IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO
Robert E. Blackburn, Judge

Civil Action No. 98-RB-1636 (MJW)

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

v.

RONALD J. HOTTOVY,

Defendants.

AMENDED FINAL JUDGMENT, PERMANENT INJUNCTION, & PROHIBITION

Blackburn, J.

This matter is before me for determination of the appropriate remedy to be imposed following a jury verdict in favor of the plaintiff, the Securities and Exchange Commission. The jury found that the defendant, Ronald J. Hottovy, violated sections 17(a)(1) and 17(a)(3) of the Securities Act of 1933; section 10(b) of the Securities Exchange Act of 1934, and rule 10b-5 thereunder; and section 13(b)(5) of the Securities Exchange Act of 1934 and rules 13b2-1 and 13b2-2 thereunder. I must determine what remedies or relief should be accorded to the plaintiff based on the jury's verdict. I have the benefit of the parties' briefs and oral arguments.

I. Summary of Facts and the Jury's Verdict

From December 1991, through May 1996, Hottovy was the Chief Financial Officer (CFO) of Scientific Software-Intercomp, Inc. (SSI). SSI produced and marketed software used in the oil and gas industry. As CFO, Hottovy was responsible, *inter alia*, for the management of accounts payable, accounts receivable, auditing, payroll,

preparation of financial statements, and preparation and execution of documents to be filed with the Securities and Exchange Commission.

Beginning in 1992, SSI began the practice of recognizing revenue from various software license contracts which were contingent because additional terms had been added to the contracts in side letters. These contingent contracts did not constitute a firm commitment by a customer to pay SSI. At trial, Hottovy claimed he was not aware of the side letters and thus was not aware that the contracts were contingent. He said he permitted the recognition of revenue on these contracts not knowing that the contracts were contingent. Having heard the trial in this case, and having reviewed all of the evidence, I find that Hottovy was aware of at least some of the side letters which made SSI contracts contingent. I also find that Hottovy permitted the recognition of revenue on such contracts knowing that at least some of those contracts were contingent. I make this finding for the purpose of determining what remedies are appropriate in this case.

In early 1995, SSI had a prospective contract with the U.S. Navy, potentially worth $700,000 in revenue. Against the advice of two auditors for separate divisions of SSI, Hottovy directed that the revenue from the prospective Navy contract be recognized before the contract was fully executed. Hottovy oversaw the filing of SSI's Form 10Q with the SEC, reflecting that the revenue from the Navy contract had been recognized. A note on this form indicated that the Navy contract was not yet fully executed. On this basis, Hottovy has argued that this Form 10Q was not inaccurate or deceptive.

In April of 1995, SSI announced that it would state a loss for the fourth quarter of 1994. SSI stated the loss was due to the fact that certain contracts with customers "did not meet all of the necessary requirements to be recognized as revenue in the fourth quarter. In addition, several other contracts were reversed when the resellers did not meet payment obligations during and subsequent to the quarter. " *Plaintiff's Memorandum*, filed August 16, 2002, Press Release dated April 6, 1995, Appendix A, tab 9. At that time, payments due under several contracts SSI had with various customers were in arrears.

In its Complaint, the SEC alleged that Hottovy knew, or was reckless in not knowing, that SSI's revenue, net income, and earnings per share were materially overstated in various filings SSI made with the SEC. These filings included a registration statement filed prior to a public offering of stock, and the annual and quarterly reports filed by SSI with the SEC. In addition, the SEC alleged that Hottovy falsified SSI's books, records or accounts, and made false or misleading statements in the preparation of reports and documents required under applicable law. Each of these claims was based on the SEC's allegation that Hottovy employed a variety of means to improperly recognize revenue in SSI's accounting records, and to report that information to the SEC. The relevant events alleged in the Complaint took place between late 1993 and mid-1995.

