

UNITED STATES DISTRICT COURT  
FOR THE DISTRICT OF COLUMBIA

SECURITIES AND EXCHANGE COMMISSION  
100 F Street, N.E.  
Washington, DC 20549,

Plaintiff,

v.

LANGLEY PARTNERS, L.P., NORTH OLMSTED  
PARTNERS, L.P., QUANTICO PARTNERS, L.P.,  
AND JEFFREY THORP  
c/o Andrew G. Gordon, Esq.  
Paul, Weiss, Rifkind, Wharton & Garrison LLP  
1285 Avenue of the Americas  
New York, NY 10019-6064,

Defendants.

CASE NUMBER 1:06CV00467

JUDGE: John D. Bates

DECK TYPE: General Civil

DATE STAMP: 03/14/2006

**COMPLAINT**

Plaintiff Securities and Exchange Commission ("Commission") alleges:

**SUMMARY OF ALLEGATIONS**

1. Defendant hedge funds Langley Partners, L.P., North Olmsted Partners, L.P. and Quantico Partners, L.P. (collectively, "Langley Partners"), and their portfolio manager, defendant Jeffrey Thorp ("Thorp"), perpetrated an illegal trading scheme to evade the registration requirements of the federal securities laws in connection with twenty-three unregistered securities offerings, which are commonly referred to as "PIPEs" (Private Investment in Public Equity). From 2000 to 2002, defendants realized more than \$7,000,000 in ill-gotten gains as a result of the unlawful trading scheme, which violated the antifraud and registration provisions of the federal securities laws.

2. Typically, after agreeing to invest in a PIPE transaction, Thorp sold short the issuer's stock, frequently through "naked" short sales in Canada. Later, once the Commission declared the resale registration statement effective, Thorp used the PIPE shares to close out the short positions — a practice Thorp knew was prohibited by the registration provisions of the federal securities laws. To avoid detection and regulatory scrutiny, Thorp employed a variety of deceptive trading techniques, including wash sales and matched orders, to make it appear that he was covering his short sales with legal, open market stock purchase when in fact the covering transactions were not open market transactions because Thorp was on both sides of the trades.

3. Langley Partners' unlawful PIPE investment strategy and deceptive trading scheme involved twenty-three issuers that sought PIPE financing (collectively, "the PIPE Issuers"). During the relevant period, the common stock of each PIPE Issuer was registered with the Commission pursuant to either Section 12(b) or Section 12(g) of the Securities Exchange Act of 1934 ("Exchange Act") and traded on either the NASDAQ National Market, the New York Stock Exchange, or the Over-The-Counter Bulletin Board.

4. In each of the transactions, Thorp also made materially false representations to the PIPE Issuers to induce them to sell securities to Langley Partners. As a precondition of participation in a PIPE, Langley Partners had to represent that it would not sell, transfer or dispose of the PIPE shares other than in compliance of the registration provisions of the Securities Act of 1933 ("Securities Act"). This representation was material to the PIPE Issuers, who, as the stock purchase agreements made clear, relied on the investors' representations in order to qualify for an exemption from the registration requirements for their private offering. At the time Thorp signed the securities purchase agreements, however, he intended, if he had not already done so, to distribute the restricted

PIPE securities in violation of the registration provisions of the Securities Act.

5. On seven occasions, Thorp also engaged in insider trading by selling the securities of PIPE Issuers on the basis of material nonpublic information. Thorp engaged in this conduct notwithstanding his express agreement to keep information about the PIPE confidential and/or to refrain from trading prior to the public announcement of the PIPE.

6. By engaging in the acts alleged herein, the defendants engaged in, and unless permanently restrained and enjoined by the Court will continue to engage in, transactions, acts, practices and courses of business that violate Section 10(b) of the Exchange Act [15 U.S.C. § 78j(b)] and Rule 10b-5 promulgated thereunder [17 C.F.R. § 240.10b-5], Section 17(a) of the Securities Act [15 U.S.C. § 77q(a)], and Section 5 of the Securities Act [15 U.S.C. § 77e].

