

1 Nicolas A. Morgan, Cal. State Bar No. 166441
2 Lisa A. Gok, Cal. State Bar No. 14760
3 Marianne Wisner, Cal. State Bar No. 163339
4 Roberto Tercero, Cal. State Bar. No. 143760

5 Attorneys for Plaintiff
6 Securities and Exchange Commission
7 RANDALL R. LEE, Regional Director
8 SANDRA J. HARRIS, Associate Regional Director
9 5670 Wilshire Boulevard, 11th Floor
10 Los Angeles, California 90036
11 Telephone: (323) 965-3998
12 Facsimile: (323) 965-3908

13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF CALIFORNIA

SECURITIES AND EXCHANGE
COMMISSION,

Plaintiff,

v.

STEVEN E. MUTH and
DOOR CHAIR, LTD.,

Defendants.

Case No.

**COMPLAINT FOR VIOLATIONS
OF THE FEDERAL SECURITIES
LAWS**

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

JURISDICTION AND VENUE

1. This Court has jurisdiction over this action pursuant to Sections 20(b), 20(d)(1) and 22(a) of the Securities Act of 1933 (“Securities Act”), 15 U.S.C. §§ 77t(b), 77t(d)(1) & 77v(a), and Sections 21(d)(1), 21(d)(3)(A), 21(e) and 27 of the Securities Exchange Act of 1934 (“Exchange Act”), 15 U.S.C. §§ 78u(d)(1), 78u(d)(3)(A), 78u(e) & 78aa. Defendant has, directly or indirectly, made use of the means or instrumentalities of interstate commerce, of the mails, or

1 of the facilities of a national securities exchange, in connection with the
2 transactions, acts, practices and courses of business alleged in this Complaint.

3 2. Venue is proper in this district pursuant to Section 22(a) of the
4 Securities Act, 15 U.S.C. § 77v(a), and Section 27 of the Exchange Act,
5 15 U.S.C. § 78aa, because certain of the transactions, acts, practices and courses of
6 conduct constituting violations of the federal securities laws occurred within this
7 district.

8 SUMMARY

9 3. This action involves the market manipulation of the stock price of
10 Creative Host Services, Inc. ("Creative Host" or the "company") by Steven E.
11 Muth. Muth was a registered representative of Kirkpatrick, Pettis, Smith, Polian
12 Inc. ("Kirkpatrick" or the "firm"), which is a registered broker-dealer. Muth, in
13 concert with others, fraudulently manipulated Creative Host's stock price from
14 \$0.78 to \$29.00 between November 17, 1999 and June 15, 2000, a gain of 3,618%,
15 even though Creative Host operated at a net loss during this time period.

16 4. Muth manipulated Creative Host's stock price by restricting supply
17 and artificially creating demand for the stock. Specifically, Muth caused
18 Kirkpatrick's clients to buy and control 90% of Creative Host's free trading
19 shares; engaged in high-pressure sales tactics; used Kirkpatrick's affiliation with
20 Mutual of Omaha Insurance Company to gain client trust; refused to execute client
21 sell orders; encouraged customers to use margin without explaining the associated
22 risks; hired promoters to tout the shares on the Internet; delayed submitting orders
23 to buy Creative Host stock; facilitated price leadership by Kirkpatrick; and
24 prearranged trades. As a result of his fraudulent scheme, Muth received ill-gotten
25 commissions of \$950,562 from Kirkpatrick and trading profits of \$83,751.

26 5. As a result of Muth's fraudulent scheme, relief defendant Door Chair,
27 Ltd. ("Door Chair"), controlled by Muth, received \$463,030 in ill-gotten trading
28 profits to which it has no legitimate claim.

