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Securities Litigation Issues Impacting Energy Companies

*By Clifford Thau, Steven Paradise, Marisa Antos-Fallon, and Temilola Sobowale**

Recently we have seen a renewed focus on securities litigation and regulatory enforcement actions against energy companies. Chesapeake Energy Corp. faced an SEC investigation and investor suits when CEO Aubrey McClendon's borrowing practices became public, investors accused First Solar, Inc. of concealing manufacturing flaws in its solar panels, and BP reached a settlement with the SEC concerning the Deepwater Horizon explosion and spill. Looking behind these headline stories, we highlight four major securities litigation and regulatory issues that are likely to continue to impact energy companies going forward: (1) securities litigation regarding alleged improper disclosure of safety issues, (2) securities litigation related to reserve estimates in public filings, (3) shareholder and regulatory focus on hydraulic fracturing, and (4) a new SEC rule requiring disclosure of certain payments made in connection with resource extraction.

Securities Litigation Concerning Safety Disclosures

In 2012 and 2013, the federal courts issued several decisions in securities fraud cases against energy companies alleging improper disclosure of safety issues. Although these decisions each raise unique issues of interest to the energy industry, one common theme in these decisions is that they provide examples of the types of safety disclosures that a court will find "material" for purposes of a securities law claim. Accordingly, for companies working in potentially high-risk fields, these cases supply helpful guidance for formulating safety disclosures and evaluating litigation risk.

In February 2012, the U.S. District Court for the Southern District of Texas dismissed securities fraud claims against BP, p.l.c., B.P. America, Inc. and officers and directors of both entities related to the Deepwater Horizon explosion and spill.[1] Although the court ultimately dismissed the

[1] *In re BP P.L.C. Securities Litig.*, 852 F. Supp. 2d 767 (S.D. Tex. 2012). In a separate decision issued on the same day, the court also dismissed in part securities fraud claims brought against BP by a separate class of plaintiffs. *In re BP P.L.C. Securities Litig.*, 843 F. Supp. 2d 712 (S.D. Tex. 2012). Both decisions were issued prior to the SEC settlement discussed above.

complaint due to plaintiffs' failure to adequately plead facts supporting their allegations of BP's intent to deceive investors, the court first ruled on the materiality of BP's alleged misstatements. The court held that BP's general statements highlighting its focus on managing risk and commitment to safety were too vague to be material to a reasonable investor, but found other BP statements material despite a lack of specificity. For example, the court found statements describing BP's safety program as a "common framework" for "all BP operations" material because a reasonable investor would have considered the breadth of the program important to his or her investment decision. The court also found that BP's decision to highlight its safety program in its public filings was itself evidence that the information was material. [2]

Safety-related disclosures arose again when the Southern District of New York dismissed fraud claims against Transocean, Ltd. and its officers, again in connection with the Deepwater Horizon spill, for failure to allege either material misrepresentations or an intent to deceive investors.[3] On the issue of materiality, the court examined Transocean's allegedly misleading statements in light of other public statements made during the same time period and determined that statements suggesting that the company was not facing systemic safety issues did not conceal any material information. Specifically, the court held that any disclosure of Transocean's safety challenges in these statements would not have "significantly altered the total mix of information available" because the company also disclosed, for example, that it would not pay safety-related bonuses, and that it was commissioning an independent audit of its safety procedures.

By contrast, in *In re Massey Energy Co. Securities Litigation*, decided by the Southern District of West Virginia, the court rejected defendants' arguments that Massey's allegedly misleading safety metrics were not material because of other information in the marketplace.[4] Specifically, the court found that whether public records showing Massey's safety infractions rendered Massey's allegedly false statements not material was a fact-specific inquiry that could not be resolved on a motion to dismiss. Also, like the BP court, the Massey court found that seemingly vague statements can be material. For example, the court found statements that safety "was the first priority" and "job one every day" at Massey to be material because (i) they described the company's achievements and current goals rather than predictions for the future and (ii) the company "closely aligned their statements of commitment to safety to their productivity and success as a company."

The useful takeaways from the *BP* and *Massey* decisions are that (i) courts may consider even general statements concerning safety initiatives to be material, (ii) facts concerning safety initiatives may be considered to be material when emphasized in public filings and statements, and (iii) misleading statements concerning safety problems may be considered material even when accurate information about the safety problems is otherwise available to the market through other sources.

Securities Litigation Concerning Reserve Estimates

The past several years have also seen significant regulatory enforcement activity and developments in private securities litigation with respect to reserve estimates. In 2011, the SEC and the New York Attorney General started investigations and issued subpoenas to numerous energy companies relating to their reserve estimates. In August 2012, Exco Resources announced that the SEC had recommended no enforcement action against the company, and in September, another energy company with fracking operations made a similar announcement. Investigations of other companies, however, appear to be continuing. Cabot Oil & Gas Corp.'s most recent quarterly report described the subpoena from the New York Attorney General, with no indication that the investigation had concluded. Quicksilver Resources Inc.'s 2012 10-K included a similar disclosure concerning the subpoena it received from the SEC, and noted that representatives from the Company met with the SEC in February 2013.

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2 After plaintiffs in the *BP* action filed a consolidated amended complaint, in February 2013 the court denied in part defendants' renewed motion to dismiss, allowing securities fraud claims based on certain alleged misrepresentations to proceed. The court's analysis focused on the falsity of the alleged misstatements, as defendants' motion to dismiss did not challenge the materiality of the alleged misstatements. *See In re BP P.L.C. Securities Litig*., 2013 WL 487011 (S.D. Tex. Feb. 6, 2013).

3 *Foley v. Transocean, Ltd.*, 861 F. Supp. 2d 197 (S.D.N.Y. 2012).

4 *In re Massey Energy Co. Securities Litig.*, No. 10 Civ. 689, 2012 U.S. Dist. LEXIS 42563 (S.D. W. Va. Mar. 28, 2012).

In addition, in December 2012, a Texas Court of Appeals issued a notable decision in a private securities lawsuit alleging misrepresentations concerning reserve estimates. In *Highland Capital Management L.P. v. Ryder Scott Co.*, the Court reversed a grant of summary judgment in favor of Ryder Scott with respect to Texas Securities Act (TSA) claims brought by Seven Seas Petroleum, Inc. bondholders.[5] The bondholders alleged that Ryder Scott, retained by Seven Seas to provide reserve estimates, had overestimated the value of Seven Seas' proven oil reserves, which estimates were included in Seven Seas' public filings. With respect to claims that Ryder Scott had aided and abetted violations of Section 33(C) of the TSA, the Court rejected Ryder Scott's argument that its proved reserve estimates were rendered not material by cautionary language in Seven Seas' prospectus regarding the difficulty of estimating oil and gas reserves. The Court held that despite the "clear and prominent" cautionary language, summary judgment was inappropriate because the reserve estimate was a "preeminent consideration" for Seven Seas investors, and because of Plaintiffs' allegations that the estimate was not made in accordance with industry standards and SEC guidelines as Ryder Scott had represented.