7. The Commission seeks a judgment from the Court: (a) enjoining the defendants from engaging in future violations of the above sections of the federal securities laws; (b) ordering defendants Langley Partners, L.P., North Olmsted Partners, L.P. and Quantico Partners, L.P., jointly and severally, to disgorge, with prejudgment interest, the illegal profits and proceeds they obtained as a result of the actions described herein; and (c) ordering defendants Langley Partners, L.P., North Olmsted Partners, L.P., Quantico Partners, L.P. and Thorp to pay civil money penalties pursuant to Section 20(d) of the Securities Act [15 U.S.C. § 77t(d)] and Section 21(d) of the Exchange Act [15 U.S.C. § 78(u)(d)].

### **JURISDICTION AND VENUE**

8. The Court has jurisdiction over this action pursuant to Sections 20(b), 20(d) and 22(a) of the Securities Act [15 U.S.C. §§ 77t(b), 77t(d), 77v(a)] and Sections 21(d), 21(e) and 27 of the

Exchange Act [15 U.S.C. §§ 78u(d), 78u(e), 78aa].

9. The defendants made use of the means and instrumentalities of interstate commerce or of the mails in connection with the acts, practices, and courses of business alleged herein. Venue is proper in this District pursuant to Section 22(a) of the Securities Act [15 U.S.C. § 77v(a)] and Section 27 of the Exchange Act [15 U.S.C. § 78aa].

### DEFENDANTS

10. **Jeffrey Thorp**, age 42, is a resident of New York, New York.

11. **Langley Partners, L.P.**, a Delaware limited partnership, is a hedge fund with its principal place of business at 535 Madison Avenue, New York, New York. Langley Capital, LLC (“Langley Capital”) is the general partner of Langley Partners, and Thorp is the managing member of Langley Capital. During the relevant period, Thorp was the portfolio manager of, and only authorized trader for, Langley Partners.

12. **North Olmsted Partners, L.P.**, a California limited partnership, is a hedge fund with its principal place of business at 535 Madison Avenue, New York, New York. During the relevant period, Thorp was the portfolio manager of, and only authorized trader for, North Olmsted Partners.

13. **Quantico Partners, L.P.**, a Delaware limited partnership, was a hedge fund with its principal place of business at 535 Madison Avenue, New York, New York. Langley Capital was the general partner of Quantico Partners. During the relevant period, Thorp was the portfolio manager of, and only authorized trader for, Quantico Partners. Quantico Partners has been merged into Langley Partners.

## STATEMENT OF FACTS

### PIPEs Background

14. Issuers utilize the PIPEs market when more traditional means of financing, such as a registered repeat offering, are for various reasons impractical. PIPE securities are generally issued pursuant to Section 4(2) of the Securities Act or Regulation D under the Securities Act, which provide an exemption from registration for a non-public offering by an issuer. Because PIPEs are unregistered offerings, PIPE investors receive restricted securities when a transaction closes. Before investors can trade those restricted securities, the issuer must file, and the Commission must declare effective, a resale registration statement, a process that may take 60 to 120 days to complete. PIPE investors therefore must wait a certain period of time before they can freely trade the securities that they received in the PIPE. The sale of the securities to the PIPE investor is typically conditioned upon effectiveness of the resale registration statement. To compensate investors for this temporary illiquidity, PIPE issuers customarily offer the restricted securities at a discount to market price.

15. Many PIPE investors “hedge” their investment by selling short the PIPE issuer’s securities before the resale registration statement is declared effective. The size of the “hedge” is limited by the investor’s ability to locate shares of the PIPE issuer’s securities to borrow in order to sell short. A PIPE investor that wishes to fully “hedge” its investment therefore typically wants to purchase in the offering only as many shares as it knows it can locate to borrow. In thinly-traded securities (such as many of those at issue in this case), where locating shares can be difficult, investors wishing to “hedge” must limit their investment, which correspondingly limits their ability to profit from the PIPE transaction.

