IN THE MONEY: Anti-Short Crusaders Accused Of Illegal Sales
By **Carol S. Remond**
A Dow Jones Newswires Column
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English

Brent Pierce and Grant Atkins, two Canadian citizens who were central in crafting an anti-short-selling campaign back in 2002, are now accused of violating federal securities registration laws.

According to a cease-and-desist order issued by the Securities and Exchange Commission Thursday, Pierce, Atkins and a now bankrupt company named Lexington Resources Inc. illegally sold stock without properly registering it with the commission.

The SEC alleges that stock promoter Pierce and his associates spearheaded a massive promotional campaign to pump the stock and improperly resell it to the public through an account at an unidentified offshore bank. The SEC alleges that the illegal sales generated proceeds of "over $13 million."

Atkins declined to comment or provide the name of his lawyer. Pierce couldn't immediately be reached. A recording on a Swiss cellphone listed for Newport Capital Corp., a firm for which Pierce is a director and officer, advised callers to try later.

Atkins and Pierce have 20 days to reply to the allegations in the SEC order.

The two have been involved with several small-cap companies over the years. Back in 2002, Atkins and Pierce were associated with Investor Communications International Inc., a Blaine, Wash., promotional firm that was a large investor in a budding pharmaceutical company named GeneMax Corp.

In a move designed to hamper short sellers who were taking bearish bets on the company, GeneMax that year attempted to exit the global electronic settlement system managed by the Depository Trust & Clearing Corp., or DTCC.

The campaign to exit DTCC gained some support among small companies, mostly trading on the over-the-counter bulletin board, that believed they were subject to illegal short selling. But the move was later defeated by the SEC, which ruled that investors, not companies, should decide whether to hold securities in electronic or physical format.

Atkins, who had been president of the shell company used to take GeneMax public, was a director of the company and a consultant for ICI. Meanwhile, Pierce was identified as a shareholder, "controlling person" and president of ICI in two filings with the SEC.

Making Popular 'Naked Shorts'

In September 2002, GeneMax filed lawsuits against two Canadian brokerage firms, alleging stock manipulation. A month later, the company filed suit against various broker-dealers in the U.S., accusing them of illegal, or naked, short selling.

Both suits were later dismissed. But the suit filed in federal court soon became a model in a still-ongoing legal campaign against DTCC and brokerage firms accused by some companies of facilitating abusive short selling.

Several of these suits have been dismissed over the years. Most recently, online discounter Overstock.com (OSTK), Canadian companies Biovail Corp. (BVF) and Fairfax Financial Holdings (FFH) filed suits in state courts alleging some form of abusive short selling. Those suits are ongoing.

(The term "naked short selling" gained prominence earlier this month after SEC Chairman Christopher Cox used it to explain the adoption of an emergency order to protect 17 financial institutions and mortgage behemoths Fannie Mae (FNM) and Freddie Mac (FRE) from investors betting against their stocks. Short sellers typically borrow stock in the hope of profiting when the price of the security goes down. Short-selling without borrowing the stock has been dubbed naked short selling.)

This is hardly the first time that an insider who claimed that his company was victim of illegal short selling is accused of improperly selling stock.

In 2005, the SEC sued Gary Valinoti, alleging that the former chief executive officer of Jag Media Holdings Inc. (JAGH) engaged in unregistered sales and transfers of securities. Without admitting or denying the SEC allegations, Valinoti agreed to settle the charges and consented to a final judgment that permanently enjoins him from violating securities laws. Under the deal, Valinoti agreed to disgorge about $2.9 million in illicit gains and to pay $1.39 million in pre-judgment interests.

Jag Media, like GeneMax, had sued brokerage firms it accused of manipulating its stock. That suit was also dismissed.

Same goes for Universal Express Inc. (USXP), another self-proclaimed poster child of the abuse of naked short selling. The SEC sued Universal Express and Chief Executive Richard Altomare in 2004, accusing them of selling 500 million unregistered shares into the market, using erroneous press releases to prop the company's stock price.