Although the claims in *Ryder Scott* were brought under Texas state law, because the TSA and the federal securities law are interpreted similarly, the *Ryder Scott* decision provides useful guidance to energy companies regarding the limitations of cautionary statements regarding possible reserve estimates.

Shareholder and Regulatory Focus on Hydraulic Fracturing

Although not yet the subject of securities litigation, hydraulic fracturing (fracking) has recently been an area of focus for both shareholders and regulators. For the past several years, shareholder proposals requesting greater disclosure related to fracking have appeared in proxy statements. In 2012, shareholder votes regarding fracking went forward at Chevron, Ultra Petroleum, and ExxonMobil, receiving the support of between 28 and 35 percent of shareholders.[6] In 2013, shareholders of seven companies proposed resolutions that would require a report on measures "above and beyond regulatory requirements" to minimize risks associated with fracking. Two of these proposals have been withdrawn following an agreement between shareholders and the companies.[7]

We understand too that the SEC's Division of Enforcement has investigated issuers' disclosure of their prospects for developing fracking operations.

The staff of the SEC's Division of Corporation Finance also has shown increased interest in disclosures relating to fracking, requesting extensive fracking-related disclosures as part of its comment letter process in recent years. Requested disclosures include risks associated with underground migration, wastewater disposal, and the existence of toxic additives in fracking fluid.

In light of potential new regulations, emerging research on safety implications, and public opinion related to fracking, we are likely to continue to see new developments in fracking operations. Given this changing landscape and the high level of interest in this area on the part of shareholders and regulators, companies should pay close attention to their public disclosures concerning the potential environmental, safety, and other operational risks related to fracking.

New Disclosure Requirements for Resource Extraction Issuers

The SEC's Rule 13q-1 became effective November 2012 and was enacted in response to a provision in the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), requiring "resource extraction issuer[s] to include in an annual report . . . information relating to any payment made . . . to a foreign government or the Federal Government for the purpose of the commercial development of oil, natural gas, or minerals."[8] "Resource extraction issuers" is defined to include those engaged in the commercial development of oil, natural gas, or minerals.

The rule requires issuers to make annual filings disclosing payments of $100,000 or more. The disclosure must include the type and total amount of payments made for each "project" and the government to which the payment

5 *Highland Capital Management, L.P. v. Ryder Scott Co.*, No. 10 Civ. 362, 2012 WL 6082713 (Tex. App. – Houston [1st Dist.] Dec. 6, 2012).

6 ISS, 2013 U.S. Proxy Season Preview: Environmental & Social Issues (March 7, 2013).

7 *Id.*

8 15 U.S.C. § 78m(q).

is made. The rule has been criticized by industry groups because of the ambiguity resulting from the SEC's refusal to define the term "project." The SEC has also been criticized for rejecting proposed exemptions in cases where disclosure would violate the contract at issue, or the law in the country of the contractual counter-party.

On October 10, 2012, several business and energy industry groups filed suit against the SEC in the U.S. District Court for the District of Columbia and a simultaneous petition for review with the U.S. Court of Appeals for the D.C. Circuit, each challenging the new Rule and arguing, among other things: (1) that the Rule violates the First Amendment by requiring companies to disclose sensitive, confidential information that will cause economic harm; (2) that the SEC acted in an arbitrary and capricious manner under the Administrative Procedure Act by, among other things, requiring public disclosure of payment information seemingly not required by Dodd-Frank; and (3) that the SEC violated the Securities Exchange Act of 1934 by adopting a rule that imposes an undue burden on competition.

In its Response filed January 2, 2013, the SEC disputed the petitioners' First Amendment argument claiming "the required factual, non-ideological disclosures" do not constitute "compelled speech." The SEC also argued that it did not act arbitrarily and capriciously in rejecting requested rule modifications and that an adequate assessment of the economic implications of the Rule was conducted.

On March 22, 2013, during oral argument before a panel of D.C. Circuit judges, the court questioned both parties about the existence of jurisdiction and whether review in the D.C. Circuit was appropriate. As to the merits of the case, the judges focused on whether the proposed disclosures implicate First Amendment concerns. Counsel for petitioners claimed that the statute "commandeers corporate speech to force regime change in other nations," while the SEC's counsel argued that the required factual data does not reach the core values the First Amendment seeks to protect. In response to the court's questions regarding the government interest in requiring the proposed disclosures, the SEC took the position that the disclosures are part of "a foreign policy objective to promote transparency in resource rich countries."[9]

Since Rule 13q-1's reporting obligation does not begin until the fiscal year ending September 30, 2013, we are not likely to see private securities litigation or regulatory action related to this rule for some time. Nevertheless, because the Rule requires that the disclosure be filed, instead of furnished, issuers could face future liability under Section 10(b) as well as Section 18(a) of the Exchange Act for any materially false or misleading statements contained in the disclosure. The need to demonstrate scienter (intent or knowledge of the wrongdoing) under Section 10(b) as well as the good faith defense available for Section 18(a) claims will make such allegations difficult to plead and prove. Still, the potential ambiguities surrounding the definition of "project" and the resistance to disclosure of commercially sensitive information could possibly leave companies vulnerable to claims challenging disclosures filed pursuant to this Rule.

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Recent Chancery Court Decisions Expand Availability of Direct Claims for Stockholder Dilution Under *Gentile*

*By Michael C. Holmes, Elizabeth C. Brandon, and Sarah H. Mitchell**

Two recent Court of Chancery opinions have expanded the availability of direct claims for corporate stockholders complaining of equity dilution under Delaware law. These opinions have expanded the holding of *Gentile v. Rossette*, 906 A.2d 91, 99-100 (Del. 2006), which first established that claims alleging equity dilution can be direct or derivative.

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9 *American Petroleum Institute v. SEC*, No. 12-1398 (D.C. Cir. filed Oct. 10, 2012).