After a jury trial, the jury found in favor of the SEC on each of its claims. The jury found that Hottovy had violated sections 17(a)(1) and 17(a)(3) of the Securities Act of 1933; section 10(b) of the Securities Exchange Act of 1934, and rule 10b-5 thereunder; and section 13(b)(5) of the Securities Exchange Act of 1934 and rules 13b2-1 and

13b2-2 thereunder. The jury's findings that Hottovy violated sections 17(a)(1) and 10(b)(5) included findings that Hottovy acted knowingly or recklessly with regard to those violations. The jury's findings concerning the other violations were based on their finding that Hottovy acted negligently or unreasonably. All of the violations alleged in the Complaint concerned inaccurate statements of SSI's financial status to the SEC, or in SSI's books and records.

Of course, it is impossible to know what specific actions by Hottovy underlay each of the violations found by the jury. The SEC alleged that Hottovy took a variety of actions that violated the securities laws. However, the jury's verdict does not necessarily indicate that the jury concluded that Hottovy committed all of the wrongs alleged by the SEC. At minimum, the jury's verdict indicates that Hottovy took some actions that constitute serious violations of the securities laws.

II. Remedies

In view of the jury's verdict, the court must determine the appropriate remedy for the violations. The SEC seeks three separate remedies. First, the SEC asks that the court enjoin Hottovy from any further violations of the securities laws in the future. Second, the SEC asks that the court bar Hottovy from acting as an officer or director of any publicly traded company. Finally, the SEC seeks the imposition of a civil monetary penalty against Hottovy. I will consider each remedy in turn.

1. Injunction Against Future Violations. After a jury verdict finding that a defendant has violated the securities laws, the court can enjoin the defendant from violating the securities laws in the future. 15 U.S.C. §§ 77t(b), 78u(d). In ***SEC v. Pros Int'l, Inc.***, the United States Court of Appeals for the Tenth Circuit stated the factors to

be considered in determining whether an injunction against future violations of the securities laws should be imposed. 994 F.2d 767 (10th Cir. 1993). An injunction based on the violation of securities laws is appropriate if the SEC demonstrates a reasonable and substantial likelihood that the defendant, if not enjoined, will violate securities laws in the future. ***Id.*** at 769. Four factors are of primary importance in determining the likelihood of future violations: 1) the seriousness of the violation proved; 2) the degree of scienter; 3) whether the defendant's occupation will present opportunities for future violations; and 4) whether the defendant has recognized his wrongful conduct and gives sincere assurances against future violations. ***Id.*** at 769.

> Although no single factor is determinative, we have previously held that the degree of scienter "bears heavily" on the decision. ***SEC v. Haswell,*** 654 F.2d 698, 699 (10th Cir. 1981). A knowing violation of §§ 10(b) or 17(a)(1) will justify an injunction more readily than a negligent violation of § 17(a)(2) or (3). However, if there is a sufficient showing that the violation is likely to recur, an injunction may be justified even for a negligent violation of § 17(a)(2) or (3).

Id. at 769 (citation omitted).

The facts in this case support the imposition of an injunction under the ***Pros Int'l*** standard. First, the jury in this case found that Hottovy committed serious violations of the securities laws. The jury found that Hottovy made materially false representations about SSI's financial condition in filings with the SEC, and in SSI's books. This information frequently is relied upon by investors, and materially inaccurate information presents, at minimum, a substantial risk of harm to investors. Second, the jury found that Hottovy acted knowingly or recklessly in making misrepresentations about SSI's financial condition, in violation § 17(a)(1) and § 10(b)(5). This is a relatively high degree of scienter. Most notably, I have found that Hottovy knew SSI was recognizing revenue

on contingent contracts. This amounts to a knowing misrepresentation of material facts to the investing public. In addition, the jury found that Hottovy acted negligently or unreasonably as to the other violations.

Third, Hottovy's occupation readily could present opportunities for future violations. Hottovy testified at the remedy hearing that he currently is working for a privately held company. However, he testified that there is some possibility that this company may be acquired by a company that might be publicly traded in the future. Even if Hottovy's current employment does not lead to work with a publicly traded company, his substantial skills and experience could enable him to obtain employment with a publicly traded company, if he chose to pursue that path. In short, while it is not certain that Hottovy's occupation will present opportunities for future violations, his skills and experience easily could lead to employment with a publicly traded company and thus could present opportunities for future violations of the securities laws.

