

Judge Panley

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UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

-----X
SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

- against -

ETHAN KASS,

Defendant.
-----X

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COMPLAINT

COMPLAINT

Plaintiff Securities and Exchange Commission ("Commission") for its Complaint against defendant Ethan Kass ("Kass" or "Defendant") alleges as follows:

SUMMARY

1. This action concerns a fraudulent unauthorized trading scheme by Kass who, at the time of the conduct alleged herein, was an order processing clerk at Tobias Bros. Inc. ("Tobias"), a New York-based registered investment adviser to at least five investment funds (the "Circle T" funds). Between February and May 2005, Kass executed at least 24 unauthorized securities trades that caused the Circle T funds to suffer losses of at least \$8.4 million. Kass also aided and abetted Tobias's violations of certain antifraud and books and records provisions of the

federal securities laws in connection with his fraudulent scheme.

2. Kass did not have any authority or discretion to independently make any trades on behalf of Tobias or Circle T. Rather, Kass was responsible for providing back office support, including trade order entry, internal and external trade reporting, and trade reconciliation, as directed by his supervisors or other portfolio managers associated with Tobias.

3. In furtherance of the scheme, Kass concealed his misconduct by intentionally omitting his unauthorized trades from Tobias's internal books and records, including omitting them from trade blotters that Kass's supervisors typically reviewed. To further avoid detection Kass deleted, altered or manipulated information in Tobias's internal portfolio management system so that his unauthorized trades would not appear on Tobias's real-time profit and loss monitoring system. Kass also repeatedly misrepresented and mischaracterized his unauthorized trading to Tobias's prime broker (the "Prime Broker"), which questioned him about discrepancies between internal and external trading reports.

4. Kass violated or aided and abetted violations of the federal securities laws, including the antifraud statutes, through his unauthorized trading and concealment scheme. The Commission seeks to enjoin Kass from further conduct that violates the securities laws and seeks civil money penalties from him.

VIOLATIONS

5. By virtue of the conduct alleged herein:

- a. Kass, directly or indirectly, has engaged in acts, practices and courses of business that constitute violations of Section 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act") [15 U.S.C. § 78j(b)] and

Rule 10b-5 thereunder [17 C.F.R. § 240.10b-5]; and

- b. Kass, directly or indirectly, has engaged in acts, practices and courses of business that constitute aiding and abetting violations of Sections 204 and 206(2) of the Investment Advisers Act of 1940 (the "Advisers Act") [15 U.S.C. §§ 80b-4 and 80b-6(2)] and Rule 204-2 thereunder [17 C.F.R. § 275.204-2].

6. Unless the Defendant is permanently restrained and enjoined, he will again engage in the acts, practices and courses of business set forth in this Complaint and in acts, practices and courses of business of similar type and object.

NATURE OF THE PROCEEDINGS AND RELIEF SOUGHT

7. The Commission brings this action pursuant to the authority conferred upon it by Section 21(d)(1) of the Exchange Act [15 U.S.C. § 78u(d)(1)] and Section 209 of the Advisers Act [15 U.S.C. § 80b-9], seeking to restrain and enjoin permanently the Defendant from engaging in the acts, practices, transactions, and courses of business alleged herein.

8. The Commission also seeks a judgment ordering the Defendant to pay civil money penalties pursuant to Section 21(d)(3) of the Exchange Act [15 U.S.C. § 78u(d)(3)] and Section 209(e) of the Advisers Act [15 U.S.C. § 80b-9(e)].

JURISDICTION AND VENUE

9. This Court has jurisdiction over this action pursuant to Sections 21(e) and 27 of the Exchange Act [15 U.S.C. §§ 78u(e) and 78aa], and Section 214 of the Advisers Act [15 U.S.C. § 80b-14].

10. Venue is proper in the Southern District of New York pursuant to 28 U.S.C.

§ 1391. The Defendant, directly or indirectly, has made use of the means and instrumentalities of interstate commerce, or of the mails, in connection with the transactions, acts, practices and courses of business alleged herein. A substantial number of the acts, events or omissions leading to the violations alleged herein occurred in the Southern District of New York, where the Defendant resides and where Tobias is located.