1 **THE DEFENDANT**

2 6. Steven E. Muth, age 43, is a resident of Houston, Texas. Muth was a
3 registered representative at Kirkpatrick's Englewood, Colorado branch office
4 during all periods of the fraudulent scheme. A "registered representative" is an
5 employee of an NASD member firm who gives clients advice on which securities
6 to buy and sell, and who collects a percentage of the commission income he or she
7 generates. Muth, through Kirkpatrick, executed all trades placed for clients, Door
8 Chair, and himself at Kirkpatrick's order desk. In 1991, the NASD fined Muth
9 \$2,500 and suspended him for ten days for aiding and abetting a securities
10 manipulation, permitting excess mark-ups on stock trades, failing to supervise
11 other registered representatives he oversaw, and selling securities in an offering
12 that was not registered with the Commission.

13 **THE RELIEF DEFENDANT**

14 7. Door Chair, Ltd. is a Colorado limited partnership that held
15 investments. During the fraudulent scheme, Muth was Door Chair's president and
16 sole owner, and made all of Door Chair's decisions to buy and sell securities,
17 including Creative Host stock.

18 **RELATED ENTITIES**

19 8. Creative Host Services, Inc. is a San Diego-based company that runs
20 concessions in airports across the United States. At all relevant times, its stock
21 (trading symbol: CHST) was traded on the Nasdaq Stock Market, and its
22 securities were registered with the Commission pursuant to Section 12(g) of the
23 Exchange Act, 15 U.S.C. §771(g).

24 9. Kirkpatrick, Pettis, Smith, Polian Inc., a wholly-owned subsidiary of
25 Mutual of Omaha Insurance Company, is a registered broker-dealer, NASD
26 member, and Nebraska corporation headquartered in Omaha, Nebraska. A broker-
27 dealer engages in the business of effecting transactions in securities for the
28 account of others or for its own account through a broker. From June 1999 until

1 May 29, 2000, Kirkpatrick made a market in Creative Host stock. To "make a
2 market" means to maintain firm bid and offer prices in a given security by
3 standing ready to buy or sell round lots of securities at publicly quoted prices on a
4 regular or continuous basis.

5 **THE FRAUDULENT SCHEME**

6 **TO MANIPULATE CREATIVE HOST'S STOCK**

7 **A. MUTH DRAFTS A PLAN TO INFLATE ARTIFICIALLY CREATIVE HOST'S** 8 **SHARE PRICE**

9 10. From November 1999 through mid-June 2000, Muth manipulated
10 Creative Host's share price. Muth began the fraudulent scheme by drafting a plan
11 (the "Plan") to increase the share price. The Plan called for Muth to restrict the
12 supply of Creative Host stock in the marketplace by (1) having an investor buy up
13 to 9.9% of Creative Host's shares "quietly"; (2) directing an investor to purchase
14 80,000 shares in a pending sale of a 140,000-share block; and (3) causing his
15 clients to buy 200,000 shares. To artificially increase demand for the stock the
16 Plan called for Muth to (1) hire an analyst to write a research report and (2) pay an
17 Internet website to tout the stock and encourage people to buy it. The Plan stated
18 that it presented an opportunity for "stock appreciation," and a "rare opportunity to
19 move a market" if there was a "strong broker" behind it. Muth took most of the
20 steps outlined in the Plan.

21 **B. MUTH RESTRICTS THE SUPPLY OF CREATIVE HOST SHARES**

22 11. As part of his fraudulent scheme to raise the price of Creative Host
23 stock artificially, Muth restricted the supply of Creative Host stock. He reduced
24 the supply of Creative Host stock by (i) reducing the float; (ii) refusing to execute
25 customers' orders to sell shares of Creative Host and (iii) persuading his customers
26 to use margin to increase sales and further restrict the supply of Creative Host
27 shares. The term "float" means the number of shares of a corporation that are
28 outstanding and available for trading by the public. From January 2000 to mid-

1 June 2000, the firm's customer accounts held at least 70% of Creative Host's free
2 trading shares. By the end of the manipulation in mid-June 2000, Kirkpatrick's
3 customer accounts held approximately 90% of Creative Host's free-trading shares.
4 Muth was responsible for most of the firm's trading in Creative Host.