Fourth, Hottovy has said that he disagrees with the conclusions of the jury in this case but, despite his disagreement, he seems to respect the jury's conclusions. The SEC argues that Hottovy's disagreement with the jury indicates that he has not recognized his wrongful conduct. I find that Hottovy has not fully recognized his wrongful conduct. Most notably, I find that Hottovy knew SSI was recognizing revenue on contingent contracts, yet Hottovy does not recognize that this amounts to wrongful conduct.

Finally, Hottovy has given assurances against future violations which I find to be sincere. Primarily, Hottovy has represented that he will not work as a CFO in the future, and he will do everything he can to avoid the ordeal of another SEC enforcement action

against him. The court would note, however, that one does not need to be a CFO to violate the securities laws. Again, Hottovy's skills and experience readily could allow him to work in a position, though not a CFO position, that would enable him to violate the securities laws. Changing circumstances, and a change of heart, easily could lead Hottovy to put himself in such a position.

Having considered all of the relevant factors, I find that there is a reasonable and substantial likelihood that Hottovy, if not enjoined, will violate securities laws in the future. Therefore, Hottovy is permanently enjoined from violating the federal securities law in the future, as stated at the conclusion of this order.

2. Officer and Director Bar. The court may prohibit a person from serving as an officer or director of a public company if that person's conduct demonstrates substantial unfitness to serve in those capacities. 15 U.S.C. § 78u(d)(2). An officer and director bar must be based on a violation of § 17(a)(1) or § 10(b). Again, the jury in this case found that Hottovy violated both of these sections. The SEC asks the court to impose an officer and director bar against Hottovy. The parties agree that six factors are primarily relevant in determining whether an officer and director bar is appropriate: 1) the seriousness of the violations proven; 2) whether the defendant is a recidivist; 3) the defendant's position when he committed the violations; 4) the degree of scienter; 5) the defendant's economic stake in the violation; and 6) the likelihood that the misconduct will recur. ***See, e.g., SEC v. Patel***, 61 F.3d 137, 141 (2nd Cir. 1995). Obviously, an officer and director bar is a more serious remedy than an injunction against future violations.

As discussed above, the jury in this case found that Hottovy violated both § 17(a)(1) and § 10(b). These violations both involved wrongful actions by Hottovy that were either knowing or reckless. The evidence presented at the remedy hearing indicates that Hottovy owned SSI stock options at the time of his violations, and thus he had an economic interest in seeing the price of SSI stock rise. However, there is no evidence that Hottovy actually received any economic benefit from his violations. Further, there is no indication that Hottovy has committed any other securities violations, before or since. Again, I find that there was a relatively high degree of scienter involved in some of Hottovy's violations. His recognition of revenue on contracts he knew to be contingent amounts to a knowing misrepresentation of material facts to the investing public. As discussed above, the court finds that there is a substantial likelihood that Hottovy will violate the securities laws in the future.

Having considered these factors, all of the evidence presented at the trial and at the remedy hearing, and the jury's verdict in this case, I find that Hottovy's violations were sufficiently serious, and the risk of future violations is sufficiently high, that Hottovy is substantially unfit to serve as an officer or director of a public company in the near term. On balance, I find that, that a two year officer and director bar should be imposed upon him. I further find that this officer and director bar and the court's injunction against future violations, combined with the ordeal and cautionary tale this case has presented to Hottovy, are sufficient to alleviate the risk that Hottovy will violate the securities laws in the future.

3. Civil Monetary Penalty. The court may impose a monetary penalty on Hottovy, based on his violation of the provisions of the Exchange Act. 15 U.S.C.

§ 78u(d)(3). This statute provides for three tiers of civil penalties, and gives the court broad discretion to determine if such a penalty is appropriate. "The court shall have jurisdiction to impose, upon a proper showing, a civil penalty . . ." 15 U.S.C. § 78u(d)(3)(A). "The amount of the penalty shall be determined by the court in light of the facts and circumstances." 15 U.S.C. § 78u(d)(3)(B). The penalty provisions of the Act were designed to "achieve the dual goals of punishment of the individual violator and deterrence of future violations." ***SEC v. Moran***, 944 F. Supp. 286, 296 (S.D.N.Y. 1996).

