

**UNITED STATES OF AMERICA**  
**Before the**  
**SECURITIES AND EXCHANGE COMMISSION**

**SECURITIES EXCHANGE ACT OF 1934**  
**Release No. 62072 / May 11, 2010**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-13885**

<p><b>In the Matter of</b></p> <p><b>LEONARD J. ADAMS,</b></p> <p><b>Respondent.</b></p>	<p><b>ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING A CEASE-AND-DESIST ORDER</b></p>
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**I.**

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Leonard J. Adams ("Adams" or "Respondent").

**II.**

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over Respondent and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-and-Desist Order ("Order"), as set forth below.

### III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

#### Summary

1. These proceedings arise out of numerous violations of Rule 105 of Regulation M, a rule designed to protect the independent pricing mechanism of the securities market shortly before follow-on and secondary offerings, by Leonard J. Adams.<sup>1</sup> Adams violated Rule 105 in connection with offerings from at least March 2006 through December 2008 (the "relevant period"). Adams engaged in a strategy of participating in numerous secondary offerings of stock in public companies in order to improve his access to initial public offerings underwritten by the same broker-dealers through which he participated in the secondary offerings. At all relevant times through October 9, 2007, Rule 105 prohibited covering a short sale with securities obtained in a public offering when the short sale occurred during a restricted period, generally five business days before the pricing of the offering. Since October 9, 2007, Rule 105 prohibits any person effecting a short sale during the restricted period from purchasing shares offered in a secondary offering. Adams violated Rule 105 in connection with at least 94 offerings between March 2006 and December 2008, resulting in gains of \$331,387.

#### Respondent

2. **Leonard J. Adams**, age, 61, is a resident of Boca Raton, Florida. Adams is retired from a family-owned fabric manufacturing business and has been a full-time investor since 1993.

#### Background

##### **Rule 105**

3. Prior to October 2007, Rule 105 of Regulation M, "Short Selling in Connection with a Public Offering," provided, in pertinent part:

In connection with an offering of securities for cash pursuant to a registration statement ... filed under the Securities Act, it shall be unlawful for any person to cover a short sale with offered securities purchased from an underwriter or broker or dealer participating in the offering, if such a short sale occurred during the ... period beginning five business days before the pricing of the offered securities and ending with such pricing ...

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<sup>1</sup> "The first time an issuer conducts a public offering of its securities, the offering is referred to as an initial public offering ("IPO"). Subsequent offerings by the issuer are referred to as follow-on offerings or repeat offerings. A secondary offering is an offering of securities held by security holders, for which there already exist trading markets for the same class of securities as those being offered." Short Selling in Connection With a Public Offering; Proposed Rule, 71 Fed. Reg. 75002, 75003 n.12 (Dec. 13, 2006) ("Proposing Release on Rule 105").

17 C.F.R. § 242.105(a)(1).

4. The Commission amended Rule 105 effective October 9, 2007, to provide, in pertinent part:

In connection with an offering of equity securities for cash pursuant to a registration statement ... filed under the Securities Act of 1933 ("offered securities"), it shall be unlawful for any person to sell short ... the security that is the subject of the offering and purchase the offered securities from an underwriter or broker or dealer participating in the offering if such short sale was effected during the period ("Rule 105 restricted period") that is the shorter of the period:

(1) Beginning five business days before the pricing of the offered securities and ending with such pricing; or (2) Beginning with the initial filing of such registration statement ... and ending with the pricing.

17 C.F.R. § 242.105(a)(1) (effective October 9, 2007).

5. The Commission amended Rule 105 to eliminate the covering component to "reduce[] a potential investor's incentive to aggressively sell short prior to pricing solely due to the anticipation of this discount." *Id.* Both the pre- and post-amendment versions of Rule 105 are prophylactic and prohibit the conduct irrespective of the short seller's intent in effecting the short sale. *See id.* at 45094 ("Rule 105 is prophylactic. Thus, its provisions apply irrespective of a seller's intent"); Proposing Release on Rule 105, 71 Fed. Reg. at 75002 ("The proposal, like the current rule, provides a bright line test for Rule 105 compliance consistent with the prophylactic nature of Regulation M").

### **Adams' Trading**

6. During the relevant period, Adams participated in secondary offerings in order to improve his access to IPOs. Adams opened or controlled at least 32 brokerages accounts at more than a dozen broker-dealers. These accounts gave Adams potential access to IPOs underwritten by those broker-dealers. With respect to customers such as Adams, these broker-dealers generally allocated IPOs based upon the amount of commissions and sales credits those customers generated. Because the commissions and sales credits generated by purchases of shares in secondary offerings were substantially greater than commissions generated by open market transactions, Adams agreed to participate in numerous secondary offerings. And to hedge those transactions, he frequently sold short the stock of the issuing companies.

