

≈ RECENT CIVIL AND CRIMINAL PROSECUTIONS OF
INSIDER TRADING VIOLATIONS

Gary Lynch *
Associate Director
Division of Enforcement
Securities and Exchange Commission
Washington, D.C.

Michael J. Missal *
Staff Attorney
Division of Enforcement
Securities and Exchange Commission
Washington, D.C.

January 4, 1985

* The Securities and Exchange Commission, as a matter of policy, disclaims responsibility for any private publication or statement by any of its employees. The views expressed herein are those of the authors and do not necessarily reflect the views of the Commission or of the authors' colleagues on the staff of the Commission.

I. Introduction

Capital formation and the growth of the United States' economy depend on investor confidence in the fairness and integrity of our securities markets. The investing public has a legitimate expectation that the prices of actively traded securities reflect publicly available information about issuers. Insider trading, commonly defined as the trading of securities while in the possession of material non-public information in violation of a duty of trust or confidence, threatens our securities markets by decreasing the public's confidence in the fairness and integrity of the markets.

The Securities and Exchange Commission has aggressively pursued insider trading violations under the general anti-fraud provisions of the federal securities laws. "Insider trading", however, is a term not found or defined in the federal securities laws. Congress, in recently passing the Insider Trading Sanctions Act, which is discussed in Dan Goelzer's outline in these course materials, determined, after public and congressional discussion and debate, to continue not to define legislatively "insider trading."

Since adoption of the Securities Exchange Act of 1934 ("Exchange Act") and the promulgation of Rule 10b-5 thereunder in 1942, the Commission has utilized these provisions to remedy unlawful trading and tipping by persons in a variety of positions of trust and confidence who have illegally transmitted or used material non-public information. In some cases, Section 17(a) of the Securities Act of 1933 ("Securities Act"), and more recently Section 14(e) of the Exchange Act and Rule 14e-3 thereunder, have been used as well. The Commission has brought approximately 140 actions alleging insider trading, the majority within the last four years. The Justice Department has joined the Commission in attempting to curtail insider trading by expanding its criminal enforcement of insider trading violations.

This outline, which assumes the reader's familiarity with the development of the law relating to insider trading, will very briefly review several of the recent cases setting the parameters of conduct which contravenes the proscriptions against insider trading. The outline will then turn to its primary objective of listing and briefly describing recent civil enforcement actions brought by the Commission and recent criminal prosecutions for insider trading violations.

II. The Development of Insider Trading Under Rule 10b-5

A. The Disclose or Abstain Rule

The prohibition against insider trading has roots in the common law. In Strong v. Repide, 213 U.S. 419 (1909), the Supreme Court held that a director who purchased securities of an issuer through an agent without disclosing his identity or the company's intention to sell certain assets violated a duty to disclose such information to the selling shareholder.

The "disclose or abstain" rule was applied by the Commission in its decision In re Cady, Roberts & Co., 40 S.E.C. 907 (1961). In Cady, Roberts, a partner of a director of a public company traded securities after receiving material non-public information from the director. It is interesting to note, in light of the recent Dirks opinion, that the Commission accepted the contention of the director that he thought the information was public at the time he transmitted it to his partner in a brokerage firm. Thus, there was no conscious violation of a duty to the public company by the director. The Commission held, however, that by virtue of the relationship between the director and the partner, the partner was under an obligation, as was the director, to disclose such information or else abstain from trading. 40 S.E.C. at 911.

The "disclose or abstain" rule was approved by the Second Circuit in the seminal case of Securities and Exchange Commission v. Texas Gulf Sulphur, 401 F.2d 833 (2d Cir. 1968) (en banc), cert. denied, 394 U.S. 976 (1969). The court articulated a broad "disclose or abstain" rule commenting that "Rule (10b-5) is based in policy on the justifiable expectation of the securities marketplace that all investors trading on impersonal exchanges have relatively equal access to material information...." 401 F.2d at 848.

In the years immediately following Texas Gulf Sulphur, the broad "disclose or abstain" rule continued to be the dominant approach to insider trading. Recently, however, in recognition of two important Supreme Court decisions where the Supreme Court rejected the theories of liability supported by the Commission, the Commission's theories propounded in insider trading cases have become more focused.

B. Chiarella, Dirks and Newman

1. Chiarella v. United States, 445 U.S. 222 (1980).

In Chiarella v. United States, the Supreme Court considered whether a person with no prior relationship to the sellers of securities had a duty to disclose to them material non-public information concerning those securities. Chiarella was a mark-up man for a financial printer who purchased securities while in the possession of material non-public information derived from his employment. A jury of the District Court for the Southern District of New York found Chiarella criminally liable under Rule 10b-5 for his actions and the Court of Appeals for the Second Circuit affirmed the conviction.

The Supreme Court reversed the judgment of the Second Circuit. The Court interpreted the district court's instructions to the jury as, in effect, charging that the petitioner had a duty to everyone in the market, and specifically, a duty to the persons who sold securities to him. In finding that there was no duty to disclose in this particular case, the Court specifically and narrowly held that a duty to disclose under Section 10(b) and Rule 10b-5 does not arise from the mere possession of material non-public information, and that Chiarella had no duty to disclose his information to the sellers of the securities. The Court discussed several theories of liability for insider trading under Section 10(b) and Rule 10b-5, including the theory that Chiarella's conduct breached his duty to his employer and its clients by misappropriating information for his own use, but the majority refused to consider these other theories since they were not included in the jury instructions.

