Katten
KattenMuchinRosenman LLP
CORPORATE & FINANCIAL
WEEKLY DIGEST

Corporate & Financial Weekly Digest

Posted at 1:57 PM on June 25, 2010 by William M. Regan

Securities Brokers Required to Disclose Bonus Commissions

Co-authored by Jessica M. Garrett

Hampton Porter Investment Bankers, LLC, was a registered securities broker-dealer whose owners and top-level managers were found to have engaged in a "pump and dump" scheme. According to the U.S. Court of Appeals for the Ninth Circuit, certain publicly traded companies granted Hampton Porter (or its owners) large blocks of free, or deeply discounted, stock. In return, Hampton Porter drove up the price of these thinly traded stocks by pressuring clients into purchasing shares, by discouraging clients from selling shares, and by refusing in some instances to execute clients' sales orders. In the meantime, Hampton Porter sold its shares at artificially inflated prices.

The government indicted Hampton Porter's owners, managers and senior brokers, alleging that each participated in a securities fraud conspiracy. Hampton Porter's owners and managers pleaded guilty, but the senior brokers, including defendants Bryan Laurienti, Curtiss Parker, Donald Samaria, David Montesano, and Michael Losse, pleaded not guilty. The senior brokers conceded that a fraudulent scheme existed but argued that they had not joined the conspiracy. The jury acquitted Mr. Losse, but found the remaining brokers guilty on all counts. The Ninth Circuit affirmed defendants' convictions but vacated their sentences and remanded for further proceedings due to technical errors in the trial court's application of applicable sentencing guidelines.

While the Ninth Circuit addressed a number of defenses to the government's claims, the court's discussion on the duties of brokers to disclose bonus commissions to their clients is particularly noteworthy.

Count One of the indictment alleged that defendants conspired to commit securities fraud in violation of 18 U.S.C. Section 371, by individually acting, or aiding and abetting an act, in furtherance of the fraudulent scheme in connection with client purchases of "house stocks." Specifically, the government alleged that Hampton Porter failed to disclose to its customers that company brokers received "bonus commissions" when a client purchased shares of four targeted stocks, referred to by defendants as "house stocks." These bonus commissions were potentially many times larger than the ordinary commission (which was disclosed to customers) that the brokers would be paid for the sale of "non-house stocks." Further, the brokers could lose those their bonus commissions if clients sold their "house stocks."

To prove the conspiracy count, the government had to show that a conspiracy existed, that a particular defendant knew the purposes of the conspiracy and joined the conspiracy, and that some member of the conspiracy (including the owners and managers) performed an overt act in furtherance of the conspiracy. The court found that the undisclosed bonus commissions—even if not independent criminal conduct—were nevertheless sufficient circumstantial evidence of defendants' agreement to join the conspiracy.

In affirming the convictions, the court held that a broker has a duty to disclose material information about a stock purchase if the broker and client have a fiduciary relationship or a similar relationship of trust and confidence. Notably, the court strongly suggested that it might uphold criminal liability even in the absence of a trust relationship where a defendant fails to disclose material information about bonus commissions (e.g., where, as here, a defendant discloses the ordinary commission applicable to most stocks, but not the bonus commission applicable to four “house stocks”). (*U.S. v. Laurienti*, 2010 WL 2473573 (C.A.9 (Cal.) June 16, 2010))

Katten Muchin Rosenman LLP
Charlotte Chicago Irving London Los Angeles New York Washington, DC