The distinction between direct and derivative claims is particularly important in the post-merger context. For example, minority shareholders of an acquired corporation often allege that their equity was unfairly diluted pre-merger, resulting in minority shareholders receiving a much smaller share of the merger consideration. If this claim were derivative, the minority shareholders would have no standing to pursue it after a cash-out merger because the merger eliminated their ownership interest in the acquired corporation. But if the claim were direct, the minority shareholders could pursue the claim even after the cash-out merger.

Since *Gentile*, courts and commentators have indicated that the availability of direct dilution claims is limited to cases involving a majority, controlling stockholder. The recent Chancery Court opinions illustrate that *Gentile* claims are available in situations where there is no controlling stockholder, either through a number of stockholders working as a "control group" or through self-dealing transactions by interested directors. These two opinions illustrate that corporate boards should take great care when issuing stock.

A Group of Minority Shareholders May Be a "Control Group"

In *In re Nine Systems Corp. Shareholders Litig.*, C.A. No. 3940-VCN (Del. Ch. Feb. 28, 2013), plaintiffs were the former shareholders of Nine Systems Corporation (NSC). Plaintiffs alleged that a group of three shareholders with a combined ownership interest of roughly 54 percent acted to unfairly dilute plaintiffs' equity and voting power through a series of self-dealing transactions involving recapitalization of NSC. Plaintiffs alleged that the three shareholders increased their collective ownership from 54 percent to 85 percent or even 90 percent.

Plaintiffs claimed that they were unaware of the dilution of their shares until four years later, when Akamai Technologies, Inc. (Akamai) proposed to purchase NSC for $175 million. After the Akamai transaction closed, plaintiffs lost their stockholder status. As a result, at summary judgment, the defendants sought dismissal of the dilution claims, arguing that the claims were properly derivative and thus subject to dismissal under the "continuous ownership" rule. The court disagreed.

Vice Chancellor Noble explained that, under the *Gentile* exception, a derivative claim may also be a direct claim when a controlling shareholder extracts or expropriates the minority shareholders' economic value and voting power. Although NSC had no single majority shareholder, Vice Chancellor Noble pointed out that a "control group" may be the functional equivalent of a controlling shareholder.

Vice Chancellor Noble's opinion clarified that plaintiffs face a heightened standard in proving the existence of such a control group. He noted that "[e]stablishing the existence of a control group is not an easy task" and "[t]hat [the alleged participants in the control group] signed on to a common objective (*i.e.*, shared parallel interests) is not determinative." He reasoned that this heightened standard must apply so that every act taken by a majority is not viewed as the act of a control group.

On the other hand, the court held that "[a]s long as the facts of record support a reasonable inference — not necessarily the better inference — that a control group existed, summary judgment is not appropriate." In the instant case, Vice Chancellor Noble recognized that none of the three major shareholders alone owned a majority of the shares, none alone owed fiduciary duties, and each was free to vote in its self-interest. Regardless, he declined to grant summary judgment because the plaintiffs had put forth sufficient evidence to create an issue of fact as to whether there was a control group.

Specifically, the court held that the following evidence in support of a control group was sufficient to defeat summary judgment: (1) the three shareholders' voting majority allowed them to use written consents to approve changes requiring shareholder consideration and gave them majority control of the board, (2) the details of the recapitalization plan were developed in advance of meetings by the directors controlled by the three shareholders while excluding other directors, and (3) designees of the shareholders collaborated to develop the structure of the new shares, which had the effect of materially diminishing the rights of minority shareholders.

Notably, the court rejected the defendants' argument that they could not be a control group because one of the three major shareholders chose not to participate in the challenged transactions. The court noted that the third shareholder was aware of the transactions and was given the opportunity to participate, but declined. Because the third shareholder's decision not to participate did not alter the effect of the recapitalization on the minority shareholders, the court held that there was sufficient evidence of a control group to pass summary judgment.

At the motion to dismiss stage in the same action, Vice Chancellor Noble likewise determined that the plaintiffs had alleged facts to support a direct claim for equity dilution. *See Dubroff v. Wren Holdings, LLC*, 2009 WL 1478697, at *3 (Del. Ch. May 22, 2009). But plaintiffs' success at the summary judgment stage demonstrates that plaintiffs only need to gather evidence creating a reasonable inference of a control group to take a direct dilution claim to trial. To avoid any appearance of impropriety, corporate directors should ensure that interested blocs of directors do not develop plans for new rounds of stock issuance among themselves while excluding non-interested directors.

Court Explains How Control Can Be Exercised By Non-Shareholders

The Delaware Court of Chancery's opinion in *Carsanaro v. Bloodhound Technologies*, C.A. 7301-VCL (Mar. 15, 2013) significantly expanded the availability of direct claims for corporate shareholders complaining of pre-merger equity dilution. Before *Carsanaro*, such claims were only available where a controlling stockholder existed before the merger and expropriated value or control from minority shareholders. Under *Dubroff* and *Nine Systems*, it is clear that a group of shareholders whose combined ownership interest is greater than 50 percent may be found to be a control group, which is the functional equivalent of a controlling shareholder. *Carsanaro* goes a step further by holding that the control group need not hold more than 50 percent of the outstanding shares in order for a minority shareholder to bring a dilution claim under *Gentile*.

Plaintiffs were the founder and software developers of Bloodhound Technologies, Inc. (Bloodhound), a company that created web-based software applications to allow health care providers to monitor claims for fraud. In 1999, Bloodhound was a startup company, and it sought venture capital funding. Plaintiffs alleged that after Bloodhound raised its initial rounds of venture capital financing, the venture capitalists obtained control of Bloodhound's board of directors. Afterwards, plaintiffs alleged that the venture capitalist-controlled board financed Bloodhound through self-interested and highly dilutive stock issuances.

Plaintiffs alleged that they did not learn of the dilutive stock issuances until April 2011, when Bloodhound was sold for $82.5 million. At that time, plaintiffs discovered that their overall equity ownership had been diluted to under one percent. As a result of the equity dilution, plaintiffs received less than $36,000 in the cash-out merger.

Plaintiffs also alleged that the board of directors unfairly diverted proceeds of the merger. The board approved a management incentive plan under which then-current management of Bloodhound received $15 million of the merger consideration.

In considering whether the plaintiffs had standing to pursue direct claims after the cash-out merger, Vice Chancellor Laster posed a hypothetical under which individual board directors issued themselves shares of a corporation in anticipation that the corporation would be sold profitably in the near future. In the hypothetical, after the stock issuance to the directors, the directors owned only 20 percent of the outstanding shares. Despite the absence of a controlling shareholder or control group owning greater than 50 percent of the company, Vice Chancellor Laster stated that stockholders would have a direct claim against the board of directors for breach of fiduciary duty under *Gentile*.