5 **1. Muth Reduces the Float**

6 12. In November 1999 pursuant to the Plan, Muth caused one of his
7 wealthy clients purchase more than 22% of Creative Host's outstanding shares
8 over a ten-day period. The client made his purchases "quietly" by filing late with
9 the Commission the form required to report large stock purchases, a Schedule
10 13D. The client's purchases included the purchase of an 80,000-share block of
11 Creative Host shares.

12 13. Muth also used aggressive sales tactics to cause his other clients to
13 buy more than 200,000 additional shares of Creative Host, namely high-pressure
14 sales tactics, unauthorized trading and falsely stating that Creative Host had a
15 "virtual monopoly" on airport concessions. During the period from December 31,
16 1999 to June 15, 2000, the firm's customer accounts held between 70% and 90%
17 of Creative Host's free trading shares. The purchases of Creative Host stock by
18 Muth's clients reduced the amount of shares available for sale, *i.e.*, reduced the
19 float, which made the stock highly price sensitive.

20 14. Muth also obtained monthly Depository Trust Company ("DTC")
21 securities position listing reports paid for by San Diego-based Creative Host,
22 which identified the broker-dealers holding Creative Host stock, so that Muth
23 could determine from which broker-dealers he should target additional purchases.

24 **2. Muth Refuses to Execute Sell Orders**

25 15. To further restrict the supply of Creative Host stock on the open
26 market and increase the stock's price sensitivity, Muth refused to execute sell
27 orders when at least five clients, including a 73-year-old widow, instructed him to
28 sell their Creative Host shares.

1 **3. Muth Persuades Clients to Margin Creative Host Shares**

2 16. Muth persuaded clients to margin their shares in Creative Host to
3 have them purchase more shares with the margin proceeds, further reducing the
4 float. To put shares on "margin" means to use them as collateral to obtain credit
5 from a broker-dealer. Muth persuaded investors to use margin by telling them that
6 margin would not cost anything and would provide a great source of profit. Muth,
7 however, did not tell them about margin's risks. For example, he did not tell them
8 that if Creative Host's price declined, the firm could issue a "margin call," *i.e.*, a
9 demand that a customer deposit enough money or securities to bring a margin
10 account up to the initial margin or minimum maintenance requirements. If a
11 customer fails to answer the margin call, the broker-dealer may liquidate securities
12 in the account. Most of Muth's client accounts held between 70% and 100% of
13 their portfolio in speculative stocks such as Creative Host. Use of margin
14 proceeds to purchase additional Creative Host shares further reduced the supply
15 and created more demand, further contributing to the rise in Creative Host's share
16 price. By May 31, 2000, Kirkpatrick's customers held 824,815 Creative Host
17 shares, which represented almost all of the free trading shares. At that time, these
18 shares were valued at approximately \$15,354,815.

19 **C. MUTH CREATES ARTIFICIAL DEMAND**

20 17. In furtherance of the Plan to manipulate Creative Host's stock price,
21 Muth also created artificial demand. He created this demand through (i) false and
22 misleading touts on the Internet; (ii) delayed orders; (iii) price leadership; and (iv)
23 prearranged trading.

24 **1. Touting on the Internet**

25 18. In May 2000, when Creative Host's stock price had increased to the
26 \$15-17 range, Muth, pursuant to the Plan, hired Internet stock touters to post
27 messages on the Internet touting Creative Host. On May 12 and 15, 2000, these
28 touters, without reasonable basis, projected in Internet newsletters that Creative

1 Host's share price would rise to \$30 near term and to \$60-70 mid-term. There
2 was, however, no reasonable basis for these projections because Creative Host's
3 annual report on Form 10-KSB, filed on April 13, 2000 with the Commission,
4 revealed that the company continued to operate at a net loss. Further, Creative
5 Host's president was unaware of any developments that accounted for the increase
6 in share price from \$0.78 to \$29 per share.