2. Dirks v. Securities and Exchange Commission, 103 S.Ct. 3255 (1983).

Dirks was an investment analyst with a registered broker-dealer who received information of a massive fraud concerning an issuer (Equity Funding of America) and transmitted the information to certain of his clients who sold the issuer's securities before the information was publicly disclosed. The Commission entered an order censuring Dirks, finding that he aided and abetted violations of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. 21 S.E.C. Docket 1401 (1981).

The Court of Appeals for the District of Columbia affirmed the Commission's censure. The court stated that "the obligations of corporate fiduciaries pass to all those to whom they disclose their information before it has been disseminated to the public at large." Dirks v. Securities and Exchange Commission, 681 F.2d 824, 834 (D.C. Cir. 1982).

The Supreme Court reversed the District of Columbia Circuit and held that Dirks' conduct had not violated the federal securities laws. First, with regard to Dirk's liability as a tippee, the Court stated that a tippee of an insider assumes a fiduciary duty to the shareholders only when the insider has breached his fiduciary duty to the shareholders and the tippee knows or should know that there has been a breach. Second, the Court stated that an insider breaches a duty by disclosing non-public information only when the tipper has an improper purpose in communicating the information. In this case, the insider who informed Dirks of the Equity Funding fraud did not breach any duty to the shareholders of Equity Funding because he was motivated by a desire to expose the ongoing fraud and received no monetary or personal benefit for revealing the non-public information. However, the Court, in an important footnote, stated that "[u]nder certain circumstances, such as where corporate information is revealed legitimately to an underwriter, accountant, lawyer or consultant working for the corporation, these outsiders may become fiduciaries of the shareholders." 103 S. Ct. at 3261, n.14.

3. United States v. Newman, 664 F.2d 12 (2d Cir. 1981), cert. denied 104 S. Ct. 193 (1983).

A form of the misappropriation theory as discussed in Chief Justice Burger's dissent in Chiarella was applied by the Second Circuit in Newman. In that case, the court reversed a lower court dismissal of an indictment charging Newman, a securities trader, and employees of Morgan Stanley & Co., Inc. and Lehman Brothers Kuhn Loeb, Inc. with conspiracy to purchase the securities of several companies while in possession of material non-public information. The non-public information had been furnished to Lehman Brothers Kuhn Loeb and Morgan Stanley by their corporate clients.

The Newman court ruled that a misappropriation of confidential, proprietary information from an investment banking firm by an individual in a position of trust and confidence may constitute a fraud and deceit and provide a basis for liability under Section 10(b) and Rule 10b-5 when it occurs in connection with the purchase or sale of securities. The alleged conduct of the defendants in Newman was found to be the type of conduct which Chief Justice Burger, in his dissent in Chiarella, articulated as violative of Section 10(b). The Newman court observed that:

"[b]y sullyng the reputations of [their] employees as safe repositories of client confidences, appellee and his cohorts defrauded those employers as surely as if they took their money." 664 F.2d at 17.

III. Recent Cases

Following Chiarella, Dirks and Newman, the Commission has continued to aggressively pursue insider trading cases within the analytical framework established by these opinions. The types of respondents in insider trading cases are varied and include not only traditional insiders and their friends and relatives, but attorneys, law firm employees, accountants, bank officers, brokers and financial reporters. The following are some of the significant insider trading cases recently brought by the Commission and the Department of Justice:

A. Litigated Commission Actions

1. Securities and Exchange Commission v. Lund, No. 81-371-MML (C.D. Cal., Judgment entered September 19, 1983).

In Lund, Horowitz, an officer of P&F Industries informed Lund, an officer of Verit Industries, of discussions of a joint venture between P&F and another company. Prior to the public disclosure of the joint venture, Lund purchased P&F securities for his own account. Following the announcement, the price of P&F securities doubled at which point Lund sold the P&F securities and profited by \$12,500.

The District Court found that Horowitz did not breach his fiduciary duty to P&F or its shareholders by disclosing the information to Lund. Consequently, the action against Lund could not be based upon a tippee theory. Instead, the court found that the relationship between Horowitz and Lund, which existed prior to the communication, when coupled with the communication, made Lund a "temporary insider" of P&F. The court cited footnote 14 of Dirks in reaching this determination. As a "temporary insider", the court found Lund liable under Section 10(b) and Rule 10b-5 thereunder for trading while in possession of non-public material information received in the context of his relationship with Horowitz.

2. Securities and Exchange Commission v. Materia, Docket No. 84-6043(2d Cir. October 1, 1984)

The misappropriation theory as articulated in Newman was also applied in Materia. The defendants were alleged to have traded while in possession of misappropriated material non-public information obtained from Materia's employer, the New York financial printing concern of Bowne. The Second Circuit, in affirming the district court's finding that Materia had violated Sections 10(b) and 14(e) of the Exchange Act and Rules 10b-5 and 14e-3 thereunder, cited Newman for the proposition that a violation of Section 10(b) of the Exchange Act and

Rule 10b-5 can be found even absent a duty or relationship between purchasers and sellers of stock. The court found a breach of duty by Materia to his employer by virtue of his misappropriation and improper use of the material non-public information obtained from his employer.