The court also stated that stockholders have standing to pursue direct challenges to dilutive stock issuances where: (i) the complaint states a claim for breach of the duty of loyalty, (ii) a controlling stockholder stood on both sides of the transaction, or (iii) the board that effectuated the transaction lacked a disinterested and independent majority. On the other hand, the court stated that standing would not exist if there is no reason to infer disloyal expropriation. Specifically, the court noted two instances where stockholders would lack standing to pursue direct dilution claims: (x) where the board issued stock to an unaffiliated third party as part of an employee compensation plan and (y) where a majority of disinterested and independent directors approves the terms of a stock issuance.

Applying this test to the facts of *Carsanaro*, Vice Chancellor Laster held that the plaintiffs had standing to assert direct claims for wrongful expropriation and unfair diversion of merger proceeds. He held that each stock issuance was a self-interested transaction implicating the duty of loyalty. He also held that the defendant stockholders and their director representatives could be regarded as a control group for purposes of *Gentile*.

In light of these cases, boards should exercise care in issuing stock in situations where a merger or similar transaction may occur in the near future and should consider utilizing a special committee process for transactions involving potentially-dilutive stock issuances, particularly where board members have an interest in the entity acquiring the new stock.

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From *Revlon* to *Galaviz*: Judicial Treatment of Forum-Selection Clauses in Corporate Charters or Bylaws

*By Elizabeth C. Brandon and Laurel S. Fensterstock**

In *In re Revlon, Inc. Shareholders Litigation*,[10] Vice Chancellor Laster commented that Delaware corporate law might permit corporations to adopt forum-selection provisions in their charters:

> Perhaps greater judicial oversight of frequent filers [of derivative suits] will accelerate their efforts to populate their portfolios by filing in other jurisdictions. If they do, and if boards of directors and stockholders believe that a particular forum would provide an efficient and value-promoting locus for dispute resolution, then corporations are free to respond with charter provisions selecting an exclusive-forum for intra-entity disputes.

Vice Chancellor Laster's implicit endorsement of these forum-selection provisions in corporate charters and bylaws sparked a flurry of amendments to existing corporate charters designating exclusive forums for intra-corporate disputes. In general, charter provisions were adopted or proposed in connection with transactions where shareholder approval was not required, *i.e.*, initial public offerings, spin-offs or reorganizations in bankruptcy.

[10] C.A. No. 4578-VCL (Del. Ch. March 16, 2010).

Established companies, however, generally opted to adopt amendments to bylaws. Since *In re Revlon*, exclusive-forum provisions have been considered by several courts, with mixed results.

A California Federal Court Addresses the Issue

After *In re Revlon*, the court in *Galaviz v. Berg*[11] was the first court to address a challenge to a forum-selection clause. In *Galaviz*, shareholders of Oracle brought a derivative action in federal court in California against Oracle and its directors, alleging breach of fiduciary duties and abuse of control. In 2006, well before the complaint was filed but after the alleged wrongdoing occurred, Oracle's board amended the corporate bylaws to include a provision selecting Delaware as the exclusive-forum for derivative suits. Oracle sought to dismiss the complaint based on improper venue because plaintiffs did not bring the case in Delaware.

In January 2011, in a case of first impression, the court denied the motion to dismiss and held that a forum-selection provision at issue was not enforceable under federal procedural law.[12] In concluding that the exclusive-forum provision constituted an impermissible "unilateral amendment," the court considered the following facts: (1) the unilateral adoption of the provision by directors who were defendants in a lawsuit after the majority of the alleged wrongdoing had occurred; (2) the board adopting the provision after shareholders had purchased Oracle shares; and (3) the lack of shareholder approval. The court observed, however, that "were a majority of shareholders to approve" this type of provision (through a charter amendment, for example), "the arguments for treating the venue provision like those in commercial contracts would be much stronger, even in the case of a plaintiff shareholder who had personally voted against the amendment." Thus, the *Galaviz* holding raises questions

[11] 763 F. Supp. 2d 1170 (N.D. Cal. Jan. 3, 2011).

[12] *Id*. at 1174-75. In determining the enforceability of forum-selection clauses in contracts, federal courts consider, among other things, (1) "whether the challengers were aware of their potential liability," (2) "whether the challengers were experienced business people," (3) "whether the forum-selection clause was hidden," (4) "whether enforcement of the forum-selection clause would deprive the challenger of his or her 'day in court,'" and (5) "whether any related case was pending in the selected forum."

about the enforceability of unilateral amendments adopting exclusive-forum provisions with no shareholder input.

Shareholders Respond to *Galaviz*

Following *Galaviz*, in 2012, shareholders filed a flurry of cases in the Delaware Court of Chancery seeking to invalidate forum-selection clauses from their respective bylaws. The defendant companies in those lawsuits each adopted its exclusive-forum bylaw after the *In re Revlon* decision. Notably, the allegations in these lawsuits tracked the rationale from *Galaviz*: because the exclusive-forum bylaw was adopted without the consent of shareholders, the amendment was invalid and the directors breached their fiduciary duties by adopting them. Most of the defendant companies repealed the challenged bylaw prior to the deadline for responding to the complaint, which resulted in dismissal of the complaints.[13]

Courts Inside and Outside of Delaware Construe Forum-Selection Clauses

Following *Galaviz*, Delaware and other courts have addressed the overall enforceability of forum-selection clauses with varying outcomes. The following cases provide insight into how courts have construed exclusive-forum provisions in mutually-executed agreements or corporate governance documents.

