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8
9 **UNITED STATES DISTRICT COURT**
DISTRICT OF NEVADA

10
11 SECURITIES AND EXCHANGE
12 COMMISSION,

13 Plaintiff,

14 v.

15 DANIEL CALUGAR and
SECURITY BROKERAGE, INC.,

16 Defendants.
17

Case No. CV-S-03-1600-RCJ-RJJ

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

18
19 Plaintiff Securities and Exchange Commission (“Commission”)
20 alleges as follows:

21 **JURISDICTION AND VENUE**

22 1. This Court has jurisdiction over this action pursuant to Sections
23 20(b), 20(d)(1) and 22(a) of the Securities Act of 1933 (“Securities Act”), 15
24 U.S.C. §§ 77t(b), 77t(d)(1) & 77v(a), and Sections 21(d)(1), 21(d)(3)(A),
25 21(e) and 27 of the Securities Exchange Act of 1934 (“Exchange Act”), 15
26 U.S.C. §§ 78u(d)(1), 78u(d)(3)(A), 78u(e) & 78aa. Defendants have, directly

1 or indirectly, made use of the means or instrumentalities of interstate
2 commerce, of the mails, or of the facilities of a national securities exchange,
3 in connection with the transactions, acts, practices and courses of business
4 alleged in this complaint.

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

10 SUMMARY

11 3. This matter involves a scheme to defraud mutual fund
12 shareholders through practices known as market timing and late trading by
13 Daniel G. Calugar and his broker-dealer company, Security Brokerage, Inc.

14 4. From at least 2001 to September 2003, Calugar, trading through
15 Security Brokerage, engaged in a scheme involving market timing of various
16 mutual funds using investments totaling between \$400-\$500 million. Market
17 timing refers to the practice of short term buying and selling of mutual fund
18 shares in order to exploit inefficiencies in mutual fund pricing. Most of
19 Calugar's market timing trades were through two mutual fund families:
20 Alliance Capital Management, LP ("Alliance") and Massachusetts Financial
21 Services ("MFS").

22 5. Calugar also engaged in late trading of MFS and Alliance funds.
23 Late trading refers to the practice of placing orders to buy or sell mutual fund
24 shares after close of market at 4:00 p.m. EST, but at the mutual fund's Net
25 Asset Value ("NAV"), or price, determined at the market close. Late trading
26 enables the trader to profit from market events that occur after 4:00 p.m. EST

1 located in New York, New York, is registered with the Commission as an
2 investment adviser. It is an investment adviser to its affiliated mutual funds
3 (collectively, “Alliance”).

4 10. MFS Fund Distributors, Inc. is a corporation with its principal
5 place of business in Boston, Massachusetts, and it serves as the principal
6 underwriter and distributor of the shares in several mutual funds (collectively
7 “MFS”).

8 **THE FRAUDULENT SCHEME**

9 **A. Late Trading**

10 11. “Late trading” refers to the illegal practice of placing orders to
11 buy or sell mutual fund shares after close of market at 4:00 p.m. EST, but at
12 the mutual fund's NAV, or price, determined at the market close. Late
13 trading is prohibited because it enables the trader to profit from market
14 events that occur after 4:00 p.m. EST but that are not reflected in that day's
15 price.

16 12. Calugar knew that late trading was prohibited because MFS and
17 Security Brokerage entered into a Dealer Agreement that specifically
18 prohibited Security Brokerage from engaging in late trading. Further, MFS’
19 prospectus also expressly prohibited late trading. In addition, as the owner
20 of a self-clearing broker-dealer firm, Calugar knew, or was highly reckless in
21 not knowing, that late trading was illegal under federal securities laws.

22 13. Nevertheless, Calugar and Security Brokerage engaged in late
23 trading for at least two years in both Alliance and MFS funds.

24 14. Security Brokerage self-cleared its trades (i.e. handled the
25 settlement of its clients trades) through National Securities Clearing
26 Corporation (“NSCC”). Security Brokerage created false internal records in

1 which the order time for its trades was entered as 3:59 p.m. EST for all
2 trades. However, Calugar and Security Brokerage routinely transmitted their
3 orders to the NSCC up to two hours after 4:00 p.m. EST. Because Calugar
4 was making trading decisions using his own money, he was acting as the
5 customer and the broker and had no legitimate reason for delaying the
6 transmission of his trades to NSCC. By sending his trades after 4:00 p.m.
7 EST, Calugar was able to extend the time to make his market timing trading
8 decisions, and, therefore, to take advantage of information occurring after the
9 close of the market.