The Materia court also distinguished a Second Circuit decision in a private action based on the same facts involved in the Newman case, Moss v. Morgan Stanley, Inc., 719 F.2d 5 (2d Cir. 1983), cert. denied, 104 S. Ct. 1280 (1984). In Moss, the court affirmed the dismissal of a private 10b-5 suit brought by shareholders of a target company holding that under Chiarella, the purchasers violated no duty to the sellers of the securities. The Materia court held that the Moss analysis was not relevant to a SEC action for a violation of Rule 10b-5.

3. S.E.C. v. Musella, et al., 578 F. Supp. 425 (S.D.N.Y. 1984)
In the Matter of James L. Covello and Daniel V. Covello, Exchange Act Rel. No. 20826 (Apr. 5, 1984)

The Newman analysis of the misappropriation theory was also applied in S.E.C. v. Musella, a case involving trading on the basis of material non-public information improperly obtained from Sullivan & Cromwell, a New York law firm. In this particular portion of the case, in which the Commission was seeking the entry of preliminary injunctions against two bond traders, Daniel and James Covello, the court held that an employee of a law firm owed a fiduciary duty of silence to the law firm and its corporate clients. In entering preliminary injunctions against the Covello brothers, the court found that the Covellos inherited the law firm employee's duty not to trade on the basis of misappropriated market information when they received information from the law firm employee. The court relied on Dirks in stating that outsiders may become "temporary insiders" when they are given access to information solely for corporate purposes.

Since the filing of the complaint, eight defendants, including the Covellos, have consented to the entry of permanent injunctions against future violations of Sections 10(b) and 14(e) of the Exchange Act and Rules 10b-5 and 14e-3 thereunder. The court also ordered certain of the defendants to disgorge their illegal profits. The case against six other defendants is currently pending.

In a related administrative matter, the Commission barred the Covello brothers from associating with any broker, dealer, municipal securities dealer or investment company.

4. S.E.C. v. Switzer, et al., [1984] Fed. Sec. L. Rep. ¶91,589 (W.D. Okla. 1984)

The Commission brought suit against the football coach of the University of Oklahoma and others, alleging violations of Section 10(b) of the Exchange Act and Rule 10b-5 based on the purchase of shares of Phoenix Resources Corp. The Commission alleged that Switzer and others received information concerning a proposal to liquidate Phoenix, which would result in a value per share in excess of its then current market price, from a director of Phoenix prior to any public announcement.

In dismissing the action, the court found that Switzer had inadvertently overheard the information of the proposal to liquidate Phoenix at a high school track meet. The court found that since the director had not breached any fiduciary duties owed to Phoenix shareholders by transmitting the information to Switzer, then Switzer had neither acquired nor assumed derivative fiduciary duties. Therefore, the court concluded, there were no violations of Section 10(b) or Rule 10b-5.

B. Settled Commission Actions

1. S.E.C. v. Karanzalis, et al., 84 Civ. 2070 (CLB)(S.D.N.Y. 1984)

The Commission's complaint alleged that the defendants violated Sections 10(b) and 14(e) of the Exchange Act and Rules 10b-5 and 14e-3 thereunder by engaging in a scheme to misappropriate material non-public information from the New York law firm of Skadden, Arps, Slate, Meagher and Flom concerning proposed tender offers and business combinations. The defendants, some of whom were employees of the firm, traded securities while in possession of the misappropriated information.

All seven defendants consented to the issuance of permanent injunctions against future violations of Sections 10(b) and 14(e) of the Exchange Act and Rules 10b-5 and 14e-3 thereunder and agreed to disgorge all illegal profits.

2. S.E.C. v. E. Jacques Courtois, Jr., 84 Civ. 0593 (CSH) (S.D.N.Y., filed January 26, 1984)

Courtois, a Canadian national, was formerly a vice-president in the Mergers and Acquisitions department at the investment banking firm of Morgan Stanley & Co. The Commission's complaint charged Courtois with violations of Section 10(b) and Rule 10b-5, alleging that Courtois misappropriated material non-public information about impending corporate takeovers. Courtois then

disclosed this information to others who traded on the information. This case evolved from an investigation of a scheme involving other Morgan Stanley employees that resulted in previous actions, including U.S. v. Newman, infra.

On February 6, 1984, Courtois consented, without admitting or denying any of the allegations in the complaint, to the issuance of a permanent injunction. As part of his plea agreement in a related criminal proceeding (see discussion of criminal case, infra), Courtois agreed to disgorge \$150,000 into a fund to provide partial recompense to defrauded investors.

3. S.E.C. v. Thomas F. Brett, Sr., 84 Civ. 1539
(E.D.Pa., filed March 30, 1984)

The Commission's complaint alleged that Brett purchased shares of stock on the basis of material non-public information concerning merger negotiations. It was alleged that Brett received the information from his son, who was an attorney involved in the merger negotiations.

The complaint alleged that Brett violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder using a misappropriation theory analysis. Brett consented to the entry of a permanent injunction without admitting or denying any of the allegations. The court also ordered Brett to disgorge all profits received.

4. S.E.C. v. David Spiker, William Peterson and Norm Brock, 84-429-RJM (W.D. Wa., filed June 18, 1984).

In the Matter of William E. Peterson and David Spiker, Exchange Act Rel. No. 21113 (July 2, 1984)

Spiker and Peterson, brokers with the Spokane, Washington firm of Dillon Securities, and Brock, an officer, director and outside counsel of Fourth of July Silver, Inc. ("Fourth"), were alleged to have violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder by trading while in the possession of material non-public information. The Commission's complaint alleged that the defendants breached certain fiduciary duties by misappropriating information and trading on such information concerning the exchange of Fourth's stock for real estate.