Enforced:

- In *RWI Acquisition LLC v. Todd*,[14] the court granted defendant's motion to dismiss based on a forum-selection clause. Plaintiff, a Delaware LLC (RWI Del.), filed a declaratory judgment action in Delaware to determine that defendant, a resident of New Mexico, did not have any equity or other interests in RWI Del. In connection with this investment transaction, the parties entered into five agreements, two of which — the stock purchase agreement and the employment agreement — contained forum-selection clauses in favor of the state and federal courts in New Mexico. The court granted defendant's motion to dismiss for lack of personal jurisdiction and improper venue, explaining that in order to decide the interest defendant had in RWI Del., it would first need to decide the rights defendant had under the employment agreement that mandated the action be brought in New Mexico. The court reaffirmed the Chancery Court's deference to forum-selection clauses and explained that the court will grant a motion to dismiss based upon a forum-selection clause where the parties use express language clearly indicating that the forum-selection clause excludes all other courts before which those parties could otherwise properly bring an action.
- In *Carlyle Inv. Mgmt. L.L.C. v. Nat'l Indus. Group (Holding)*,[15] the court denied defendants' motion to vacate a default judgment based on the enforceability of a forum-selection clause. Plaintiff, one of the largest private equity firms in the world, and defendant, a multi-national million dollar conglomerate, entered into a variety of agreements whereby defendant would invest in plaintiff's closed-end investment funds that would primarily be invested in residential mortgage-backed securities. These agreements contained forum-selection clauses requiring any disputes to be litigated in Delaware. When the investments turned sour, National Industries filed suit against Carlyle in Kuwait, ignoring the forum-selection clauses. Carlyle then filed suit to enjoin National Industries from litigating a dispute regarding the agreements in Kuwait. A default judgment was entered for Carlyle that included an anti-suit injunction preventing National Industries from litigating in Kuwait. National Industries sought to vacate the default judgment. The court denied defendants motion to vacate holding that the forum-selection clause was enforceable; the parties consented freely and knowingly to the court's exercise of jurisdiction by signing the agreement and international forum-selection clauses should be enforced to maintain international comity.

[13] Out of the 12 cases originally filed, 10 have been dismissed. In the two cases that remain, *Boilermakers Local 154 Retirement Fund, et al. v. Chevron Corp.*, No. 7220, and *ICLUB Investment P'Ship v. Fedex Corp.*, No. 7238, defendants jointly moved for judgment on the pleadings on the grounds that, among other things, the companies did not need shareholder approval to adopt all bylaws. Plaintiffs filed their opposition briefs on February 1, 2013, and Chancellor Strine heard oral argument on the joint motion on April 10, 2013. A decision is expected sometime before mid-July.

[14] CIV.A. 6902-VCP, 2012 WL 1955279 (Del. Ch. May 30, 2012).

[15] CIV.A. 5527-CS, 2012 WL 4847089 (Del. Ch. Oct. 11, 2012).

Not Enforced:

- In *Duff v. Innovative Discovery LLC*,[16] the court denied defendants' motion to dismiss finding that the forum-selection clause did not indicate the parties intent to make jurisdiction exclusive. The issue before the court was whether a forum-selection clause providing for "sole" jurisdiction in California courts should be honored when a conflicting forum-selection clause in a related agreement provided for jurisdiction in Delaware courts. In denying defendants' motion to dismiss, the court explained Delaware courts will only declare a forum-selection clause "strictly binding" when the parties use "express language clearly indicating that the forum-selection clause excludes all other courts before which those parties could otherwise properly bring an action." To the extent the forum-selection provisions in the two agreements conflict, they make the parties' intent as to the contractual choice of forum far from "crystalline" and the court will not interpret a forum-selection clause to indicate the parties intended to make jurisdiction exclusive. The court ruled that defendants failed to show that California was the exclusive-forum for the lawsuit.
- In *Mitek Systems, Inc. v. U.S. Services Automobile Association*,[17] a Delaware court refused to enforce a forum-selection clause in a licensing agreement that designated Delaware, the later filed action, as the exclusive-forum for disputes related to the agreement, finding instead that transfer to the first-filed action in Texas was appropriate. In March 2012, USAA filed suit in the Texas federal court, seeking a declaratory judgment of non-infringement, invalidity, and unenforceability of five patents covered by the license agreement. After USAA filed suit, Mitek likewise filed suit in Delaware federal court alleging that USAA infringed the same five patents and breached the license agreement. The Delaware court considered whether the forum-selection clause of the license agreement precluded the applicability of the first-filed rule. Although the court noted that "the clause appears valid" and agreed that a forum-selection clause is given substantial consideration, the court explained that forum-selection clauses are not enforced when they violate strong concerns of public policy. Finding that judicial efficiency and comity would be undermined if both the Texas and Delaware actions proceeded in parallel, the district court determined that the forum-selection clause did not preclude the application of the first-filed doctrine and transferred the Delaware action to Texas.

Rule on Clause Before Issuing Injunction

- Finally, a Texas appeals court recently considered a procedural issue related to a forum-selection clause. In *In re MetroPCS Communications, Inc.*,[18] shareholders challenged the pending merger of MetroPCS, Deutsche Telekom and T-Mobile and sought a temporary restraining order to enjoin several alleged "deal protection devices," including "Poison-Pill Lock-Up" and "Force-the-Vote" provisions. The trial court granted the TRO, agreeing with the plaintiffs that the deal protection devices irreparably harmed shareholders by, among other things, warding off other potential acquirers. Defendants appealed the order because the trial court failed to address their motion to dismiss or stay the action based on the forum-selection clause in MetroPCS's bylaws, which mandated Delaware as the proper forum. The appeals court found that because the motion to dismiss or stay was filed before the request for a TRO, the trial court abused its discretion by granting injunctive relief without first ruling on the forum-selection clause issue. Accordingly, the court vacated the TRO and stayed the case until the motion to dismiss could be decided.

Conclusion

The overall picture on exclusive-forum provisions in corporate charters or bylaws remains unclear. Despite the potential benefits to mitigate litigation costs, questions remain concerning the enforceability of the provisions in general and whether shareholder approval or input is required in corporate governing documents. Depending on the contract analysis a court applies and the ancillary issues at play, some courts may find forum-selection

16 CIV.A. 7599-VCP, 2012 WL 6096586 (Del. Ch. Dec. 7, 2012).

17 CIV. Action No. 12-462-GMS, 2012 WL 3777423, (D. Del. Aug. 30, 2012).

18 391 S.W.3d 329 (Tex. App. – Dallas 2013, orig. proceeding).

provisions contractually binding on shareholders while others, like the court in *Galaviz*, will not.

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The Dodd-Frank Hedge Fund Adviser Registration Requirements Mean Enhanced Visibility Into Hedge Fund Management Metrics and Increased Enforcement Actions Against Hedge Fund Advisers

*By Jennifer Poppe and Andrea Batista**

Introduction

With the passage of the Dodd-Frank Act, many investment advisers to hedge funds are no longer exempt from registration requirements and the myriad of obligations that result from being regulated by the SEC. The SEC and other regulatory authorities are relying on this new information to monitor risk in the financial markets and uncover patterns of misconduct. As recent comments from the Chief of the SEC Enforcement Division's Asset Management Unit and a survey of recent SEC complaints show, enforcement activity against hedge fund advisers is increasing. It is, therefore, becoming increasingly important for sponsors of private equity funds and hedge funds to comply with registration requirements, identify conflicts of interest, and appropriately disclose those conflicts.