7 19. The touts contributed to a dramatic rise in Creative Host's stock price
8 and trading volume. Volume increased 432% on May 12, 2000 from 24,700 to
9 131,300 shares. On May 15, the next trading day, Creative Host's share price
10 increased 12.9%, from \$18.94 to \$21.38, and trading volume increased an
11 additional 84.8% (to 242,600 shares), from the previous trading day. Creative
12 Host's share price continued to rise as the tout was reposted on Internet message
13 boards on financial websites such as Raging Bull and Yahoo! Finance. By
14 May 19, 2000, the stock price closed at \$25. During the week-long touting period,
15 Creative Host's stock price increased 30.7%.

16 **2. Delayed Orders**

17 20. Muth repeatedly delayed sending buy orders to Kirkpatrick's order
18 desk until the end of the day, specifically until the last three hours of trading.
19 Between November 1, 1999 and May 31, 2000, 47% of all orders that the firm
20 processed concerning Creative Host, were processed in the last hour of the trading
21 day. By placing orders late in the day, Muth put additional buying pressure on
22 Creative Host's stock price toward the close of the trading day. This additional
23 pressure resulted in higher closing prices. Higher closing prices helped Muth's
24 customers avoid margin calls, furthering Muth's manipulation of Creative Host's
25 share price.

26 21. To avoid risk, Kirkpatrick maintained a policy of ending each day
27 "flat," i.e., it would hold no shares in its proprietary trading accounts for the stocks
28 it traded. As a result, the firm's order desk had to execute the orders placed at the

1 end of the day by purchasing or selling stock on the open market rather than from
2 its own supply because the firm typically had little or no inventory. Muth was
3 aware of Kirkpatrick's policy, and he exploited it to raise Creative Host's stock
4 price toward the end of the day by placing clients' buy orders late in the day.

5 22. Muth's late buy orders, coupled with the firm's policy to end each day
6 flat, put pressure on the firm's order desk to raise its bid price because it had no
7 inventory from which to draw to fill orders. A "bid," or "bid price," is the price a
8 prospective buyer is ready to pay. Between December 1999 and May 2000,
9 Kirkpatrick, more than 50% of the time, raised its bid price in the last two hours of
10 the trading day to fill Muth's buy orders. In one period, from April 4 to
11 April 10, 2000, 76.9% of the firm's bid price increases occurred during the last two
12 hours of the trading day.

13 23. In addition to raising its bid price, the firm's order desk also
14 purchased stock at the other market makers' asking prices so that it could execute
15 Muth's late buy orders. The greater demand permitted market makers to increase
16 their asking prices. An "ask," or "asked price," is the price at which a security is
17 offered for sale on an exchange or in the over-the-counter market. On some days
18 near the end of the trading day, to fill buy orders, Muth successfully requested the
19 firm's trader to "take out the asks," or buy every share presently offered for sale at
20 the asked price, further causing Creative Host's share price to rise.

21 3. Price Leadership

22 24. Muth generated artificial demand for Creative Host stock by causing
23 Kirkpatrick to make increasingly higher bids for the stock. Muth caused
24 Kirkpatrick to achieve this price leadership through numerous solicited buy orders
25 he placed. Muth solicited customers to make these buy orders using Kirkpatrick's
26 affiliation with Mutual of Omaha, high-pressure sales tactics, and his false
27 statement about Creative Host's purported monopoly of the airport concession
28 market. Additional buy orders came from prearranged trades with Creative Host

1 market makers and unauthorized trades that Muth submitted to the firm's order
2 desk.