On June 19, 1984, the defendants consented to the issuance of permanent injunctions. Further, the defendants agreed to disgorge \$96,400 in illegally obtained profits.

In a related administrative matter, defendants Spiker and Peterson were suspended from associating with any broker or dealer for a period of four months.

5. S.E.C. v. Martin E. Stein, Sr., CA No. 84-730-CIV-J-12 (M.D. Fla., filed August 3, 1984)

The Commission's complaint alleged that Stein violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder in connection with his purchases of stock in the Florida Companies while in the possession of material non-public information. The complaint alleged that Stein, a member of the board of directors and of the executive committee of a bank that authorized a loan involving The Florida Companies, misappropriated this information for his personal benefit by purchasing stock while in possession of this information.

Without admitting or denying the allegations of the complaint, Stein consented to the issuance of a permanent injunction and agreed to disgorge his illegal profits of \$191,379.

6. S.E.C. v. James D. Huff, 84 Civ. 3709 (D.D.C., filed December 6, 1984)

The Commission's complaint accused Huff, an executive with Applied Data Research Inc., with trading Applied Data stock while in possession of material non-public information concerning corporate developments of Applied Data. The complaint alleged that Huff sold Applied Data stock on July 13, 1983 prior to a negative earnings announcement and then purchased Applied Data stock in early October, 1983 prior to an announcement of two major army contracts.

Simultaneously with the filing of the complaint, Huff consented, without admitting or denying any of the Commission's allegations, to a permanent injunction barring him from future violations of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. Huff also agreed to disgorge illegally obtained profits of approximately \$25,000.

7. S.E.C. v. Kenneth D. Morgan, 84 Civ. 8895 (S.D.N.Y., filed December 12, 1984).

Morgan, a former vice-president of a McGraw-Hill, Inc. subsidiary, was accused of buying Monchik-Weber Corporation stock while in possession of material non-public information

concerning McGraw-Hill's planned acquisition of Monchik-Weber. The Commission's complaint alleged that Morgan violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder by obtaining information concerning the McGraw-Hill acquisition of Monchik-Weber prior to its public disclosure and purchasing 9,000 shares of Monchik-Weber stock based on this information.

Morgan rescinded his purchase of Monchik-Weber stock prior to the settlement date of the purchase and thus did not realize any profits on the transaction. Morgan consented to the issuance of a permanent injunction against future violations of Section 10(b) and Rule 10b-5.

C. Pending Commission Actions

1. S.E.C. v. Peter N. Brant, et al., 84 Civ. 3470
(CBM)(S.D.N.Y., filed May 17, 1984).
In the Matter of Peter N. Brant, Exchange Act
Rel. No. 21136 (July 12, 1984)

The Commission alleged that Brant, a former broker with Kidder, Peabody & Co., and four others, including former Wall Street Journal reporter R. Foster Winans, violated Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder by trading while in the possession of material non-public information. The information was the date of publication and content of articles to be published by the Wall Street Journal, primarily in the Journal's "Heard on the Street" column.

The Commission's complaint alleges that Winans misappropriated information and breached his duty to the Wall Street Journal and its parent company Dow Jones & Co. by engaging in a scheme whereby he disclosed the contents and publication dates of articles to appear in the Wall Street Journal to Brant. In addition, the complaint also alleges that this conduct caused Winans to breach his duty owed to the readers of the Wall Street Journal. As a result of the scheme, the defendants profited by over \$900,000.

On May 18, 1984, a temporary restraining order was entered against all five defendants as well as an asset freeze against three of the defendants. On June 11, 1984, Brant and defendant Kenneth Felis, a former Kidder, Peabody broker, consented to the issuance of preliminary injunctions. On July 12, 1984, Brant, without admitting or denying any of the Commission's allegations, consented to the issuance of a permanent injunction

and disgorged \$454,437.19, which represented his share of the trading profits. In a related administrative matter, the Commission, also on July 12, 1984, permanently barred Brant from associating with any broker, dealer, investment adviser or investment company. The case against the other four defendants is stayed pending the completion of all criminal trials in this matter. (See discussion of criminal case, infra.)

2. S.E.C. v. W. Paul Thayer, et al.,
CA-3-84-0471-R (N.D. Tex. 1984).

The Commission filed a complaint against Thayer, former deputy secretary of Defense and former chairman of the LTV Corporation, and eight others alleging violations of Sections 10(b) and 14(e) of the Exchange Act and Rules 10b-5 and 14e-3 thereunder based on trading of securities while in possession of material non-public information. The complaint alleged that Thayer improperly disclosed information to certain of the other defendants relating to proposed takeovers and other material corporate events. The complaint also seeks disgorgement from the defendants of their illegal profits of approximately \$1,900,000.

3. S.E.C. v. John B. Tenney and Laurence M. Gibney,
84 Civ. 829 (D. Ore., filed August 7, 1984).

The Commission's complaint accused Tenney, the former president of Commodore Resources Corp., and Gibney, president of the Oregon brokerage firm of Omega Northwest, Inc., of violating various provisions of the securities laws including Section 10(b) and Rule 10b-5 thereunder. Among other things, the complaint alleges that Gibney sold shares of Commodore stock from his personal and other accounts while in possession of material non-public information concerning Commodore's financial problems, which he obtained from Tenney.

