer wanted Pegasus’ services and whose accounts were churned), reclassifying the accounts to suspend status, and placing a one-cent credit on those accounts to make them active again (in suspend status) in the billing system that Pegasus utilized. In order to attach the penny-credits to disconnected customer accounts, Pegasus employees had to move the accounts from a de-activated category with a zero balance to an active category by assigning the one-cent credits to such accounts. By these means, Pegasus added accounts to its no-core subscriber population that neither received services nor made payments, but remained active for purposes of the publicly reported subscriber count.

The combination of the re-aging and penny-suspend policies caused Pegasus’ no-core population to rise significantly from period to period during 2001. By the fourth quarter of 2001, the penny-credit accounts became the largest subset of the so-called “no-core” group of active subscribers, meaning a category of subscribers who were not receiving core programming services.
<table>
<thead>
<tr>
<th></th>
<th>Total Count</th>
<th>No Core</th>
<th>% of Total Count</th>
</tr>
</thead>
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<tr>
<td>Q1 2001</td>
<td>1,440,000</td>
<td>105,966</td>
<td>7%</td>
</tr>
<tr>
<td>Q2 2001</td>
<td>1,461,000</td>
<td>131,476</td>
<td>9%</td>
</tr>
<tr>
<td>Q3 2001</td>
<td>1,496,000</td>
<td>155,003</td>
<td>10%</td>
</tr>
<tr>
<td>Q4 2001</td>
<td>1,519,000</td>
<td>188,554</td>
<td>12%</td>
</tr>
</tbody>
</table>

Pegasus discontinued these subscriber “retention” policies when Pegasus announced a change in its subscriber counting methodology in its 2001 Form 10-K and reduced its subscriber base by approximately 138,000. The bulk of this reduction consisted of subscribers who had been subject to re-aging and the penny-credit policies employed as part of the remarketing program.

**F. Public Reporting of Subscriber Numbers**

Until April 2000, Pegasus released information concerning its subscriber base on a monthly basis and thereafter it reported such information on a quarterly basis. Pegasus published its subscriber data in the form of press releases and conference calls with stock analysts who were covering the company. The same subscriber data was contained in periodic filings made with the Commission on forms 10-K and 10-Q during the relevant time. Subscriber data was also referenced or incorporated by reference in registration statements filed with the Commission covering the offer and sale of securities.

Pegasus reported subscriber numbers in the periodic reports filed with the Commission between 1999 and December 2001. In each annual and quarterly filing on Forms 10-K and 10-Q during those reporting periods, Pegasus disclosed the number of subscribers and attributed increases in subscriber numbers to, among other things, “internal growth.” Pegasus did not explain that a substantial portion of the subscriber base growth included a large number of subscribers whose status as subscribers was prolonged or re-activated by the re-aging of accounts and the issuance of one-cent credits as described above.

**G. Pegasus Announces a Change in its Subscriber Counting Methodology**

In its 2001 Form 10-K Pegasus announced that it was changing its method for publicly reporting its number of subscribers in order to improve its public reporting and internal analyses. The disclosures made in the 2001 Form 10-K by Pegasus regarding the subscriber counting policy change read as follows:

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5 The amounts shown here reflect the total no-core category, which for purposes of this analysis includes the 54-114 day re-aged accounts, penny-suspends, suspends turned active, and unknown origin subscriber groups.
We have recently undertaken a review of the method by which we publicly report the number of our subscribers. Our publicly reported subscriber counts in the past have included a number of accounts whose service has been suspended for prolonged periods of time. Because we believe it would improve our public reporting and internal analyses, we are changing our method of reporting subscribers, beginning with the first quarter of 2002 so as to exclude these accounts. We estimate that if we had instituted this change at December 31, 2001, we would have reported approximately 1.4 million subscribers. This change would have had no effect on our 2001 consolidated financial statements if we had implemented it during 2001, and will have no effect on our future consolidated financial statements.

This announcement did not mention that in addition to suspended accounts, the written-off subscriber accounts also included 70,415 disconnected subscriber accounts which had penny-credits added. Although Pegasus did make a correction in April 2002 to its previously reported subscriber numbers for 2001, Pegasus did not revise its subscriber numbers reported for the periods between 1999 and the end of 2000.