3 25. Muth's large volume of buy orders – in conjunction with his delayed
4 orders and the firm's policy of ending each day flat – placed additional pressure on
5 Kirkpatrick's order desk to consistently advance the firm's bid price to fill orders.
6 Kirkpatrick acted as the high bid price leader from November 1, 1999 through
7 May 31, 2000. During this period, the closing high bid price rose from \$.96875 to
8 \$24.50, a 2,429% increase. The firm maintained the high bid 38.72% of the time,
9 and it held the high bid exclusively 23.44% of the time, both of which were more
10 than for any of the other 30 Creative Host market makers. Indeed, Kirkpatrick was
11 the exclusive high bidder more than twice as often as any other market maker.
12 The firm advanced the high bid price in 492 of the 1,823 instances (26.99%) that it
13 was raised during the period. In these instances, other market makers quickly
14 joined the firm's new bid price. The firm also advanced the bid to an exclusive
15 high bid 154 times more than any of the other 30 market makers.

16 26. Kirkpatrick rarely decreased Creative Host's ask price. The firm
17 decreased its ask price less than 2% of the time during the period November 1,
18 1999 to May 31, 2000. As a result, the firm maintained a higher ask price than the
19 other market makers, discouraging investors from buying Creative Host stock
20 from Muth's clients. As a result of this and Muth's other manipulative activities,
21 Muth's clients maintained control of 70% to 90% of Creative Host's shares
22 between December 31, 1999 and May 31, 2000. Furthermore, from
23 November 1, 1999 through May 31, 2000, Kirkpatrick conducted 35.5% of the
24 trading volume in Creative Host stock, the largest volume of any of the 30 market
25 makers. The firm's price leadership contributed to Muth's manipulation of
26 Creative Host stock.

27 * * *

28 * * *

1 **4. Prearranged Trading**

2 27. "Prearranged trades," also referred to as "matched orders," involve
3 the purchase and sale of the same amount of securities at substantially the same
4 price and time, giving the appearance of legitimate market activity. Muth engaged
5 in prearranged trading to create the appearance of active demand for Creative Host
6 stock. Muth spoke to traders at other broker-dealers about Creative Host and
7 negotiated trades, both price and quantity, that he then gave to Kirkpatrick's order
8 desk for execution along with instructions to contact the specific trader with whom
9 Muth had negotiated. Muth prearranged trades until at least May 2000. By
10 creating the appearance of active demand, Muth stimulated demand for the stock,
11 which further increased Creative Host's stock price.

12 **D. THE PRICE COLLAPSE**

13 28. In May 2000, the firm's Risk Department noted that Muth may have
14 been manipulating Creative Host's stock. On June 16, 2000, the firm restricted
15 Muth's ability to trade certain stocks. The price for Creative Host's shares began
16 to fall. Because many of Muth's clients held their Creative Host shares on margin,
17 Kirkpatrick began issuing margin calls and selling the margined stock of clients to
18 satisfy the firm's unanswered margin calls. This sell-off contributed to a steep
19 drop in Creative Host's share price from \$29 on June 15, 2000 to \$4.12 by August
20 1, 2000, a drop of \$24.88. The sell-off between June 15 and August 1, 2000 also
21 contributed to a decrease in the value of investors' Creative Host shares of at least
22 \$15 million.

23 **E. MUTH'S ILL-GOTTEN GAINS**

24 29. Muth received \$950,562 in commissions from his clients' trades in
25 Creative Host. In addition, Muth used his nominee, Door Chair, to sell Muth's
26 own Creative Host shares. Muth controlled Door Chair and was in charge of all of
27 its trading. From November 17, 1999 to May 4, 2000 Muth, individually and
28 through Door Chair, purchased and sold 101,500 shares of Creative Host stock at

1 prices ranging from \$1.13 to \$17 per share. Muth received a total of \$546,781
2 from his sale of Creative Host shares, \$83,751 of which was obtained through an
3 account in Muth's name and \$463,030 of which was obtained through an account
4 in Door Chair's name. Overall, Muth received a total of \$1,497,343 as a result of
5 his manipulation of Creative Host stock.