The company went into receivership last year and Altomare recently served several months in jail for failing to pay his share of a $21.9 million fine imposed by the SEC.

All fine examples of companies and insiders complaining of naked short selling whom Chairman Cox might want to consider before extending his restrictive short-selling order to other securities.

(**Carol S. Remond** is an award-winning columnist who won a Gerald Loeb Award in 2005 for best news service content with "Exposing Small-Cap Fraud," a series of articles that described how three small companies unscrupulously pumped up their stocks.)

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IN THE MONEY: Cox's Scary Story Got Market To Change Focus

By **Carol S. Remond**
A Dow Jones Newswires Column
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Christopher Cox told investors a scary story to get them out of their funk earlier this week. And for now it's working.

Like most tales of horror, Cox's story of bearish traders running amok and overpowering U.S. securities firms is more fiction than reality. But it provided some relief to a market focused on the billions of dollars of bad mortgages and associated financial instruments sitting on the books of large and small financial institutions.

Short-sellers typically borrow shares to sell them short and profit when the price drops. Trading without a borrowing agreement is called naked short-selling.

Two days after the Securities and Exchange Commission issued an emergency order making it harder to bet against mortgage behemoths Fannie Mae (FNM) and Freddie Mac (FRE) and that of 17 securities firms, stock prices have sharply rebounded.

The emergency order published late Wednesday is scheduled to become effective Monday and is designed to "eliminate any possibility that naked short selling may contribute to the disruption of markets."

It effectively requires that short sellers pre-borrow rather than just locate stock before entering into a transaction. A similar rule, dubbed Reg SHO, is already in place for securities that experience settlement failures. Once fails-to-deliver surpasses 0.5% of a company's shares outstanding for five consecutive days, its stock is placed on the so-called threshold list and meets borrowing and delivery requirements similar to that of the emergency order.

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   Trading Data Don't Indicate Short-Selling Abuses
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There are multiple reasons why firms might be unable to deliver stock on time for settlement, including illegal or naked short selling.

But in the case of the securities covered by the emergency order, none are currently on the threshold list, nor do they appear to ever have been on it.

That might explain why SEC Chairman Cox on Thursday appeared to back off his repeated references to naked short selling as a factor in the recent market meltdown and clarified that regulators haven't seen evidence of increased illegal short selling.

What's for sure is that the emergency order was put together in haste and took everyone by surprise, even SEC staffers who mistakenly added a trading symbol representing the South Korean Hang Seng Index to the list of protected securities.

The order is two-parts. It requires traders to pre-borrow stock before selling short the listed. It also requires firms entering in short sales to be able to deliver stock on settlement date, three days after a short sale takes place.

So far, market makers in both the equities and options markets, which are normally exempt from the locate requirement when responding to customers' orders or hedging positions, are subject to the order. But SEC staffers have said that the commission is receptive to comments by those firms and is likely to provide some type of exemption.

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IN THE MONEY: Gelbaum Plows Millions Into PIPE Market
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By **Carol S. Remond**
A Dow Jones Newswires Column

Reclusive Californian financier David Gelbaum is doing his part to try to stave off recession.

A volatile first quarter prompted most participants in the private investment in public equity, or PIPE, market to take a step back, but former hedge fund mathematician Gelbaum invested more than $68 million in that same period. (The PIPE market allows investors to buy sizable stakes in small-cap stocks via private placements rather than in the open market.)

Gelbaum's fund, the Quercus Trust, made its first appearance in PlacementTracker's Institutional Investor League Tables with six transactions in the quarter ending March 31. Its buying dwarfed other funds that bought securities in the PIPE market in the first quarter of the year; Goldman Sachs & Co. came in second with four deals worth $38 million and Heights Capital Management Inc. was third with five transactions worth $36.7 million.

Gelbaum and Quercus were featured in an **In The Money** column last July shortly after the retired financier began buying large positions in small stocks, mostly in solar and other alternative energy, in the open market. His penchant for alternative energy stocks wasn't surprising; he's donated large sums to environmental causes.