The Commission's complaint seeks a final judgment of permanent injunction, a rescission of certain sales of Commodore stock and a disgorgement of the illegal profits. On December 10, 1984, Gibney consented to the issuance of a permanent injunction. The case against Tenney is still pending.

4. S.E.C. v. Joseph Fox, David Ball, Patricia
Randall and Carl Fleece, Civ. Action
No. CA5-84-172 (N.D. Tex., filed October 1, 1984)

The Commission's complaint alleges that the defendants, all current or former executives of Texas Instruments, Inc., violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder when they breached a fiduciary duty to their employer by misappropriating material non-public information concerning the company

and trading on the basis of such information. The complaint seeks a permanent injunction against future violations of Section 10(b) and Rule 10b-5, and a disgorgement of all illegal profits.

The complaint alleges that the four defendants purchased put options for Texas Instruments stock on June 9 and 10, 1983 just prior to the company announcing decreasing home computer sales and other related problems on June 10, 1983. Texas Instruments stock fell \$38 3/4 on the first day of trading following the public announcement and the defendants are alleged to have realized illegal profits of at least \$750,000.

4. S.E.C. v. Federico Ablan and Cesar K. Duque, et al., 84 Civ. 8532 (LBS) (S.D.N.Y., filed November 28, 1984)

In the first case seeking a civil money penalty under the Insider Trading Sanctions Act of 1984, the Commission accused Ablan, Duque and two companies controlled by Ablan of violating Section 10(b) of the Exchange Act and Rule 10b-5 thereunder by purchasing Monchik-Weber Corporation stock while in possession of material non-public information about McGraw-Hill, Inc.'s plan to acquire Monchik-Weber. The Commission alleged that Ablan and Duque received this material non-public information in their capacities as agents and advisers to a director of MonchikWeber.

The complaint seeks disgorgement of the illegal profits of more than \$138,000, as well as a civil penalty of three times the illegal profits made after the enactment of the Insider Trading Sanctions Acts of 1984. Shortly after the complaint was filed, the court issued a temporary restraining order and freezing the defendants' assets.

- D. The following cases are those not described above which were brought in the Commission's fiscal years 1982 and 1983.
 1. In the Matter of Frank Joseph Bauer, Exchange Act Rel. No. 20099 (August 18, 1983).
 2. S.E.C. v. Carmichael, et al., Civil Action No. 83-5958 (S.D.N.Y., filed August 16, 1983).
 3. S.E.C. v. Clements, et al., Civil Action No. 82-3604 (D.D.C., filed December 20, 1982).

4. S.E.C. v. James DeYoung, Civil Action No. 83-2234 (D.D.C., filed August 4, 1983).
5. S.E.C. v. Gaspar, et al., Civil Action No. 83-3037 (S.D.N.Y., filed April 20, 1983).
6. S.E.C. v. G. Heileman Brewing Company, Civil Action No. 83-834 (E.D. Wis., filed June 29, 1983).
7. S.E.C. v. Griffith, et al., Civil Action No. 83-1316A (N.D. Ga., filed June 23, 1983).
8. S.E.C. v. Dennis Dale Groth, Civil Action No. 83-4534 (N.D. Ca., filed September 26, 1983).
9. S.E.C. v. Joseph E. Hall, Civil Action No. 83-6904 (S.D.N.Y., filed September 21, 1983).
10. S.E.C. v. Robert E. Johnson, Civil Action No. 3-83-0257G (N.D. Tex., filed February 11, 1983).
11. S.E.C. v. Kapachunes, et al., Civil Action No. 83-5368 (S.D.N.Y., filed July 21, 1983).
12. S.E.C. v. Raymond Edward Kassar, Civil Action No. 83-20267 (N.D. Ca., filed September 26, 1983).
13. S.E.C. v. James D. Lewis, Civil Action No. 2-83-228 (E.D. Tenn., filed August 11, 1983).
14. S.E.C. v. Madan, et al., Civil Action No. 83-5053 (S.D.N.Y., filed July 7, 1983).
15. S.E.C. v. John C. Maurer, Civil Action No. 83-2412 (D.D.C., filed August 18, 1983).
16. S.E.C. v. Sam B. Montgomery, Civil Action No. 82-6728 (S.D.N.Y., filed October 12, 1982).
17. S.E.C. v. Peter Muth, Civil Action No. 82-7317 (S.D.N.Y., filed November 4, 1982).
18. S.E.C. v. Olzman, et al., Civil Action No. 83-2489 (D.D.C., filed August 24, 1983).
19. S.E.C. v. Pierre J. Petrou, Civil Action No. 82-3413 (D.D.C., filed December 2, 1982).