16. Thorp violated Section 5 by covering his pre-effective date short positions with the

actual shares received in the PIPE. This is because shares used to cover a short sale are deemed to have been sold when the short sale was made.

17. Thorp knew the lawful way to “hedge” PIPE investments, but chose instead to close out his pre-effective date short positions with PIPE shares. This unlawful trading scheme permitted him to profit from outsized allocations of PIPE offerings without incurring corresponding market risk.

### **The Unlawful Trading Scheme**

18. During the period 2000 through 2002, Thorp implemented the unlawful trading scheme that enabled Langley Partners to invest in PIPE offerings without incurring market risk. His strategy was simple: to short sell Langley Partners’ entire restricted PIPE allocation as quickly as possible before the Commission declared the resale registration statement effective and then to close out those short positions using the PIPE shares.

19. In each of the twenty-three transactions listed below (except TiVo, Inc. (“TiVo”)), in which Thorp and Langley Partners engaged only in illegal insider trading), Thorp and Langley Partners employed an unlawful trading strategy in violation of the antifraud and registration provisions of the federal securities laws:

	PIPE Issue	PIPE Closing Date
1	Irvine Sensors	08/14/00
2	Amtech	09/13/00
3	NaPro	11/16/00
4	EcTel	03/25/01
5	PhotoMedex	03/27/01
6	BriteSmile	04/30/01
7	Guilford	06/08/01
8	Generex	07/30/01
9	HealthExtras	09/25/01
10	Visionics	10/05/01
11	SIGA	10/12/01
12	MGI Pharma	10/31/01
13	Alloy	11/01/01
14	Gentner	11/15/01
15	IntelData	11/28/01
16	Viisage	12/14/01
17	Rail America	12/18/01
18	Impco	01/11/02
19	PurchasePro.com	02/13/02
20	Matritech	03/04/02
21	AVI BioPharma	03/25/02
22	Cell Pathways	03/26/02
23	TiVo (insider trading only)	08/28/01

20. Although the manner of establishing and covering the short positions differed from deal to deal, the MGI Pharma, Inc. (“MGI Pharma”) PIPE offering that closed on October 31, 2001 illustrates defendants’ basic trading strategy: Langley Partners invested \$1,100,000 in the offering, receiving 100,000 restricted MGI Pharma shares at \$11 per share – a discount of approximately 15% from MGI Pharma’s then-market price of approximately \$13 per share. Langley Partners quickly short sold all 100,000 of its restricted shares (50,000 at \$13.15 and 50,000 at \$13.56), garnering

proceeds of \$1,335,500. Thus, Langley Partners had purchased 100,000 shares in the PIPE and shorted 100,000 shares before the resale registration statement was effective. Once the Commission declared the resale registration statement effective, Langley Partners, through the deceptive and nearly undetectable methods described below, used its freely tradable PIPE shares to close out its 100,000 share short position. Langley Partners' profit was therefore locked in at the moment its short sales were executed: the \$1,335,500 short sale proceeds minus the \$1,100,000 investment, for a net profit of \$235,500.

21. Langley Partners engaged in the same illegal trading scheme in connection with each of the PIPE offerings (except for TiVo), garnering a total of approximately \$7,000,000 in ill-gotten gains.

22. Langley Partners employed several different methods — often used in combination for the same PIPE — to establish its short positions. Because Langley Partners wanted to complete its short selling as quickly, and as cheaply, as possible, it often executed its pre-effective date short sales through a Canadian broker-dealer.