H. The Decision to Report the Re-Activated Subscribers as Active Is Independent of the Business Decision to Re-Activate them

Certain officers at Pegasus approved of the re-aging and penny-suspend tactics as part of a remarketing effort designed to stem the rising trend in subscriber disconnections. Pegasus’ stated reason for the reporting of re-aged subscribers and penny-credit subscribers was to allow for the possibility of winning back these customers. However, even if the re-aging and penny-credits were done for the business purpose of remarketing, certain Pegasus officers made a separate decision to include re-aged and penny-credit subscribers in their publicly reported subscriber counts. In other words, Pegasus could have backed these accounts out of its count of active subscribers before publicly reporting that metric.

I. Respondent’s Conduct

As the Chief Financial Officer of Pegasus, Smith was directly responsible for reporting financial results in public filings made with the Commission. Beginning in August 2001, he took over responsibility for marketing, customer care and other operational functions at Pegasus. Because re-aging and penny-credit policies were considered remarketing initiatives, Smith was involved in the cut-off extensions as well as the penny-suspend activations. Smith directed others at Pegasus to start or, in certain cases, to stop penny-suspend jobs.

Smith also participated in earnings calls and signed Pegasus’s Forms 10-K and 10-Q and registration statements on Forms S-4 during 1999 through 2000. In doing so, he was negligent in discussing subscriber data with stock analysts and submitting subscriber information that was incorporated into filings made with the Commission. Specifically, he did not inform public investors about the existence of Pegasus’ no-core subscribers and did not explain the impact of re-aging and penny-suspects subscribers on Pegasus’ performance metrics such as churn and
subscriber growth. As a result, Pegasus’ stock analysts and shareholders were misled about the nature and number of the company’s subscribers and its prospects for future growth.

In November 2001, Smith signed his last Pegasus public filing, in the form of the third quarter 2001 Form 10-Q. In February 2002, prior to Pegasus’ release of 2001 earnings, Smith sent a letter to Pegasus’ president and former general counsel detailing the discrepancy between reported subscriber numbers and active subscribers. He recommended that Pegasus’ Board of Directors and Audit Committee be informed of the problem and suggested corrective action. Smith resigned from Pegasus in March 2002, prior to Pegasus’ filing of the 2001 Form 10-K containing the subscriber disclosure.

V.

LEGAL DISCUSSION

Sections 17(a)(2) and 17(a)(3) of the Securities Act prohibit material misstatements and omissions in the offer or sale of a security. From 1999 to 2001, Pegasus issued stock in registered transactions on the U.S. securities markets. Because of the conduct described above, Pegasus violated these provisions. Negligent conduct can violate Sections 17(a)(2) and (3). See, e.g., SEC v. Hughes Capital Corp., 124 F.3d 449, 453 (3d Cir. 1997).

Section 13(a) of the Exchange Act and Rules 13a-1 and 13a-13 thereunder require issuers with securities registered under Section 12 of the Exchange Act to file annual and quarterly reports with the Commission. The obligation to file such reports embodies the requirement that they be true and correct. Rule 12b-20 further requires the inclusion of any additional material information that is necessary to make required statements, in light of the circumstances under which they were made, not misleading. Negligence is enough for a reporting violation. S.E.C. v. Savoy Indus., 587 F.2d 1149, 1167 (D.C. Cir. 1978).

Section 13(b)(2)(A) of the Exchange Act requires issuers to “make and keep books, records, and accounts, which in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer.” Section 13(b)(2)(B) requires issuers to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that transactions are recorded as necessary to permit preparation of financial statements in conformity with generally accepted accounting principles and to maintain the accountability of assets. Because of the conduct described above, Pegasus and PSC violated these provisions.

By his conduct, described above, Smith was a cause of Pegasus’ and PSC’s violations of these provisions. Where the primary violations underlying a finding that a person is “a cause of” violations do not themselves require a finding of scienter, the standard of liability for being “a cause of” such violations is negligence. See, KPMG LLP v. SEC, 289 F.3d 109, 120 (DC Cir. 2002).
VI.

As a result of the conduct described above, Respondent caused Pegasus and PSC to violate Section 17(a)(2) and 17(a)(3) of the Securities Act, Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rules 13a-1, 13a-13 and 12b-20 thereunder.

Respondent’s Cooperation During the Investigation

In accepting the offer of settlement, the Commission recognizes the cooperation of the Respondent during the course of the investigation.

VII.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in the Respondent’s Offer.

Accordingly, it is hereby ORDERED that:

A. Respondent shall cease and desist from committing or causing any violations and any future violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act.

B. Respondent shall cease and desist from causing any violations and any future violations of Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1, and 13a-13 thereunder.

By the Commission.

Nancy M. Morris
Secretary