20. S.E.C. v. Smith, et al., Civil Action No. 83-733 (D.C. Mass., filed March 18, 1983).
21. In the Matter of Everett J. Wadler, Exchange Act Release No. 20109 (August 24, 1983).
22. S.E.C. v. Wattenbarger, et al., Civil Action No. 83-2867 (D.D.C., filed September 29, 1983).
23. S.E.C. v. Andes, et al., Civil Action No. 82-1659 (E.D. Pa., filed April 14, 1982).
24. S.E.C. v. Baranowicz, et al., Civil Action No. 82-3082 (C.D. Cal., filed June 21, 1982).
25. S.E.C. v. Aaron M. Binder, Civil Action No. 81-5209 (C.D. Cal., filed October 8, 1981).
26. S.E.C. v. Certain Unknown Purchasers, Civil Action No. 81-6553 (S.D.N.Y., filed October 26, 1981).
27. S.E.C. v. Christoph Securities Inc., et al., Civil Action No. 82-2216 (N.D. Ill., filed April 12, 1982).
28. S.E.C. v. Cooper, et al., Civil Action No. 82-3462 (C.D. Cal., filed July 15, 1982).
29. S.E.C. v. Guy O. Dove, III, Civil Action No. 82-1522 (D.D.C., filed June 3, 1982).
30. S.E.C. v. Fabregas, et al., Civil Action No. 82-3440 (C.D. Cal., filed July 14, 1982).
31. S.E.C. v. Feole, et al., Civil Action No. 82-5018 (C.D. Cal., filed September 28, 1982).
32. S.E.C. v. Martin, et al., Civil Action No. 82-381 (W.D. Wa., filed April 7, 1982).
33. S.E.C. v. Randolph, et al., Civil Action No. 82-5343 (N.D. Cal., filed September 30, 1982).
34. S.E.C. v. Reed, et al., Civil Action No. 81-7984 (S.D.N.Y., filed December 23, 1981).
35. S.E.C. v. Rubinstein, et al., Civil Action No. 82-4043 (S.D.N.Y., filed June 21, 1982).

36. S.E.C. v. Mark C. Saunders, Civil Action No. 82-0354 (E.D. Va., filed April 19, 1982).
37. S.E.C. v. Thomas W. Schafer, Civil Action No. 81-6225 (S.D.N.Y., filed November 25, 1981).
38. S.E.C. v. Schwartz, et al., Civil Action No. 82-0457 (N.D. Cal., filed January 25, 1982).
39. Sharon Steel Corporation (Investigative Report Pursuant to Section 21(a) of the Exchange Act), Exchange Act Release No. 18271 (November 19, 1981).
40. S.E.C. v. Voigt, et al., Civil Action No. 82-344 (S.D. Ind., filed March 12, 1982).
41. In the Matter of Wulff Hansen & Co., et al., Exchange Release No. 19080 (September 27, 1982).

E. Recent Criminal Prosecutions

1. U.S. v. Newman, Courtois, Carniol and Spyropoulos, 82 Cr. 166 (CSH) (S.D.N.Y., indictment returned March 1, 1982).

The indictment charged the four defendants with violating the antifraud provisions of the federal securities laws by misappropriating material non-public information from Morgan Stanley & Co., Inc. and Lehman Brothers Kuhn Loeb, Inc. concerning corporate takeovers managed by the firms. The information illegally misappropriated was the basis for purchases of securities in target companies. See, U.S. v. Newman, 664 F.2d 12(2d Cir. 1981) cert. denied 1045 S. Ct. 193 (1983).

The disposition of the above-referenced action, and of a related case, U.S. v. Antoniu, 80 Cr. 742 (CES)(S.D.N.Y. 1980) was as follows:

- a. Antoniu - pled guilty to a two count information on November 13, 1980; sentenced to three months imprisonment, three years probation and fined \$5,000;
- b. Newman - found guilty by a jury on May 21, 1982 on 15 counts of securities fraud, conspiracy to commit securities fraud and mail fraud; sentenced to one year and a day in jail, three years probation and fined \$10,000;

- c. Spyropoulos - pled guilty to conspiracy to commit securities fraud on January 31, 1983; sentenced to three years probation and fined \$10,000;
- d. Courtois - pled guilty to one count of criminal conspiracy and three counts of securities fraud on December 7, 1983; sentenced to six months imprisonment and fined \$10,000 on February 13, 1984; and
- e. Carniol - left the country and now living in Belgium; extradition sought.

In addition, the following actions were related to the above:

- f. U.S. v. Nussbaum, 81 Cr. 672(JMC)
(S.D.N.Y. 1981)

Nussbaum, a dentist, was a tippee in the Morgan Stanley - Lehman Brothers Kuhn Loeb scheme described infra. On December 8, 1981, Nussbaum pled guilty to a one count information charging him with conspiracy to misappropriate material non-public information about impending corporate mergers. At the time of his plea, Nussbaum also acknowledged that he committed perjury in the Commission's investigation.

Nussbaum was sentenced to five years probation, 350 hours of community service and fined \$10,000; and

- g. U.S. v. Paul, 83 Cr. 14 (RJW) (S.D.N.Y.,
indictment returned January 12, 1983).

Paul, a stockbroker, was charged with five counts of perjury in a Commission deposition, five counts of making false statements to federal officers and one count of obstruction of a Commission proceeding. The charges resulted from false statements Paul made during the Commission's investigation of the scheme to misappropriate information from Morgan Stanley & Co. and Lehman Brothers Kuhn Loeb.

On March 16, 1983, Paul pled guilty to two counts of filing false tax returns after two days of trial. On May 4, 1983, Paul was sentenced to three years probation, 250 hours of community service and fined \$10,000.

2. U.S. v. Hutchinson, 83 Cr. 613 (C.D. Calif. 1983)
U.S. v. Fabregas, 83 Cr. 614 (C.D. Calif. 1983)
U.S. v. Chadwick, 83 Cr. 615 (C.D. Calif. 1983)
U.S. v. Cooper, 83 Cr. 616 (C.D. Calif. 1983)

The above actions arose from insider trading in Brunswick Corporation securities immediately prior to the announcement of a tender offer for Brunswick securities by Whittaker Corporation on January 25, 1982. Cooper, a vice-president of Bankers Trust, and Fabregas, a vice-president of Credit Suisse, were contacted by the Whittaker Corporation in connection with Whittaker's request for additional capital needed for the proposed takeover of Brunswick. Cooper tipped Chadwick, an attorney in Los Angeles and another person, who in turn tipped Hutchinson.