10 **B. Market Timing**

11 15. “Market timing” refers to the practice of short term buying and
12 selling of mutual fund shares in order to exploit inefficiencies in mutual fund
13 pricing. Market timing can dilute the value of mutual fund shares to the
14 extent that a timer is permitted to buy, sell, or exchange shares rapidly and
15 repeatedly to take advantage of arbitrage opportunities. In addition, timing
16 raises transaction costs for mutual funds, such as taxes and trading costs, by,
17 for example, requiring the sale of securities to meet redemptions.

18 16. From at least mid-2001 through September 2003, Calugar,
19 through Security Brokerage, was a frequent market timer in various mutual
20 funds. He primarily engaged in timing trades in the funds of the Alliance
21 and MFS fund families.

22 17. MFS represented to its investors in prospectuses that “The MFS
23 funds do not permit market timing or other excessive trading practices that
24 may disrupt portfolio management strategies and harm fund performance.”
25 MFS funds claimed to prohibit market timing in the funds.

26 18. Similarly, representations in Alliance’s prospectuses gave

1 investors the misleading impression that Alliance sought to prevent timing in
2 the funds. The prospectuses for each of the Funds state: “You should
3 consider an investment in the Fund as a long-term investment.” Regarding
4 the purchase and sales of shares of the Funds, the Funds' prospectuses state:
5 “A Fund may refuse any order to purchase shares. In particular, the Funds
6 reserve the right to restrict purchases of shares (including through
7 exchanges) when there appears to be evidence of a pattern of frequent
8 purchases and sales made in response to short-term considerations.”

9 19. Calugar received the prospectuses of the funds he traded and/or
10 summaries of the prospectus' provisions, which he had directed his
11 subordinates to prepare.

12 20. Despite these representations in Alliance and MFS
13 prospectuses, and despite Calugar's knowledge of those representations,
14 Calugar, through Security Brokerage, was the single largest timer at
15 Alliance, and had agreements with Alliance for timing capacity of \$220
16 million. In return, Calugar and Security Brokerage agreed to make long-term
17 investments (“sticky assets”) in Alliance hedge funds as a quid pro quo.
18 Calugar made a similar proposal to MFS, which was not accepted, but still
19 engaged in market timing in MFS funds.

20 21. Calugar and Security Brokerage thus participated in a scheme
21 with Alliance and MFS to engage in market timing that most other fund
22 investors were not permitted to do. The Funds as well as Calugar profited at
23 the expense of such investors. Calugar and Security Brokerage made trading
24 profits of \$175 million from their market timing and late trading at Alliance
25 and MFS. The Funds profited by way of increased advisory and other fees.

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FIRST CLAIM FOR RELIEF

FRAUD IN THE OFFER OR SALE OF SECURITIES

Violations of Section 17(a) of the Securities Act

22. The Commission realleges and incorporates by reference ¶¶ 1 through 21 above.

23. The defendants, and each of them, by engaging in the conduct described above, directly or indirectly, in the offer or sale of securities by the use of means or instruments of transportation or communication in interstate commerce or by use of the mails:

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

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

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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 the defendants
5 committed the alleged violations.

6 **II.**

7 Issue judgments, in a form consistent with Fed. R. Civ. P. 65(d),
8 permanently enjoining each defendant and their officers, agents, servants,
9 employees and attorneys, and those persons in active concert or participation
10 with any of them, who receive actual notice of the order by personal service
11 or otherwise, and each of them, from violating Section 17(a) of the Securities
12 Act, 15 U.S.C. § 77q(a), and Section 10(b) of the Exchange Act, 15 U.S.C.
13 § 78j(b), and Rule 10b-5 thereunder, 17 C.F.R. § 240.10b-5.

14 **III.**

15 Issue in a form consistent with Fed. R. Civ. P. 65, a temporary
16 restraining order and a preliminary injunction freezing the assets of
17 defendants, prohibiting each of the defendants from destroying documents,
18 and ordering expedited discovery from defendants.

19 **IV.**

20 Order each defendant to disgorge all ill-gotten gains from his or its
21 illegal conduct, together with prejudgment interest thereon.

22 **V.**

23 Order each defendant to pay civil penalties under Section 20(d) of the
24 Securities Act, 15 U.S.C. § 77t(d), and Section 21(d)(3) of the Exchange Act,
25 15 U.S.C. § 78u(d)(3).
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VI.

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

VII.

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

DATED: December __, 2003

ALKA PATEL
NICOLAS MORGAN
Attorney for Plaintiff
Securities and Exchange Commission