Summary of the Dodd-Frank Registration Requirements for Hedge Fund Advisers

In response to the financial crisis of 2008 and the lack of transparency into the management of hedge funds and other private funds, Title IV of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376, 1570-1580 (2010) (the Dodd-Frank Act) eliminated the private adviser exemption.[19] As a result, many advisers to hedge funds and private equity funds are subject to the same registration requirements, regulatory oversight, and examinations that apply to other SEC-regulated investment advisers. Additionally, the Securities and Exchange Commission (the SEC or Commission) and Commodity Futures Trading Commission (CFTC) have adopted rules that increase the amount of information advisers must report related to their management of hedge funds and other private funds. The SEC and CFTC make no secret of the fact that the very same information may be used in examinations and, ultimately, enforcement actions against bad actors.

As a result of the elimination of the private adviser exemption,[20] private advisers, including most hedge fund advisers (although there are certain enumerated exemptions), must register with the Commission and file periodic reports. Hedge fund managers are required to file two forms: Form ADV and Form PF. While most information on Form ADV is viewable by the public, Form PF, which contains more sensitive information, is confidential and in most instances will not be available to the public. Both are designed to give federal regulatory authorities a view into the management of private funds. Between the data provided in both forms, the SEC has enhanced visibility into the operations, strategies, and financials of many funds that previously were not within the SEC's purview.

In addition to the new reporting obligations, the SEC is also emphasizing the importance of compliance through its report on adviser registration. Since the March 30, 2012 deadline for investment advisers to file Form ADV, the Commission has issued a report on compliance with the requirement.[21] The Commission reports that 1,504

19 Section 403 of the Dodd-Frank Act; *see also* Rules Implementing Amendments to the Investment Advisers Act of 1940; Final Rule, Release No. IA-3221 (June 22, 2011), 76 Fed. Reg. 42,950 (July 19, 2011) (to be codified at 17 C.F.R. pts. 275 & 279), *available at* http://www.sec.gov/rules/final/2011/ia-3221.pdf (hereinafter Release No. IA-3221).

20 Dodd-Frank Act § 403, 124 Stat. at 1571; Release No. IA-3221.

21 Securities and Exchange Commission, *Dodd-Frank Act Changes to Investment Adviser Registration Requirements* (Oct. 1, 2012), *available at* http://www.sec.gov/divisions/investment/imissues/df-iaregistration.pdf (hereinafter Adviser Registration Report); 17 C.F.R. § 175.203-1(e) (stating that private advisers are exempt from registration until March 30, 2012)

additional investment advisers have registered with the SEC since the effective date of the Dodd-Frank Act through October 1, 2012.[22] Of all private fund assets registered with the Commission, hedge fund assets constitute the majority (54 percent).[23]

Recent comments from the Chief of the Enforcement Division, as well as recent actions against hedge fund advisers, signal increased enforcement focus on hedge fund advisers.

Comments from the Chief of the Enforcement Division and Recent SEC Complaints Signal Increased Focus on Hedge Fund Advisers

On January 23, 2013, Bruce Karpati, the Chief of the SEC Enforcement Division's Asset Management Unit, confirmed that enforcement activity against hedge fund managers and other private equity managers that are new registrants will likely increase.[24] Karpati's speech for Private Equity International focused on reorganization, hiring, and special initiatives within the Commission to address risk and misconduct in the private equity and hedge fund industries. Karpati's comments reiterated points he made in a December 18, 2012 speech before the Regulatory Compliance Association. A summary of Karpati's remarks can be found here.

Just since October 1, 2012, the Commission has initiated many actions against hedge fund managers involving a variety of schemes. The types of misconduct below represent some of the more notable enforcement actions and are illustrative of how conflicts of interest, if not managed, controlled, and disclosed, can spiral into actionable misconduct. While some actions involve multiple types of misconduct, these broadly fall into three categories: (a) misappropriation of funds by hedge fund advisers, either for the benefit of the company or individual advisers to the detriment of investors, coupled with false valuations of the funds to hide the scheme; (b) insider trading on material nonpublic information; and (c) manipulation of fund assets or valuations in order to inflate the amount of fund management fees the adviser can charge.

(a) Misappropriation of Funds and False Valuations

- *SEC v. Hochfeld*, No. 12 CV 8202 (S.D.N.Y): On November 9, 2012, the SEC filed suit against Berton M. Hochfeld (Hochfeld) and Hochfeld Capital Management, L.L.C. (HCM).[25] The SEC alleged that Hochfeld, through HCM, managed Hepplewhite Fund, LP (a hedge fund), and misappropriated assets from the fund for personal use. Hochfeld also is alleged to have materially overstated to the fund's limited partners the value of their investments. Hochfeld advised on the hedge fund in violation of a prior bar by the SEC from associating with an investment adviser.[26] On March 19, 2013, the SEC ordered that Hochfeld again be barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization.[27]
- *SEC v. Aletheia Research and Management, Inc.*, No. 12-CV-10692-JFW (RZX) (C.D. Cal.): On December 14, 2012, the SEC announced that it charged a Santa Monica-based hedge fund manager, Peter J. Eichler, and his investment advisor firm, Aletheia Research and Management, Inc. (Aletheia), with conducting a "cherry-picking" scheme by steering winning trades to their own trading accounts to the detriment of their investors in violation of their fiduciary duties to their clients.[28]

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22 *Id.* at 2.

23 *Id.* at 3.

24 Bruce Karpati, Chief, SEC Enforcement Division's Asset Management Unit, Q&A Remarks at the Private Equity International Conference (Jan. 23, 2013), *available at* http://www.sec.gov/news/speech/2013/spch012313bk.htm (hereinafter Karpati Remarks).

25 Complaint, *SEC v. Hochfeld*, No. 12 CV 8202, 2012 WL 5461591 (S.D.N.Y. Nov. 9, 2012).

26 On November 26, 2012, Hochfeld and HCM consented to the court's judgments against them including, among other relief, the appointment of a receiver over the funds involved, an accounting of all assets under their control, and an asset freeze over Hochfeld, HCM, and Hepplewhite Fund, LP. Litig. Release No. 22545, SEC, *Court Orders Asset Freeze and Appointment of a Receiver in SEC Action Charging Hedge Fund Adviser and Its Principal with Securities Fraud*, 2012 WL 5928264 (Nov. 26, 2012), *available at* http://www.sec.gov/litigation/litreleases/2012/lr22545.htm.