But Quercus' binge buying resulted in sharp jumps in the stock prices of companies it accumulated. So much so that some traders began following Gelbaum's investment plays, trying to unload some of their stocks for a quick profit. Short sellers who predicted, mostly correctly, that stocks would fall again when Gelbaum was done buying also became a follower of his.

Ownership filings with the Securities and Exchange Commission show that Quercus has taken positions in at least 20 companies, with some of his largest holdings in Beacon Power Corp. (BCON), WorldWater & Solar Technologies Corp. (WWAT), Emcore Corp. (EMKR), Bluefire Ethanol Fuels Inc. (BFRE) and Open Energy Corp. (OEGY).

Quercus' appearance in the PIPE market league tables suggests that the wealthy philanthropist, while still plowing money into small companies with mostly unproven business, has shifted its investment strategy away from purchases in the open market and into the PIPE market.

According to PlacementTracker, Quercus invested in 16 different PIPE transactions since September 2007, with a total of about $156.5 million in that market alone.

Purchases through private placements provide wealthy investors with a direct conduit to provide capital to the companies they're betting on.

A key advantage of PIPE deals is that the capital goes directly to the company rather than the pockets of investors betting for or against the stock. Private placement securities, traditionally issued at a discount, also provide more bang for a buck, allowing investors to take even larger equity positions.

Born in Minneapolis, Gelbaum moved to California when his father became founding chairman of the math department at the University of California, Irvine. He was later hired by Edward Thorp, also a math professor, who wrote "Beat the Dealer," a book about card counting in blackjack. Thorp's math formulas led him to launch the nation's first market-neutral hedge fund, Princeton/Newport Partners. Gelbaum then went on to form a new firm, Sierra Enterprises Group.

There is very little public information available about Gelbaum. According to published reports, he has made large contributions to the Wildlands Conservancy, a California group he founded in 1995 with David Myers. In 2001, he donated some $101.5 million to the Sierra Club, by far the largest private gift to that group. In the 1990s, Gelbaum also spent millions acquiring land to link several wildlife corridors.

PlacementTracker is published by Sagient Research Systems.

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IN THE MONEY:Rocker To Countersue Overstock As Discovery Begins

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By **Carol S. Remond**

A Dow Jones Newswires Column

After meandering in the California court system for more than two years, a libel case brought by online retailer Overstock.com (OSTK) against a hedge fund and a research firm it accuses of colluding against the company is about to kick into high gear.

But while Overstock Chief Executive Officer Patrick Byrne recently rejoiced that a decision by the California Supreme Court not to review petitions in the case opened the door for the discovery process to begin, he might soon have to disclose more than he anticipated.

That's because, according to people familiar with the situation, Rocker Partners LLC and Gradient Analytics Inc. are poised to file counterclaims against the company. Rocker is expected to file its counterclaim on Friday. Gradient's timing is unclear.

Overstock sued Rocker and Gradient in Superior Court of the State of California in Marin County in August 2005, alleging that the short selling fund and research firm engaged in unfair practices and conspired to produce negative reports to depress its stock price for profit.

Rocker, which was renamed Copper River Management after the retirement of founder David Rocker, and Gradient have denied wrongdoings, claiming that Overstock is simply trying to silence critics.

In September, after the state supreme court denied its petition for review, Gradient said that California had given companies "the tools to stop critical analysis of their financial practices by market analyst, researchers, journalists and others."

Rocker and Gradient had long said that they would file their own claims against Salt Lake City-based Overstock, but those plans seem to have been put on hold while they tried to have the case dismissed. Now that the crucial phase of discovery is about to begin - each party will ask the other to produce documents and information that they believe is supportive of their claims - Rocker's and Gradient's legal teams are shifting into a more offensive mode.

People familiar with the matter said Rocker will allege in its counterclaim that Overstock and its CEO orchestrated a short squeeze to boost the company's stock in violation of a California securities statute. The fund is likely to claim that Byrne made false statements, perhaps through the use of Internet bloggers, in order to inflate the price of his company's stock in violation of California Corporations Code.