6 **FIRST CLAIM FOR RELIEF**

7 **FRAUD IN THE OFFER OR SALE OF SECURITIES**

8 **VIOLATIONS OF SECTION 17(a) OF THE SECURITIES ACT**

9 **(AGAINST DEFENDANT MUTH)**

10 30. The Commission realleges and incorporates by reference ¶¶ 1 through
11 29 above.

12 31. Defendant Muth, by engaging in the conduct described above,
13 directly or indirectly, in the offer or sale of securities by the use of means or
14 instruments of transportation or communication in interstate commerce or by use
15 of the mails:

- 16 a. with scienter, employed devices, schemes, or artifices to
17 defraud;
- 18 b. obtained money or property by means of untrue statements of a
19 material fact or by omitting to state a material fact necessary in
20 order to make the statements made, in light of the
21 circumstances under which they were made, not misleading; or
- 22 c. engaged in transactions, practices, or courses of business which
23 operated or would operate as a fraud or deceit upon the
24 purchaser.

25 32. By engaging in the conduct described above, the defendant violated,
26 and unless restrained and enjoined will continue to violate, Section 17(a) of the
27 Securities Act, 15 U.S.C. § 77q(a).

28 * * *

SECOND CLAIM FOR RELIEF
FRAUD IN CONNECTION WITH THE
PURCHASE OR SALE OF SECURITIES
VIOLATIONS OF SECTION 10(b) OF THE EXCHANGE ACT
AND RULE 10b-5 THEREUNDER
(AGAINST DEFENDANT MUTH)

33. The Commission realleges and incorporates by reference ¶¶ 1 through 29 above.

34. Defendant Muth, by engaging in the conduct described above, directly or indirectly, in connection with the purchase or sale of a security, by the use of means or instrumentalities of interstate commerce, of the mails, or of the facilities of a national securities exchange, with scienter:

- a. employed devices, schemes, or artifices to defraud;
- b. made untrue statements of a material fact or omitted to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; or
- c. engaged in acts, practices, or courses of business which operated or would operate as a fraud or deceit upon other persons.

35. By engaging in the conduct described above, the defendant violated, and unless restrained and enjoined will continue to 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.

* * *

* * *

* * *

* * *

1 **PRAYER FOR RELIEF**

2 WHEREFORE, the Commission respectfully requests that the Court:

3 **I.**

4 Issue findings of fact and conclusions of law that defendant Muth
5 committed the alleged violations.

6 **II.**

7 Issue a judgment, in a form consistent with Fed. R. Civ. P. 65(d),
8 permanently enjoining defendant Muth and his officers, agents, servants,
9 employees and attorneys, and those persons in active concert or participation with
10 any of them, who receive actual notice of the order by personal service or
11 otherwise, and each of them, from violating Section 17(a) of the Securities Act,
12 Section 10(b) of the Exchange Act, and Rule 10b-5 thereunder.

13 **III.**

14 Order defendant Muth to disgorge all ill-gotten gains obtained directly or
15 indirectly from his illegal conduct, together with prejudgment interest thereon.

16 **IV.**

17 Order relief defendant Door Chair to disgorge all profits gained directly or
18 indirectly from Muth's illegal conduct.

19 **V.**

20 Order defendant Muth to pay civil penalties under Section 20(d) of the
21 Securities Act, 15 U.S.C. § 77t(d), and Section 21(d)(3) of the Exchange Act, 15
22 U.S.C. § 78u(d)(3).

23 **VI.**

24 Retain jurisdiction of this action in accordance with the principles of equity
25 and the Federal Rules of Civil Procedure in order to implement and carry out the
26 terms of all orders and decrees that may be entered, or to entertain any suitable
27 application or motion for additional relief within the jurisdiction of this Court.

28 * * *

VII.

Grant such other and further relief as this Court may determine to be just and necessary.

DATED: November 4, 2003

Marianne Wisner
Attorneys for Plaintiff
Securities and Exchange Commission