The defendants were accused of violating Section 14(e) of the Exchange Act and Rule 14e-3 promulgated thereunder. All four defendants pled guilty to one count of violating Section 14(e) and Rule 14e-3 and each received a fine of \$10,000.

3. U.S. v. Nugent, 83 Cr. 115 (D.D.C., information filed September 30, 1983)
U.S. v. Tatusko, 82 Cr. 230 (D.D.C., information filed September 30, 1983)
U.S. v. Peacock, 83 Cr. 275 (D.D.C., information filed September 30, 1983)

The information filed against the above - named defendants resulted from an investigation of insider trading of Santa Fe International Corporation securities immediately prior to the public announcement of a merger between Santa Fe and Kuwait Petroleum Corporation. Nugent, an officer of the Washington consulting firm of Timmons & Co., pled guilty to a one count information charging him with aiding and abetting violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder in connection with the purchase of call options for the common stock of Santa Fe. Nugent was sentenced to 300 hours of community service and was fined \$10,000.

Peacock, a Vice-President of a subsidiary of Wheelabrator-Frye, Inc., and Tatusko, a broker with the Washington, D.C. firm of Bellamah, Neuhauser and Barrett, Inc., pled guilty to a one count information charging them with obstruction of justice in connection with the Commission's investigation of this action. Peacock was sentenced to two years probation, 200 hours of community service and was fined \$5,000. Tatusko was sentenced to three years probation, 300 hours of community service and was fined \$5,000.

4. U.S. v. Materia, 84 Cr. 985 (S.D.N.Y. 1984)
U.S. v. Rossman, 84 Cr. 707 (CES) (S.D.N.Y. 1984)
U.S. v. R. D'Elia, 84 Cr. 707 (CES) (S.D.N.Y. 1984)
U.S. v. A. D'Elia, 84 Cr. 707 (CES) (S.D.N.Y. 1984)
U.S. v. Abramson, 84 Cr. 487 (ADS) (S.D.N.Y. 1984)
U.S. v. Garber, 84 Cr. 541 (WK) (S.D.N.Y. 1984)

The above actions arose from a scheme to trade in securities while in the possession of material non-public information misappropriated from the New York financial printing concern of Bowne of New York City. The participants in the scheme invested over \$1,500,000 and obtained illegal profits in excess of \$500,000. The following is the current status of the actions:

- a. Materia - a former proofreader at Bowne, was indicted on December 18, 1984 on nine counts of securities fraud, nine counts of fraud in connection with tender offers and three counts of mail fraud.
- b. Rossman - a former broker with Prudential - Bache, pled guilty on September 20, 1984 to one count of criminal conspiracy, one count of fraud in the purchase of securities and one count of fraud in connection with tender offers. Rossman, awaiting sentencing, faces a maximum of 15 years imprisonment and a \$30,000 fine.
- c. R. D'Elia - a former broker with Prudential-Bache, pled guilty on September 20, 1984 to one count of criminal conspiracy, one count of fraud in the purchase of securities and one count of fraud in connection with tender offers. R. D'Elia, awaiting sentencing, faces a maximum of 15 years imprisonment and a \$30,000 fine.
- d. A. D'Elia - R. D'Elia's father, pled guilty on September 20, 1984 to one count of conspiracy. A. D'Elia, awaiting sentencing, faces a maximum of 5 years imprisonment and a \$10,000 fine.

- e. Abramson - a former Bowne employee, pled guilty on July 19, 1984 to one count of conspiracy to commit securities fraud. Abramson, awaiting sentencing, faces a maximum of five years imprisonment and a \$10,000 fine.
 - f. Garber - a former Bowne employee, was indicted on August 16, 1984. On October 31, 1984, Garber pled guilty to multiple felony charges and was sentenced to three years probation and 300 hours of community service.
5. U.S. v. James Pondiccio, Jr., 84 Cr. 009 (CSH)
(S.D.N.Y. 1984)
U.S. v. Giuseppe Tome, 84 Cr. 534 (SWK)
(S.D.N.Y. 1984)

Pondiccio, the former assistant head trader at Lazard Freres & Co., was charged with trading on inside information in connection with the tender offer by Joseph E. Seagram & Sons, Inc. for St. Joe Minerals Corporation in March of 1981. Pondiccio received this information through his employment at Lazard Freres and made a profit of approximately \$40,000.

After pleading guilty to one count of violating the mail fraud statute, Pondiccio was sentenced on March 9, 1984 to 200 hours of community service and 5 years probation. Tome, a former consultant to Seagram, was indicted on the basis of his trading on inside information misappropriated from Seagram. Tome is currently a fugitive in Europe.