27 Order Instituting Admin. Proceedings, *In re Berton M. Hochfeld*, Release No. 3570, 2013 WL 1122497 (Mar. 19, 2013), *available at* http://www.sec.gov/litigation/admin/2013/ia-3570.pdf.

28 Litig. Release No. 22573, SEC, *SEC Charges Santa Monica-Based Hedge Fund Manager in Cherry-Picking Scheme*, 2012 WL 6561124 (Dec. 14, 2012), *available at*

- *SEC v. Commonwealth Advisors, Inc.*, No. 12-CV-700 (M.D. La.): On November 8, 2012, the SEC filed a complaint against Commonwealth Advisors, Inc. and Walter A. Morales alleging that they engaged in a scheme to hide losses in certain hedge funds they advised.[29] Defendants also allegedly misrepresented the percentage of the fund that was invested in a certain collateralized debt obligation fund and performed cross-trades while representing in Form ADV that Commonwealth Advisors did not engage in cross-trades. Defendants are also alleged to have misled investors about the valuations of the funds they managed and falsified documents to justify the valuations.
- *SEC v. New Stream Capital, LLC*, No. 3:13CV264 (D. Conn.): On February 26, 2013, the SEC filed a civil injunctive action against hedge fund managers David Bryson and Bart Gutekunst and their advisory firm, New Stream Capital, LLC, alleging that they deliberately concealed capital restructuring from fund investors, which would also boost management fees.[30] Specifically, the SEC alleged that the managers told investors that they were all on an equal footing, when they had in fact restructured the fund to provide priority in the event of liquidation for certain large investors.

(b) Insider Trading

- *SEC v. Chellam*, No. 12-CV-7983 (S.D.N.Y.): On October 26, 2012, the Commission filed a complaint against Kris Chellam who was the Co-Managing Partner of Galleon Special Opportunities Fund, a late-stage venture capital fund affiliated with the hedge fund investment adviser Galleon Management, LP. The SEC alleged that Chellam conveyed material, non-public information to Galleon founder Raj Rajaratnam.[31] Chellam settled with the SEC on January 10, 2013, agreeing to be barred from association with any broker, dealer, investment adviser, municipal securities dealer, or transfer agent.[32]
- *SEC v. CR Intrinsic Investors, LLC*, No. 1:12-CV-08466 (S.D.N.Y.): On November 20, 2012, the SEC filed suit against CR Intrinsic Investors, LLC (CR Intrinsic), Mathew Martoma, and Dr. Sidney Gilman for their roles in a $276 million insider trading scheme involving a clinical trial for an Alzheimer's drug being jointly developed by Elan Corporation and Wyeth.[33] The SEC alleges that Martoma caused hedge funds managed by CR Intrinsic and another affiliated investment adviser to trade on negative inside information he received from Dr. Gilman concerning the clinical trials, which resulted in significant gains to CR Intrinsic and a bonus for Martoma. Gilman settled with the SEC.[34] On March 18, 2013, the SEC announced that CR Intrinsic had agreed to pay $600 million in disgorgement, penalties, and interest.[35] The settlement is the largest ever in an insider-trading case. The settlement does not resolve the case against Matthew Martoma, which continues.
- *SEC v. Rajaratnam*, No. 13-CV-1894 (S.D.N.Y.): On March 21, 2013, the SEC filed a complaint against Rajarengan "Rengan" Rajaratnam for making trades in the hedge funds he managed at Galleon and Sedna

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http://www.sec.gov/litigation/litreleases/2012/lr22573.htm; Complaint, *SEC v. Aletheia Research & Mgmt., Inc.*, No. 12-CV-10692-JFW (RZX), 2012 WL 6560050 (C.D. Cal. Dec. 14, 2012). Additionally, Aletheia failed to disclose its financial troubles to its clients until immediately before filing for bankruptcy.

29 Complaint, *SEC v. Commonwealth Advisors, Inc.*, No. 12-CV-700, 2012 WL 5454010 (M.D. La. Nov. 8, 2012), *available at* http://www.sec.gov/litigation/complaints/2012/comp-pr2012-222.pdf.

30 Litig. Release No. 22625, SEC, *SEC Charges Connecticut Hedge Fund Managers with Securities Fraud*, 2013 WL 696098 (Feb. 26, 2013), *available at* https://www.sec.gov/litigation/litreleases/2013/lr22625.htm; Complaint, *SEC v. New Stream Capital, LLC*, No. 3:13-CV-00264, 2013 WL 680888 (D. Conn. Feb. 26, 2013).

31 Complaint, *SEC v. Chellam*, No. 12-CV-7983 (S.D.N.Y. Oct. 26, 2012), *available at* http://www.sec.gov/litigation/complaints/2012/comp-pr2012-216.pdf; Press Release, SEC, *SEC Charges Silicon Valley Executive for Role in Galleon Insider Trading Scheme* (Oct. 26, 2012), *available at* http://www.sec.gov/news/press/2012/2012-216.htm.

32 Order Instituting Admin. Proceedings, *In re Kris Chellam*, Release No. 3532, 2013 WL 122654 (Jan. 10, 2013), *available at* http://www.sec.gov/litigation/admin/2013/ia-3532.pdf.

33 Litig. Release No. 22539, SEC, *Securities and Exchange Commission v. CR Intrinsic Investors, LLC et al.*, Civil Action No. 12 Civ. 8466 (VM) (Nov. 20, 2012), *available at* http://www.sec.gov/litigation/litreleases/2012/lr22539.htm; Amended Complaint, *SEC v. CR Intrinsic Investors, LLC.,* No. 1:12-CV-08466, 2013 WL 1068347 (S.D.N.Y. Mar. 15, 2013).

34 Ct. Dkt. No. 3.

35 Litig. Release No. 22647, SEC, *Securities and Exchange Commission v. CR Intrinsic Investors, LLC et al.*, Civil Action No. 8466 (VM), 2013 WL 1122499 (Mar. 18, 2013), *available at* http://www.sec.gov/litigation/litreleases/2013/lr22647.htm.

Capital Management based on material nonpublic information supplied to him by his brother, Raj Rajaratnam, who was charged in a massive insider-trading scheme in 2012.[36] In a parallel action, the U.S. Attorney announced criminal charges against Rengan Rajaratnam on the same day.