DEFENDANT

11. **Kass**, age 28, resides in New York, New York. Kass began working as an intern at Tobias in 2002. He was promoted to an order processing clerk in 2004. Kass does not hold any securities licenses. Tobias terminated Kass's employment in June 2005, shortly after the firm discovered his unauthorized trading and concealment scheme. At all times relevant to this Complaint, Kass was an associated person of Tobias, as defined in Section 202(a)(17) of the Advisers Act [15 U.S.C. § 80b-2(a)(17)].

RELATED ENTITIES

12. **Tobias** is a Delaware corporation established in December 1995. It is an investment adviser registered with the Commission since 2004, and reportedly had approximately \$49 million under management as of October 2009. Tobias also was a broker-dealer registered with the Commission from 1998 until February 2, 2008. Tobias, through affiliated entities, Tobias Capital L.P., Tobias Capital Inc., and Tobias GP, LLC, provided advisory services to Circle T. Tobias's main office is located in New York, New York, and during the relevant time period, it had branch offices in Pennsylvania and Florida.

13. **Circle T**, during the relevant time, was comprised of Circle T Partners, L.P., Circle T Partners (Q.P.), L.P., Circle T International, Ltd., Etablissement Comfort #2, and Avalon

Capital, LLC. The Circle T funds were private investment vehicles open to qualified investors. Tobias, through its affiliated entities, provided Circle T with a variety of investment advisory and management services in return for fees.

FACTS

Tobias's Operations and Kass's Duties

14. At all times relevant to this Complaint, Tobias operated an investment advisory and broker-dealer business. As an investment adviser, Tobias was responsible for the investment decisions and overall management of various managed accounts, including the five investment funds that comprised Circle T. Investors in Circle T were primarily high net worth individuals, corporations and hedge funds. The portfolio manager for each Circle T fund had sole authority to purchase or sell securities on behalf of Circle T and typically transacted securities in blocks and later allocated those transactions on a pro-rata basis to the five Circle T accounts. Tobias received a management fee for these services.

15. After the respective Circle T portfolio manager made a decision to trade on behalf of a Circle T fund, Kass's supervisors occasionally assigned Kass to select the executing broker for each authorized trade and to transmit the trade to the selected broker for consummation. Tobias then required Kass to internally process the transaction by recording each trade order and any related executions into Circle T's trade blotters and also in Tobias's electronic portfolio management system. This system provided Tobias almost instantaneous information about securities holdings, purchases and sales, and profits and losses, among other information.

16. At the end of each trading day, Kass used the portfolio management system to transmit Circle T's daily trading data to its Prime Broker which compiled, compared, and

confirmed information provided by various broker-dealers about trades executed on behalf of Circle T. The Prime Broker then provided by fax a “trade break report” to Tobias at the start of the next trading day. This report contained a historic record of trades purportedly executed and reported on behalf of Circle T and reflected any discrepancies noted by the Prime Broker between Tobias’s reported trades and those reported by executing broker-dealers.

17. In February 2005, Tobias gave Kass the additional assignment of reviewing trade discrepancies as reported by the Prime Broker and to resolve those discrepancies directly with the Prime Broker, functions previously performed by an operations manager at Tobias who retired from the firm.

18. Kass seized on the opportunity to orchestrate his scheme by exploiting an internal control flaw, being simultaneously responsible for trade order entry and trade reconciliation, and he commenced making unauthorized trades while concealing those trades from his supervisors and others.

Kass’s Misconduct

19. Beginning in February 2005, Kass started furtively executing unauthorized trades that caused the investors in Circle T to incur millions of dollars in net losses. In total, between February and May 2005, Kass executed at least 24 unauthorized trades resulting in approximately \$8,474,325 in losses. Kass concealed his unauthorized trades in at least two ways. First, Kass did not enter the unauthorized trades in Circle T’s trade blotters. Second, Kass disguised his trading activity by manipulating and altering the related trade data that he did enter into Tobias’s books and records, including in its portfolio management system.