Rocker will allege that the massive run-up in Overstock's price in the second half of 2004 and early 2005 caused the fund to lose money by forcing it to cover, or buy back shares, at artificially higher prices.

Short sellers bet on falling stock prices. They typically borrow shares to sell them, hoping that they will be able to replace them with stock bought at a lower price later.

Rocker's counterclaim against Overstock will be similar to that brought by the fund against bankrupt Belgian speech technology company Lernout & Hauspie back in December 2000. That suit is still ongoing.

In its complaint against L&H, Rocker alleges it lost tens of millions of dollars when it had to cover its short position at higher prices because L&H fraudulently boosted its stock price by releasing fraudulent information in the market.

L&H filed for bankruptcy protection in November 2000 amid a burgeoning accounting scandal. The company later admitted fabricating a large portion of its sales.

Rocker hired law firm Boies, Schiller & Flexner earlier this year after a California appeals court in May denied a motion to dismiss Overstock's suit.

The short fund declined to comment on its plans.

Overstock is not the only company taking aim at hedge funds and research firms. Canadian companies Biovail Corporation (BVF) and Fairfax Financial Holdings (FFH) filed suits against several funds and research analysts in New Jersey state court in 2006. The Biovail complaint doesn't named Rocker as a defendant but Fairfax' does. All three companies are under investigation by the Securities and Exchange Commission.

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fraudulent loans. The investigation and a parallel criminal probe in Michigan led to the indictment of a former BLX executive earlier this year on charges that he and others defrauded SBA out of $77 million in guaranteed loans.

The executive, Patrick Harrington, who headed BLX's Troy, Mich., office until August 2006, recently pleaded guilty to fraud and making false statements to a grand jury. The criminal prosecutor in that case has said that the investigation is ongoing and that more indictments are expected.

A 40-page audit report issued in July and made public last week, identifies "problems with the manner in which SBA addressed performance and compliance issues with BLX's lending activities and SBA's actions to protect government funds once deficiencies were identified."

But in a move that has many, including its own Office of the Inspector General, scratching their heads, SBA asked that most of the report be redacted before it was made public.

That lack of transparency bothers U.S. Sen. John Kerry (D-Mass), chairman of the Committee on Small Business and Entrepreneurship.

"It is highly unusual for an agency to attempt to withhold the Inspector General's recommendations and their response from public scrutiny, and the SBA must explain their rationale fully and completely," Kerry said in an email.

Kerry said he is concerned that the SBA is not taking the Inspector General's recommendations seriously and that it's not adequately addressing its "failed oversight of a small business lender that resulted in years of undetected fraud."

The senator from Massachusetts said he plans to hold a hearing on the issue in the near future.

Meanwhile, the House Small Business Committee is also monitoring the situation and will take a close look at a second report to be issued by the Office of Inspector General. That report is expected to make specific recommendations for restructuring and improvement of the lenders oversight system.

BLX is the largest holding of Allied Capital Corp. (ALD), a buyout firm with about $4.5 billion of assets. SBA typically guaranteed 75% of the loans issued by small lenders like BLX.

Portions of the Inspector General's report not redacted show that despite recurring problems (which are redacted), SBA continued to renew BLX's lender status and took no action to restrict its ability to originate loans.

The audit also found that SBA's lender oversight responsibilities appear to clash with its loan production goals.

According to the report, "SBA management generally was not receptive to the audit findings and recommendations, partially agreeing with recommendation 1, neither agreeing nor disagreeing with recommendation 2, providing a conflicting and unclear response to recommendation 4 and disagreeing with recommendations 3 and 5."

A spokesman for SBA declined to comment on the extent of the redactions. SBA said in an email statement: "Because so much of the material covered in the Inspector General's report is, by law, privileged and confidential, there is very little we can say about it."

The Inspector General said in the report that although the office "does not necessarily agree with the extent of these redactions, as a courtesy, we have agreed to redact this text."