23. Using its Canadian broker-dealer, Langley Partners executed “naked” short sales by, among other things, selling short without either owning unrestricted shares or borrowing unrestricted shares to deliver. “Naked” short selling was permissible in Canada during the relevant period, so Langley Partners attempted to establish its short positions in Canada because it did not own unrestricted shares and did not want to incur the cost of borrowing unrestricted shares of the PIPE Issuers' securities. Because Langley Partners therefore had no borrowing limitations, and because it knew that it would be using its PIPE shares illegally to close out its pre-effective date short positions, Langley Partners was able to make larger PIPE investments than other investors and, as a result, was

able to earn larger profits. In addition to its “naked” Canadian short selling, Langley Partners also engaged in short selling in the United States through domestic broker-dealers or by executing short sale orders itself through electronic communications networks.

24. Once Langley Partners had established its short position, it waited until the Commission declared effective the resale registration statement and then began to use its PIPE shares to cover (or “unwind”) the short positions in violation of Section 5 of the Securities Act.

25. To close out Canadian short positions, Langley Partners either directly transferred its PIPE shares to its Canadian account or engaged in deceptive, pre-arranged matched orders with its Canadian broker-dealer. To execute the matched orders, Thorp would call or instant message his Canadian broker to inform him that Langley Partners intended to sell a certain number of its PIPE shares from its domestic prime brokerage account at a particular time and price using a particular exchange, and would instruct the broker to enter a buy order for Langley Partners’ Canadian account for the same number of shares at the same time and price and on the same exchange. The buy and sell orders would meet on the specified exchange, and the Canadian broker-dealer would use the PIPE shares that he had just purchased from Langley Partners’ domestic account to close out Langley Partners’ Canadian short positions.

26. When Thorp established his short positions in his domestic prime brokerage account, he used two unlawful trading methods to close out those short positions: “closing the box” and wash sales. To “close the box,” Langley Partners simply journaled its PIPE shares from its cash account to its short account with instructions for its prime broker to close out the short position using the PIPE shares.

27. In other instances, Thorp asked broker-dealers to register as market makers in

particular PIPE securities to assist Langley Partners in washing its PIPE shares. With the help of these broker-dealers, Langley Partners sold its PIPE shares to the brokers, which then sold the exact same shares back to Langley Partners. Once Langley Partners had received its PIPE shares back from the broker-dealers, Langley Partners used those PIPE shares to close out its domestic short positions.

28. As a necessary part of the unlawful trading scheme, Thorp intentionally made materially false representations to the PIPE Issuers to induce them to sell their securities to Langley Partners. Each securities purchase agreement between the PIPE Issuers and Langley Partners contained a provision in which Langley Partners represented that it was purchasing the PIPE securities in compliance with Section 5 of the Securities Act. In each offering, Langley Partners represented, among other things, that it was purchasing the securities for its own account and without any present intention of distributing the securities.

29. Thorp signed these securities purchase agreements despite knowing that Langley Partners (i) was not purchasing the PIPE securities for its own account, and (ii) had a present intention to distribute the PIPE securities through its short selling and to cover with the PIPE shares in violation of Section 5. In a number of instances, not only did Langley Partners have a present intention to distribute the PIPE shares at the time it signed the securities purchase agreements, it had in fact already distributed the shares through short sales that it intended to cover, and did in fact cover, with its PIPE shares.

### **Insider Trading**

30. Thorp also engaged in insider trading in connection with seven PIPE offerings (Gentner Communications, Inc.; Irvine Sensors Corporation; Matritech, Inc.; MGI Pharma, Inc.; PhotoMedex, Inc.; TiVo, Inc.; and Visionics Corporation) by selling short the PIPE Issuers' securities prior to the public announcement of the offering. Advance news of a PIPE offering can be valuable and material nonpublic information since the announcement typically precipitates a decline in the price of a PIPE issuer's securities as the market absorbs the dilutive effect of the offering. In connection with each of the seven deals, Langley Partners received offering documents from PIPE Issuers with language requiring it to maintain the information contained therein in confidence and/or to refrain from trading on that information prior to the public announcement of the offering.

31. Notwithstanding these agreements to the contrary, Langley Partners breached its duty to maintain the information about the PIPEs in confidence, misappropriated the confidential information concerning these seven offerings and traded on the basis of that material nonpublic information by selling short the PIPE Issuers' securities prior to the public announcement.