20. For example, on May 25, 2005, Kass, without authorization, entered an order to

sell short 250,000 shares of a technology stock that traded on the NASDAQ. Because Tobias did not own the shares, Kass executed a separate transaction to borrow the shares from Circle T's Prime Broker. Kass did not enter this unauthorized short sale on Circle T's trade blotters nor did he enter the trade into the internal portfolio management system, as he was required to do. This unauthorized short sale caused Circle T investors to lose approximately \$7.3 million.

21. Around May 25, 2005, Circle T's Prime Broker noted a discrepancy in connection with the 250,000 short sale of the technology stock and sought to resolve the matter directly with Kass, consistent with Tobias's procedures. Armed with confirmation from the counterparty to the trade and other evidence of a valid transaction made on behalf of Circle T, the Prime Broker asked Kass to account for the discrepancy between Tobias's trade reports and those obtained from the counterparty. In response, Kass lied to the Prime Broker and denied that the short sale was ordered on behalf of Circle T. Trading records however show that the transaction was routed from Kass's computer terminal through an electronic trading platform that was accessible at the time only by Kass.

22. In order to conceal his fraudulent unauthorized trades, Kass circumvented certain trade reporting and reconciliation mechanisms to prevent the trades from appearing on Tobias's internal systems, which Kass knew his supervisor monitored and used on a real-time basis to manage Circle T's securities holdings and to know Circle T's profits and losses. In another aspect of his concealment scheme, Kass entered his unauthorized trades into Tobias's portfolio management system for transmission to the Prime Broker after the close of business, rather than during business hours when Kass's supervisors were available to monitor his reporting of the trades. Kass subsequently deleted all records of his unauthorized trades from certain of Tobias's

books and records, including the portfolio management system, before trading commenced the next day. Portfolio managers, who relied almost exclusively on information in the portfolio system to manage Circle T's profit and losses during the trading day, would therefore be ignorant of any trade discrepancies.

23. In connection with the 24 unauthorized trades, Kass made numerous misrepresentations and omissions to Circle T's Prime Broker when that firm questioned him about trade discrepancies caused by his unauthorized trades. Kass simply misrepresented to the Prime Broker that those trades were made on behalf of Circle T, or were otherwise legitimate, authorized transactions. Kass also did not reveal to the Prime Broker or Tobias that he manipulated information in Tobias's books and records in order to conceal his unauthorized trading scheme.

24. In May 2005, the Circle T portfolio manager suspected that Circle T's investments were underperforming and performed an analysis of Tobias's internal trading records and compared them to records provided by Circle T's Prime Broker for the period between January and May 2005. That analysis revealed significant discrepancies between the profit and loss and securities holdings recorded by Kass in Tobias's records and corresponding records maintained by the Prime Broker. Generally, Tobias's internal records understated losses and overstated profits.

25. Kass knew, or was reckless in not knowing, that his representations and omissions to Circle T's Prime Broker and Tobias regarding trading in the Circle T funds were false and misleading.

26. On June 1, 2005, shortly before Tobias scheduled a meeting with Kass to confront

him about the trade and profit and loss discrepancies, Kass ended his association with Tobias and never returned to the firm's offices.

27. After leaving Tobias, Kass admitted to senior officers at Tobias that he made the trades at issue, and that he did not properly record them in Tobias's books and records.

28. The Circle T investors directly suffered losses of at least \$8,474,325 as a result of Kass's unauthorized trading. A principal of Tobias subsequently reimbursed the Circle T investors for these losses, using personal funds.

FIRST CLAIM FOR RELIEF
Violations of Section 10(b) of the Exchange Act and Rule 10b-5

29. The Commission re-alleges and incorporates by reference each and every allegation contained in Paragraphs 1 through 28.