In March, three months after the criminal indictment of BLX's Harrington was unsealed, SBA set tougher conditions to continue guaranteeing BLX's loans. SBA said in its email statement that its agreement with BLX "increased oversight, tightened reviews and examinations and provides for reimbursing the agency for any losses caused by fraudulent loans." As part of the deal, BLX agreed not to resell loans in the secondary market before those loans are reviewed by SBA.

A spokesman for Allied Capital, which owns 95% of BLX, declined to comment.

In a letter sent to SBA Wednesday, Senator Kerry questioned the extent to which the Inspector General's report was redacted and requested documents supporting three exemptions used by SBA to justify the redactions: trade secrets, deliberative process privilege and banking examination.

Kerry said in his letter that it's "surprising to see that the first three of the OIG's recommendations and both the agency response to the OIG's recommendations and the OIG's comments on the response were redacted."

Senator Kerry also questioned why large portions of the "Results in Brief" section of the report, as well as its entire "Chronology of Events" appendix were blackened out.

In his letter, Kerry asked SBA to provide documents supporting the need for redactions by Oct. 30.

Allied Capital valued its investment in BLX at about $221 million in its latest quarterly report with the Securities and Exchange Commission. That SEC report shows that BLX repaid about $10 million to the SBA "to cover amounts paid by the SBA with respect to some of the SBA-guaranteed loans that have been the subject of inquiry by the United States Attorney's Office for the Eastern District of Michigan."

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- By **Carol S. Remond**; Dow Jones Newswi

IN THE MONEY: Wealthy Philanthropist Dabbles In Small-Caps
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By **Carol S. Remond**
A Dow Jones Newswires Column

After spending millions to support environmental causes, reclusive Californian financier David Gelbaum is practicing a new form of philanthropy: helping the profits of traders who bet on the stocks of small energy companies.

Gelbaum's a mathematician who spent most of his professional life designing models to help hedge funds exploit price discrepancies in the market. So far this year, he's spent around $100 million gobbling up the stocks of several companies involved in alternative energy.

Gelbaum's binge buying has resulted in sharp jumps in the stock prices of companies his trust, The Quercus Trust, has been accumulating. Those increases have been a boon for investors looking to unload some of their stocks for a quick profit, as well as for short sellers predicting, in most cases correctly, that the price of these securities would retreat as soon as Gelbaum's buying sprees ebb.

Gelbaum has donated huge sums to environmental causes, so his interest in alternative energy stocks isn't surprising. The trust has filed ownership filings indicating that he has taken positions in at least 13 companies, with some of his largest holdings in Beacon Power Corp. (BCON), Worldwater & Power Corp. (WWAT), Emcore Corp (EMKR) and Octillion Corp. (OCTL). All of them are small-cap stocks trading on various U.S. exchanges. He's also been buying shares of foreign energy companies and investing into private entities.

But there's something very unusual about the way this Wall Street wiz has been going about acquiring those shares: Rather than giving the companies more capital, his trading in public markets has instead triggered sharp moves in the stocks. Usually when a larger investor does this it might raise suspicions about stock manipulation, but Gelbaum's investing appear genuine, not least because any attempt to unload these investments in illiquid stocks might tank the share price and lose him a fortune. As an investment method, however, it doesn't seem that logical. One sure thing, however, is that a lot of investors are making a boatload of money riding his coattails into, or selling out of, these stocks.

Wealthy investors like Gelbaum typically invest in companies by purchasing securities in private placements. There are two obvious benefits to this type of investment: The money goes to the company instead of instantly disappearing in the pockets of investors betting for or against the stock. And since private placement securities are issued at a discount, Gelbaum could have easily taken even larger equity positions in the companies he appears to want to help.

Shares acquired through this method typically include a lockup period during which they cannot be sold. But if Gelbaum is investing for the long run because he believes that the companies which shares he is buying might one day help better the environment, he should have no problem having to hold on to them for a few months.