- *SEC v. Teeple*, No. 13-CV-2010 (S.D.N.Y.): On March 26, 2013, the SEC filed a complaint charging Matthew Teeple, who worked at a hedge-fund advisory firm, with insider trading, alleging that Teeple used inside information about the merger between technology companies Foundry Networks Inc. and Brocade Communications Systems Inc. to bolster the earnings of his firm's hedge funds.[37] The SEC also charged Foundry's CIO, for tipping Teeple, and a trader at another firm, who Teeple then tipped and who used the information in trading. Criminal charges have also been filed against all three parties.
- *SEC v. Steinberg*, No. 1:13-CV-02082 (S.D.N.Y.): On March 29, 2013, the SEC filed a complaint against Michael Steinberg, a portfolio manager at Sigma Capital Management, LLC (Sigma), for insider trading.[38] Steinberg received material nonpublic information about Nvidia Corporation (Nvidia) from his analyst, Jon Horvath, who was alleged to be one of a group of analysts involved in a scheme to regularly trade on inside information. Horvath and six other members of this group of analysts were charged with insider trading by the SEC in 2012.[39] Steinberg used the information he received from Horvath to execute trades in Nvidia securities for Sigma. These trades resulted in profits of about $3 million for Sigma, as well as avoided losses. On March 15, 2013, in a related case, the SEC filed a complaint against Steinberg's employer, Sigma, based on the same insider trading allegations.[40] On March 19, 2013, however, the SEC announced that it had reached a settlement agreement with Sigma, in which the company agreed to pay nearly $14 million in disgorgement, penalties, and interest.[41]

(c) Manipulation of Fund Management Fees

- *SEC v. Yorkville Advisors, LLC*, No. 12-CV-7728 (S.D.N.Y): On October 17, 2012, the SEC filed a complaint against Yorkville Advisors, LLC, Mark Angelo, and Edward Schinik alleging that the defendants falsely inflated values of investments held by the hedge funds they managed in order to increase the firm's assets under management and increase the amount of management fees owed to defendants.[42] Defendants also allegedly used the false investment returns to solicit investors to make additional investments in the funds.
- *SEC v. Tiger Asia Management, LLC*, No. 12-CV-7601 (DMC) (D.N.J): On December 13, 2012, the SEC charged the manager of Tiger Asia Management and Tiger Asia Partners, Sung Kook "Bill" Hwang and Raymond Y.H. Park, alleging two illegal trading schemes involving a hedge fund.[43] In particular, one trading scheme allegedly involved stocks that were among the largest short position holdings in the hedge fund portfolios managed by defendants. Hwang

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36 Litig. Release No. 22658, SEC, *SEC Charges Rengan Rajaratnam with Insider Trading*, 2013 WL 1180854 (Mar. 22, 2013), *available at* http://www.sec.gov/litigation/litreleases/2013/lr22658.htm; Complaint, *SEC v. Rajaratnam*, No. 1:13-CV-01894, 2013 WL 1150902 (S.D.N.Y. Mar. 21, 2013).

37 Litig. Release No. 2260, SEC, *SEC Charges California-Based Hedge Fund Analyst and Two Others with Insider Trading* (Mar. 26, 2013), *available at* http://www.sec.gov/litigation/litreleases/2013/lr22660.htm; Complaint, *SEC v. Teeple*, No. 13 CV 2010, 2013 WL 1213813 (S.D.N.Y. Mar. 26, 2013).

38 Complaint, *SEC v. Steinberg*, No. 1:13-CV-02082, 2013 WL 1276631 (S.D.N.Y. Mar. 29, 2013), *available at* http://www.sec.gov/litigation/complaints/2013/comp-pr2013-49.pdf.

39 Complaint, *SEC v. Adondakis*, No. 12-CV-00409, 2012 WL 130086 (S.D.N.Y. Jan. 18, 2012), *available at* http://www.sec.gov/litigation/complaints/2012/comp-pr2012-11.pdf.

40 Complaint, *SEC v. Sigma Capital Management, LLC*, No. 1:13-CV-01740, 2013 WL 1069149 (S.D.N.Y. Mar. 15, 2013), *available at* http://www.sec.gov/litigation/complaints/2013/comp-pr2013-42.pdf.

41 Litig. Release No. 22650, SEC, *Securities and Exchange Commission v. Sigma Capital Management, LLC, et al.*, Civil Action No. 13-CIV-1740, 2013 WL 1143081 (Mar. 19, 2013), *available at* http://www.sec.gov/litigation/litreleases/2013/lr22650.htm.

42 Litig. Release No. 22510, SEC, *SEC Charges Hedge Fund Adviser and Two Executives with Fraud* (Oct. 17, 2012), *available at* http://www.sec.gov/litigation/litreleases/2012/lr22510.htm; Complaint, *SEC v. Yorkville Advisors, LLC*, Civil Action No. 12-CV-7728 (S.D.N.Y.) (Oct 17, 2012), *available at* http://www.sec.gov/litigation/complaints/2012/comp22510.pdf.

43 Litig. Release No. 22569, SEC, *Securities and Exchange Commission v. Tiger Asia Mgmt., LLC*, Civil Action No. 12-CV-7601 (DMC), 2012 WL 6457308 (Dec. 13, 2012), *available at* http://www.sec.gov/litigation/litreleases/2012/lr22569.htm.

directed Park to place trades in the stocks to depress the stock prices and inflate the management fees they could charge to investors. Hwang, Park, and the firms involved in the litigation have agreed to settle with the SEC for a large amount in disgorgement and penalties.

- *In re John Thomas Capital Management Group LLC*, File No. 3-15255 (ALJ): On March 22, 2013, the SEC filed an administrative action against George R. Jarkesy, Jr., Anastasios "Tommy" Belesis, John Thomas Capital Management Group LLC (JTCM), and John Thomas Financial, Inc. (JTF), all of whom are alleged to have been involved in a scheme to defraud investors in JTCM's two hedge funds.[44] Jarkesy manages JTCM, and Belesis is the CEO of JTF, which served as the primary placement agent for JTCM's two hedge funds. The SEC alleged that Jarkesy and JTCM recording inflated valuations for the funds' largest holdings and breached their fiduciary duty to the funds by loaning money from the funds to other entities, under the condition that the loans diverted large fees to JTF and Belesis.

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[44] Order Instituting Administrative and Cease-and-Desist Proceedings, *In re John Thomas Capital Mgmt. Grp. LLC, d/b/a Patriot28 LLC*, File No. 3-15255, 2013 WL 1180836 (Mar. 22, 2013), *available at* http://www.sec.gov/litigation/admin/2013/33-9396.pdf.

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