6. U.S. v. Steven Matthews Crow, 84 Cr. 239 (WK)
(S.D.N.Y., information filed April 19, 1984)
U.S. v. Kenneth Petricig, 84 Cr. 256 (WK)
(S.D.N.Y., information filed April 26, 1984)
U.S. v. Alfred Salvatore, 84 Cr. 260 (WK)
(S.D.N.Y., information filed April 26, 1984)
U.S. v. Aaron Lerman, 84 Cr. 283 (CLB)
(S.D.N.Y., information filed May 10, 1984)
U.S. v. Stephen L. Wallis and Sharon Willey,
84 Cr. 342 (WCC)(S.D.N.Y., indictment returned
June 5, 1984)

The above actions resulted from an insider trading scheme involving the misappropriation of material non-public information from the New York City law firm of Skadden, Arps, Slate, Meagher & Flom. (See discussion of S.E.C. v. Karanzalis, et al., infra). Certain of the defendants traded in securities based on the misappropriated non-public information regarding potential tender offers and business combinations of the firm's clients.

The disposition of the above actions was as follows:

- a. Crow - a former word processor supervisor at Skadden Arps, pled guilty on April 19, 1984 to one count of conspiracy to violate Sections 10(b) and 14(e) of the Exchange Act and Rules 10b-5 and 14e-3 thereunder and one count of mail fraud. Crow is currently awaiting sentencing.
- b. Petricig - a former word processor operator and proofreader at Skadden, Arps, pled guilty on April 26, 1984 to one count of conspiracy to commit mail fraud and to violate Sections 10(b) and 14(e) of the Exchange Act and Rules 10b-5 and 14e-3 thereunder and one count of mail fraud. Petricig is currently awaiting sentencing.
- c. Salvatore - a former proofreader at Skadden Arps, pled guilty on April 26, 1984 to one count of conspiracy to commit mail fraud, one count of conspiracy to violate Sections 10(b) and 14(e) of the Exchange Act and Rules 10b-5 and 14e-3 thereunder and one count of mail fraud. Salvatore is currently awaiting sentencing.
- d. Lerman - a former broker with Prudential - Bache, pled guilty on May 10, 1984 to one count of conspiracy to commit mail fraud, one count of conspiracy to violate Sections 10(b) and 14(e) of the Exchange Act and Rules 10b-5 and 14e-3 thereunder and one count of mail fraud. Lerman is currently awaiting sentencing.
- e. Wallis - a New York City taxicab driver, pled guilty on June 21, 1984 to one count of conspiracy to violate Sections 10(b) and 14(e) of the Exchange Act and Rules 10b-5 and 14e-3 thereunder, one count of violating Sections 10(b) and 14(e) of the Exchange Act and Rules 10b-5 and 14e-3 thereunder and one count of mail fraud. On September 18, 1984, Wallis was sentenced to weekends in prison for 18 months, 5 years probation and ordered to pay restitution of \$49,000.

f. Willey - a friend of Wallis, pled guilty on June 21, 1984 to one count of conspiracy to violate sections 10(b) and 14(e) of the Exchange Act and Rules 10b-5 and 14e-3 thereunder. On September 18, 1984, Willey was sentenced to 5 years probation and ordered to pay restitution of \$34,000.

7. U.S. v. Peter N. Brant, 84 Cr. 470 (ADS)
(S.D.N.Y. 1984)
U.S. v. R. Foster Winans, Kenneth P. Felis
and David J. Carpenter, 84 Cr. 605 (CES)
(S.D.N.Y. 1984)

The above actions resulted from a scheme in which trading in securities was effected while in possession of information misappropriated from the Wall Street Journal. (See discussion of S.E.C. v. Brant, et al., supra). On July 12, 1984, Brant pled guilty to one count of conspiracy to commit mail, wire and securities fraud and obstruction of justice and two counts of fraud in connection with the purchase and sale of securities. Brant, awaiting sentencing, faces a maximum sentence of 15 years imprisonment and \$30,000 in fines.

Winans, Felis and Carpenter were indicted on various charges, including violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder based on a misappropriation theory. A trial date is set for January 16, 1985.

8. U.S. v. Michael Musella, John Musella, Alan Ihne, James Stivaletti, Eugene Chiaramonte, Anthony Brunetti and Albert De Angelis, 84 Cr. 686 (JFK)(S.D.N.Y., indictment returned September 19, 1984)
U.S. v. David Rapoport, 84 Cr. 686 (JFK)
(S.D.N.Y., indictment returned December 5, 1984)
U.S. v. James L. Covello, 84 Cr. 204 (MEL)
(S.D.N.Y. 1984)
U.S. v. Joseph Palomba, 84 Cr. 673 (LBS)
(S.D.N.Y. 1984)

The above actions are the result of a scheme to trade securities while in possession of material non-public information misappropriated from the New York City law firm of Sullivan & Cromwell. (See discussion of S.E.C. v. Musella, et al., infra). Covello, a former bond trader with the firm of Gintel & Co., pled guilty to a two count information which charged him with conspiracy and violation of the antifraud provisions of the federal securities laws on April 5, 1984 and is currently

awaiting sentencing. Palomba, who is unemployed, pled guilty to a three count information on September 13, 1984 and is also awaiting sentencing. The other defendants are awaiting trial.

9. U.S. v. Thomas C. Reed, 84 Cr. 618 (RFW)
(S.D.N.Y., indictment returned
August 30, 1984)

Reed, former Secretary of the Air Force and former staff member of the National Security Council, was indicted on August 30, 1984 on charges that he violated Section 10(b) and Rule 10b-5 by purchasing options in Amax, Inc. The indictment alleges that Reed traded while in possession of material non-public information about a possible acquisition of Amax that he obtained from his father, a director of the company. Reed had previously disgorged his illegal profits in a civil action brought by the Commission. S.E.C. v. Thomas C. Reed, 81 Civ. 7984 (S.D.N.Y. 1981).