Joseph Bartlett, a lawyer who has prepared some of the ownership filings made by Gelbaum and Quercus said that Gelbaum doesn't want to talk to the press. The lawyer said in late August that Gelbaum hadn't invested in discounted private placement offerings made by several of the companies whose stock he has been buying and that he has no financial interest in boosting the prices of those stocks. Bartlett said at the time that as far as he knew, Gelbaum and Quercus hadn't sold any securities. The lawyer also said at the time that Gelbaum was looking into purchasing securities through private placements.

Market participants in the small-cap market said Gelbaum's buying spurts are so obvious they can typically see what he's buying before it's revealed in trust's regulatory filings. They say he typically trades through Bear Stearns (BSC), something Bartlett confirmed. As Gelbaum's buying became more obvious, his stock picks have now become a focus for funds looking to short shares as he drives prices higher by accumulating large positions in normally illiquid stocks.

Born in Minneapolis, Gelbaum moved to California when his father became founding chairman of the math department at the University of California at Irvine. He was later hired by Edward Thorp, also a math professor, who wrote "Beat the Dealer", a book about card counting in blackjack. Thorp's math formulas led him to launch the nation's first market-neutral hedge fund Princeton/Newport Partners.

Princeton/Newport was broken up in 1989 after the firm came into the crosshairs of an aggressive federal prosecutor in New York named Rudolph Giuliani who was taking aim at Wall Street and white collar crime. The case received national attention because it was the first time that the government used the Racketeering Influenced and Corrupt Organizations, or RICO, statute to go after a securities firm. Jay Regan, who co-founded the firm with Thorp, and five other executives were convicted of racketeering and fraud. The convictions were later overturned on appeal. Neither Thorp, nor Gelbaum were implicated in the case.

Gelbaum went on to form a new firm, Sierra Enterprises Group, with other Princeton/Newport alumni. According to regulatory filings, Sierra Enterprises and related firm ST2 LP ceased to be registered in 2001.

There is little information available about Gelbaum, who seems to have sought anonymity until he started to purchase stocks very publicly in the open market early this year.

According to published reports, Gelbaum has made large contributions to the Wildlands Conservancy, a California group he founded in 1995 with David Myers. In 2001, he donated some $101.5 million to the Sierra Club, by far the largest private gift to that group. In the 1990s, Gelbaum also spent millions acquiring land to link several wild life corridors.

When it comes to stock picking, some of Gelbaum's choices are downright speculative, even for the small cap market.

Take Octillion, for example. Securities filings show that Quercus purchased about $8.5 million worth of this heavily promoted Vancouver-based company, which describes itself as a technology incubator focused on emerging solar-related technologies.

In late August, Kenneth Coleman, in his Investment Tracker newsletter, told potential investors: "Get in early on just one stock and you could make millions...Am I putting Octillion in that league? You bet they have the potential!" Coleman, who at the time had received $17,600 from Octillion, went on to tell his readers that "Octillion could potentially give you short-term gains of 370% or more as the technology progresses, moving closer to commercialization."

Securities filings show that Octillion was incorporated in Nevada in 1998, has no revenue and has accumulated some incurred losses of $1.3 million since inception. The company's filings carry a going-concern statement that warns investors that "the ability of the company to continue as a going concern is in substantial doubt and dependent upon achieving a profitable level of operations and on the ability of the Company to obtain necessary financing to fund ongoing operations."

Harmel Rayat, Octillion's chief financial officer, principal financial officer and director, has had run-ins with U.S. regulators in the past.

In 2003, Rayat and others settled with the Securities and Exchange Commission and consented to the entry of an order, without admitting or denying findings by the SEC, to cease and desist from committing any future violation of rules preventing the sale of unregistered stock. In 2000, Rayat and EquityAlert were accused of violating an anti-fraud statute. Both consented to an order of permanent injunction entered by an Arizona district judge without admitting or denying the allegations.

Remember, Gelbaum, has millions to spare, and his investment choices might not be suited for mere mortals.

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