30. Kass, in connection with the purchase or sale of securities, directly or indirectly, by the use of the means or instrumentalities of interstate commerce or of the mails, has employed devices, schemes or artifices to defraud; has made untrue statements of material fact and has 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 has engaged in acts, practices, transactions and courses of business which operate or would operate as a fraud or deceit upon other persons, including Circle T.

31. The misstatements and omissions of fact alleged in this Complaint were material.

32. Kass knew or was reckless in not knowing that the representations alleged in this Complaint were false and misleading.

33. By reason of the activities described herein, Kass has violated and unless

restrained and enjoined, will again violate Section 10(b) of the Exchange Act [15 U.S.C. § 78j(b)] and Rule 10b-5 thereunder [17 C.F.R. § 240.10b-5].

SECOND CLAIM FOR RELIEF
Aiding and Abetting Violations of Section 206(2)
of the Advisers Act

34. The Commission re-alleges and incorporates by reference each and every allegation contained in Paragraphs 1 through 33.

35. At all relevant times, Tobias was registered with the Commission as an investment adviser, as defined by Section 202(a)(11) of the Advisers Act [15 U.S.C. § 80b-2(a)(11)], and served in that capacity with respect to the Circle T funds.

36. Tobias violated Section 206(2) of the Advisers Act when, by the use of the means and instrumentalities of interstate commerce or of the mails, it employed devices, schemes and artifices to defraud clients, and engaged in transactions, practices and courses of business which operated as a fraud and deceit upon Circle T.

37. From at least February through May 2005, Kass, directly or indirectly, aided and abetted Tobias's violations of Section 206(2) of the Advisers Act. Specifically, Kass knowingly provided substantial assistance to Tobias in employing devices, schemes and artifices to defraud clients, and engaging in transactions, practices and courses of business which operated as a fraud and deceit upon Circle T.

38. By reason of the activities described herein, Kass aided and abetted Tobias's violations of Section 206(2) of Advisers Act [15 U.S.C. § 80b-6(2)].

THIRD CLAIM FOR RELIEF
**Aiding and Abetting Violations of Section 204
of the Advisers Act and Rule 204-2**

39. The Commission re-alleges and incorporates by reference each and every allegation contained in Paragraphs 1 through 38.

40. Tobias violated Section 204 of the Advisers Act and Rule 204-2 thereunder, by failing to make and keep true, accurate and current such books and records relating to its investment advisory business as the Commission by rule, may prescribe as necessary or appropriate in the public interest or for the protection of investors.

41. From at least February through May 2005, Kass, directly or indirectly, aided and abetted Tobias's violations of Section 204 of the Advisers Act and Rule 204-2 thereunder. Specifically, Kass knowingly provided substantial assistance to Tobias in failing to maintain truthful books and records, as alleged in this Complaint.

42. By reason of the activities described herein, Kass aided and abetted Tobias's violations of Section 204 of Advisers Act [15 U.S.C. § 80b-4] and Rule 204-2 thereunder [17 C.F.R. § 275.204-2].

PRAYER FOR RELIEF

WHEREFORE, the Commission respectfully requests that the Court enter a Final Judgment:

I.

Permanently restraining and enjoining Kass and Kass's agents, servants, employees and attorneys, and all persons in active concert or participation with them who receive actual notice of the injunction by personal service or otherwise, and each of them, from future violations of

Section 10(b) of the Exchange Act [15 U.S.C. § 78j(b)] and Rule 10b-5 thereunder [17 C.F.R. § 240.10b-5], and Sections 204 and 206(2) of the Advisers Act [15 U.S.C. §§ 80b-4, 80b-6(2)] and Rule 204-2 thereunder [17 C.F.R. § 275.204-2].

II.

Imposing civil money penalties on Kass pursuant to Section 21(d)(3) of the Exchange Act [15 U.S.C. § 78u(d)(3)] and Section 209(e) of the Advisers Act [15 U.S.C. § 80b-9].

III.

Granting such other and further relief as the Court deems just and proper.

Dated: October 15, 2009
New York, New York

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