

SEC IMPOSES FIRST SANCTIONS FOR VIOLATIONS OF AMENDED RULE 105

In two separate cases settled on January 26, 2010, the SEC imposed sanctions on two investment advisers, as well as two individuals, for violations of Rule 105 of Regulation M under the Securities Exchange Act of 1934 (the “Exchange Act”). The SEC’s actions are particularly noteworthy because they are the first sanctions that the SEC has imposed under Rule 105 since it was amended in 2007.¹

In connection with a firm commitment cash offering of equity securities under the Securities Act of 1933, Rule 105(a), as amended in 2007, prohibits a person from selling “short² ... the security that is the subject of the offering and purchas[ing] the offered security from an underwriter or broker or dealer participating in the offering if such short sale was effected during” the applicable Rule 105 restricted period. Per Rule 105(a)(1)-(2), the Rule 105 restricted period is the shorter of the period beginning five business days before the pricing of the offered securities and ending with such pricing, or beginning with the initial filing of the registration statement and ending with the pricing. Under Rule 105(b)(2), a person may purchase securities in a follow-on offering in an account after having sold short the same security during the Rule 105 restricted period in a separate account, “if decisions regarding securities transactions for each account are made separately and without coordination of trading or cooperation among or between accounts.”

Both actions for violations of Rule 105 that the SEC commenced involved orders instituting administrative and cease-and-desist orders that were settled by the parties via Offers of Settlement accepted by the SEC. The SEC brought one action against Palmyra Capital Advisors LLC (“Palmyra”), an investment adviser registered with the SEC that manages three hedge funds.³ Palmyra sold short 50,000 shares of Capital One Financial Corp. (“Capital One”) on Thursday, September 18, 2008, at \$53.51 per share. It then purchased shares of Capital One in a follow-on offering that priced after the close of the market on Wednesday, September 24, 2008,

¹ See Short Selling in Connection with a Public Offering, Exchange Act Release No. 56206, 72 Fed. Reg. 45094 (Aug. 10, 2007). Please see our Client Memorandum, SEC Publishes Final Amendments to Rule 105 of Regulation M, available at http://www.willkie.com/files/tbl_s29Publications/FileUpload5686/2476/SEC_Publishes_Final_%20Amendments_to_Rule_105_of_Regulation_M.pdf.

² Rule 105(a) incorporates the definition of short sale contained in Rule 200(a) of Regulation SHO under the Exchange Act. Rule 200(a) defines a short sale as “any security which the seller does not own or any sale which is consummated by the delivery of a security borrowed by, or for the account of, the seller.” 17 C.F.R. 242.200(a) (2009).

³ *In re Palmyra Capital Advisors LLC*, Exchange Act Release No. 61421, Advisers Act Release No. 2976, Administrative Proceeding File No. 3-13763 (Jan. 26, 2010), available at www.sec.gov/litigation/admin/2010/34-61421.pdf.

four business days after Palmyra sold short the same securities. Palmyra received a 50,000-share allocation of Capital One stock on the same day at a price of \$49 per share, which shares were posted to the accounts of the three hedge funds that had effected the short sales. Palmyra thus violated Rule 105 because, on behalf of the accounts it managed, it purchased shares of Capital One stock in the follow-on offering after having shorted the same security within the Rule 105 restricted period.⁴

The SEC's order imposed significant sanctions on Palmyra, as opposed to the accounts that benefited from the trades, for its violation of Rule 105. The three funds Palmyra managed made a profit of \$225,000, which Palmyra itself was required to disgorge out of its own funds. It also was required to pay prejudgment interest of nearly \$11,000 and a civil money penalty of \$105,000.

The SEC brought the other action against AGB Partners LLC ("AGB"), an investment adviser registered with California and Idaho, but not registered with the SEC, and two individuals, Gregory A. Bied and Andrew J. Goldberger.⁵ AGB managed two investment funds, one for AGB and one for Del Rey Management LLP ("Del Rey"). Messrs. Bied and Goldberger each owned 50 percent of AGB and 50 percent of the general partner of Del Rey, GB Management.

During the May 30, 2008 through June 5, 2008 Rule 105 restricted period, AGB sold short 16,200 shares of BGC Partners Inc. ("BGC") in the AGB account at \$8.45 per share. It then caused Del Rey to purchase 200,000 BGC shares at \$8 per share in a follow-on offering.⁶

The SEC asserted that AGB and Messrs. Bied and Goldberger violated Rule 105 even though the short sale was effected for the AGB account and the purchase in the follow-on offering was effected for the separate Del Rey account. Although the AGB and Del Rey accounts were held at two different prime brokers, had separate trading strategies, and maintained separate profit and loss statements, the SEC found that AGB did not manage the accounts separately. In one case, apparently unrelated to BGC, shares from the Del Rey account were allocated to the AGB account to cover a short position. Moreover, there were no information barriers to separate the accounts or to prevent information sharing about securities positions and investment decisions. According to the SEC, Messrs. Bied and Goldberger often shared trading ideas.⁷

⁴ The five-day Rule 105 restricted period applied because the registration was filed before the fifth business day preceding pricing.

⁵ *In re AGB Partners LLC*, Gregory A. Bied, and Andrew J. Goldberger, Exchange Act Release No. 61422, Advisers Act Release No. 2977, Administrative Proceeding File No. 3-13764 (Jan. 26, 2010), available at www.sec.gov/litigation/admin/2010/34-61422.pdf.

⁶ The SEC further asserted that AGB also engaged in conduct in April of 2007 that violated the pre-amendment version of Rule 105. The sanctions that the SEC imposed reflect AGB's violations of both versions of Rule 105.

⁷ The Commission did not indicate how its interpretation of Rule 105 would apply in other possibly analogous situations, such as a single individual exercising investment discretion over several unrelated individuals' accounts and shorting stock for one account during the restricted period and then buying the same issuer's stock in an underwritten follow-on offering for cash for one or more of the other, unrelated accounts.

The SEC's order imposed monetary sanctions on AGB, Mr. Bied and Mr. Goldberger for their violations of Rule 105. They were required to disgorge \$38,444 in profit and pay prejudgment interest of \$2,921, together with a civil penalty of \$20,000.

We expect the SEC to continue its enforcement efforts with respect to violations of Rule 105. Penalties imposed on market participants who commit such violations are likely to be significant. In light of the SEC's actions, market participants who engage in short selling and participate in follow-on offerings of equity securities should review their compliance policies and procedures with respect to Rule 105. Careful consideration must be given to determining whether transactions effected for separate accounts or entities should nevertheless be aggregated for purposes of Rule 105 compliance.

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January 29, 2010

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