7. During the relevant period, Adams engaged in transactions prohibited by Rule 105 on at least 94 occasions involving secondary offerings by at least 86 issuers. These violations include at least 27 violations prior to October 9, 2007 ("pre-amendment violations"), and at least 67 violations after that date ("post-amendment violations").

8. Adams' pre-amendment violations involve two types of transactions: (1) direct covering of short positions with offering shares; and (2) transactions in which, rather than directly covering a short position with offering shares, Adams placed orders before the market opened to both buy shares in the market and sell offering shares in what amounted to riskless transactions.

9. For example, on April 17 and 18, 2007, Adams sold short 8,000 shares of Ashford Hospital Trust ("Ashford") at an average price of \$12.17 per share. On April 18, 2007, after the market closed, Ashford priced its secondary offering. On April 19, 2007, Adams purchased 5,500 shares of Ashford stock in the secondary offering at a price of \$11.75. He then used these offering shares to cover a portion of his short position and purchased an additional 2,500 shares in the market to cover the remainder of his short position.

10. As an example of what amounted to Adams' riskless transactions, from September 11, 2007 through September 12, 2007, he sold short 24,000 shares of Apollo Investment Corp. ("Apollo") stock within five days of the date the company priced its secondary offering (after the market closed on December 4, 2006) at an average price of \$20.29 per share. He then purchased 33,000 shares in the secondary offering at a price of \$20.00. On September 13, 2007, before the market opened, Adams placed orders to purchase 24,000 shares of Apollo stock in the market with two broker-dealers and to sell the 33,000 shares of Apollo stock purchased in the secondary offering with two other broker-dealers. Those transactions were executed within 18 seconds of each other at the same price of \$19.80.

11. An example of Adams' post-amendment violations is his trading in the shares of Wells Fargo in November 2008. From November 3, 2008 through November 6, 2008, Adams sold short 39,900 shares of Wells Fargo stock in six accounts at an average price of \$28.87 per share. On November 6, 2008, after the markets closed, Wells Fargo priced its secondary offering. On November 7, 2008, Adams purchased 35,000 Wells Fargo shares at the offering price of \$27 per share in connection with that secondary offering. Adams' short sales of Wells Fargo stock were within 5 days of the pricing of the offering and thus fell within the restricted period under Rule 105. As a result, Adams violated Rule 105 when he purchased the Wells Fargo offering shares.

## **Violations**

12. As a result of the conduct described above, from at least March 2006 through October 9, 2007, Adams violated Rule 105 of Regulation M then in effect, which at the time made it "unlawful for any person to cover a short sale with offered securities purchased from an underwriter or broker or dealer participating in an offering, if such short sales occurred during the ... period beginning five business days before pricing of the offered securities and ending with such pricing."

13. As a result of the conduct described above, from October 9, 2007 through December 2008, Adams violated Rule 105 of Regulation M of the Exchange Act, which makes it "unlawful for any person to sell short ... the security that is the subject of the offering and purchase the offered securities from an underwriter, broker or dealer participating in the offering if such short sale was effected during the period: (1) Beginning five business days before the pricing of the offered securities and ending with such pricing; or (2) Beginning with the initial filing of such registration statement ... and ending with such pricing."

#### IV.

In view of the foregoing, the Commission deems it appropriate to impose the cease-and-desist order agreed to in Respondent's Offer.

Accordingly, pursuant to Section 21C of the Exchange Act, it is hereby ORDERED that:

- A. Respondent shall cease and desist from committing or causing any violations and any future violations of Rule 105 of Regulation M of the Exchange Act.
- B. Respondent shall pay disgorgement of \$331,387 and prejudgment interest in the amount of \$16,613 to the United States Treasury. Payment shall be made in the following installments:

- \$87,000 within 90 days of the entry of this Order;
- \$87,000 within 180 days of the entry of this Order;
- \$87,000 within 270 days of the entry of this Order; and
- \$87,000 within 365 days of the entry of this Order.

If any payment is not made by the date the payment is required by this Order, the entire outstanding balance of disgorgement and prejudgment interest, plus any additional interest accrued pursuant to SEC Rule of Practice 600, shall be due and payable immediately, without further application. Payment shall be: (A) made by United States postal money order, certified check, bank cashier's check or bank money order; (B) made payable to the Securities and Exchange Commission; (C) hand-delivered or mailed to the Office of Financial Management, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Alexandria, VA 22312-0003; and (D) submitted under cover letter that identifies Leonard J. Adams as a Respondent in these proceedings,

the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to John T. Dugan, Associate Director, Division of Enforcement, Securities and Exchange Commission, 33 Arch Street, 23<sup>rd</sup> Floor, Boston, MA 02110.

By the Commission.

Elizabeth M. Murphy  
Secretary