As noted above, there is no indication that Hottovy is a recidivist violator of the securities laws. There is no evidence in the record in this case that Hottovy realized any personal gain from the violations found by the jury. Further, this case has been a substantial financial and emotional ordeal for Hottovy. In light of these factors, the court finds that punishment of Hottovy, or additional deterrence of Hottovy from future violations, is not necessary. In light of the court's imposition of a permanent injunction and an officer and director bar against Hottovy, and having considered all of the evidence presented at the trial and at the remedy hearing, and the jury's conclusions in this case, I find that a civil monetary penalty is not warranted.

Conclusion

THEREFORE IT IS ORDERED as follows:

1) That an **AMENDED JUDGMENT SHALL ENTER** in favor of the plaintiff, Securities and Exchange Commission, and against the defendant, Ronald J. Hottovy, consistent with the jury verdict in this case [# 90], filed July 30, 2002, and this order;

2) That, pursuant to 15 U.S.C. § 78u(d)(1), the defendant, Ronald J. Hottovy, his officers, agents, servants, employees, attorneys-in-fact, successors and assigns, and all persons in active concert or participation with them who receive actual notice of this Amended Final Judgment, Permanent Injunction, & Prohibition by personal service or otherwise, and each of them, be and hereby are **PERMANENTLY ENJOINED AND RESTRAINED** from:

A. Violating Section 10 (b) of the Securities Exchange Act (Exchange Act) [15 U.S.C. § 78j(b)], and Rule 10b-5 thereunder [17 C.F.R. § 240.10b-5], by, directly or indirectly, using any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange:

(i) to employ any device, scheme or artifice to defraud;

(ii) to make any untrue statement of material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; or

(iii) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person

in connection with the purchase or sale of any security;

B. Violating Section 17(a)(1) and (3) of the Securities Act of 1933 (Securities Act) [15 U.S.C. § 77q(a)(1) and (a)(3)] by, directly or indirectly, in the offer or sale of any security by use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, or of any facility of any national securities exchange:

(i) to employ any device, scheme or artifice to defraud; or

(ii) to engage in any transaction, act practice, or course of business which operates or would operate as a fraud upon the purchaser;

C. Violating Section 13(b)(5) of the Exchange Act [15 U.S.C. § 78m], and Rule 13b2-1 thereunder [240 C.F.R. § 240.13b2-1], by knowingly circumventing or by knowingly failing to implement a system of internal accounting controls or by knowingly falsifying any book, record, or account of any public company or by, directly or indirectly, falsifying or causing to be falsified any book, record or account of any public company; and

D. Violating Section 13(b)(5) of the Exchange Act [15 U.S.C. § 78m], and Rule 13b2-2 thereunder [240 C.F.R. § 240.13b2-2], by directly or indirectly, while an officer or director of a public company:

(i) making or causing to be made a materially false or misleading statement, or

(ii) omitting to state, or causing another person to omit to state, any material fact necessary in order to make statements made, in light of the circumstances under which such statements were made, not misleading to an accountant in connection with (1) any audit or examination of the financial statements of a public company or (2) the preparation or filing of any document or report required to be filed with the Securities and Exchange Commission;

3) That, pursuant to 15 U.S.C. § 78u(d)(2), the defendant, Ronald J. Hottovy, is **PROHIBITED** from acting as an officer or director of any issuer that has a class of securities registered pursuant to 15 U.S.C. § 78l or that is required to file reports pursuant to 15 U.S.C. § 78o(d);

4) That the prohibition stated in paragraph 3), above, shall be **LIMITED TO A PERIOD OF TWO YEARS** from the date of this order; and

5) That the plaintiff SEC's request for the imposition of a civil monetary penalty is respectfully **DENIED**.

Dated at Denver, Colorado this 8th day of January, 2003.

BY THE COURT:

Robert E. Blackburn
United States District Judge

ENTERED
ON THE DOCKET

JAN 13 2003

JAMES R. MANSPEAKER
CLERK

BY _____