### **FIRST CLAIM FOR RELIEF**

#### **INSIDER TRADING AND FRAUD**

#### **Violations of Section 10(b) of the Exchange Act and Rule 10b-5 Thereunder**

32. The Commission realleges and reincorporates paragraphs 1 through 31 as if fully set forth herein.

33. From at least 2000 to 2002, the defendants, by use of the means or instrumentalities of interstate commerce or of the mails, in connection with the purchase or sale of securities: (a)

employed devices, schemes, or artifices to defraud; (b) made untrue statements of material fact or omissions to state material facts necessary in order to make the statement made, in light of the circumstances under which they were made, not misleading; and/or (c) engaged in acts, practices or courses of business which operated or would operate as a fraud or deceit.

34. By reason of their actions alleged herein, the defendants each violated 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**

### **INSIDER TRADING Violations of Section 17(a) of the Securities Act**

35. The Commission realleges and reincorporates paragraphs 1 through 34 as if fully set forth herein.

36. From at least 2000 to 2002, the defendants, by use of the means or instrumentalities of interstate commerce or of the mails, in the offer or sale of securities: (a) employed devices, schemes or artifices to defraud; (b) obtained money or property by means of untrue statements of material fact or omissions 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/or (c) engaged in acts, practices or courses of business which operated or would operate as a fraud or deceit upon the purchasers of the securities offered and sold by the defendants.

37. By reason of their actions alleged herein, the defendants violated Section 17(a) of the Securities Act [15 U.S.C. § 77q(a)].

**THIRD CLAIM FOR RELIEF**

**REGISTRATION AND PROSPECTUS DELIVERY  
Violations of Section 5 of the Securities Act**

38. The Commission realleges and reincorporates paragraphs 1 through 37 as if fully set forth herein.

39. Defendant, directly or indirectly: (a) without a registration statement in effect as to the securities, (i) made use of the means or instruments of transportation or communication or the mails to sell such securities through the use or medium of a prospectus or otherwise, or (ii) carried or caused to be carried through the mails, or in interstate commerce, by any means or instruments of transportation, such securities for the purpose of sale or for delivery after sale; (b) carried or caused to be carried through the mails or in interstate commerce securities for the purpose of sale or for delivery after sale without being accompanied or preceded by a prospectus; and (c) made use of the means or instruments of transportation or communication in interstate commerce or of the mails to offer to sell or offer to buy through the use or medium of a prospectus or otherwise securities for which a registration statement had not been filed as to such securities.

40. By reason of their actions alleged herein, the defendants violated Section 5 of the Securities Act [15 U.S.C. § 77e].

## **PRAYER FOR RELIEF**

WHEREFORE, the Commission respectfully requests that the Court enter a judgment:

### **I.**

Finding that the defendants each violated the securities laws and Rule promulgated thereunder as alleged herein;

### **II.**

Enjoining permanently defendants Langley Partners, L.P., North Olmsted Partners, L.P., Quantico Partners, L.P. and Jeffrey Thorp from violating 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 5 and 17(a) of the Securities Act [15 U.S.C. §§ 77e and 77q(a)];

### **III.**

Ordering defendants Langley Partners, L.P., North Olmsted Partners, L.P. and Quantico Partners, L.P. jointly and severally to disgorge the profits and proceeds they obtained as a result of their actions alleged herein and to pay prejudgment interest thereon;

### **IV.**

Ordering defendants Langley Partners, L.P., North Olmsted Partners, L.P. and Quantico Partners, L.P. and Jeffrey Thorp to pay civil monetary penalties pursuant to Section 20(d) of the Securities Act [15 U.S.C. § 77t(d)] and Section 21(d) of the Exchange Act [15 U.S.C. § 78(u)(d)]; and

V.

Granting such other relief as this Court may deem just and proper.

Dated: March 14, 2006

Respectfully submitted,



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