In the Matter of MONETTA FINANCIAL SERVICES, INC.

Admin. Proc. File No. 3-9546

SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940 Release No. 2438

October 4, 2005

COUNSEL:
Peter B. Shaeffer, for Monetta Financial Services, Inc.
Jane E. Jarcho and Sunil R. Harjani, for the Division of Enforcement.

TEXT: OPINION OF THE COMMISSION

INVESTMENT ADVISER PROCEEDING
Redetermination of Sanctions Pursuant to Remand

The Court of Appeals affirmed the Commission's finding that registered investment adviser violated antifraud provision by failing to disclose to investment company clients its allocation of shares in initial public offerings to a director and trustees of those companies. The Court remanded the issue of the appropriate sanctions to be imposed. Held, it is in the public interest to censure adviser and impose a $ 40,000 civil money penalty.

I.

This proceeding is here on remand from the U.S. Court of Appeals for the Seventh Circuit. On June 9, 2003, we issued an opinion finding that Monetta Financial Services, Inc. ("MFS"), a registered investment adviser, willfully violated Section 206(2) of the Investment Advisers Act of 1940 n1 by failing to disclose to mutual fund advisory clients its allocations of shares in initial public offerings ("IPOs") to a director and two trustees of those clients. We censured MFS, issued a cease-and-desist order, and assessed a $ 200,000 civil money penalty. n2 On review, the Court of Appeals affirmed our finding that MFS had violated the Advisers Act, but remanded this matter for reconsideration of the sanctions we had imposed. n3

II.

In 1993, MFS was sole investment adviser to two registered investment companies, Monetta Fund, Inc. and the Monetta Trust ("the Fund Clients"), both of which were permitted to invest in shares of IPOs. At the time, MFS also had individual advisory clients. These included Richard Russo and William Valiant, trustees of the Monetta Trust, and Paul Henry, a director of the Monetta Fund (collectively the "Director-Clients").

During the period February to September 1993, MFS, which received IPO shares from various broker-dealers, allocated shares of some fifty IPOs among its advisory clients, including the Fund Clients and individual advisory accounts. Russo received shares in nine IPOs, and Valiant and Henry shares in four IPOs each. Russo made a profit of about $ 28,000 from the sale of his IPO shares, and Valiant and Henry, profits of about $ 12,000 and $ 10,000, respectively. MFS did not disclose to the non-client directors and trustees of the Monetta Fund and the Monetta Trust its allocations of IPO shares to the Director-Clients. The Court concluded that MFS had a fiduciary duty to make that disclosure. It found that MFS's failure to do so constituted fraud or deceit within the meaning of Section 206(2) of the Advisers Act. n4

III.

The Advisers Act authorizes us to impose a civil money penalty on a respondent if we find that such a penalty is in the public interest. The Act establishes three tiers of penalties, graduated according to the seriousness of the offense. During the relevant period, the first tier provided for a maximum corporate penalty of $ 50,000 for any willful violation of the securities acts. The second tier set a maximum penalty of $ 250,000 for any willful violation involving fraud or deceit. n5 The Act grants us discretion in setting the level of penalty. Section 203(i) provides that, in determining whether a penalty is in the public interest, we may consider (1) whether the violation involved fraud or deceit, (2) the resulting harm to other persons, (3) any unjust enrichment, (4) the respondent's prior regulatory record, (5) the need to deter the respondent and other persons, and (6) such other matters as justice may require. n6

MFS asserts that no monetary penalty should be assessed. It argues that only one of the public interest factors is relevant: whether the violation involved fraud or deceit. It states that its violation was merely a negligent omission with no underlying impropriety, that no one was hurt or unjustly enriched, and that it did not receive any improper benefit. It also points out that its record is otherwise unblemished, and argues that there is no need for deterrence because it voluntarily ceased its violative activity and others in the industry are now well aware of their obligations in the IPO area. MFS characterizes its conduct as a unitary violation, claiming that its only offense was the failure to disclose its IPO allocation procedure, not the allocations themselves. It further states that, if we do determine to impose a penalty, it should not be more than a small percentage of the Act's first-tier maximum of $ 50,000, and cites the penalties assessed in three settled cases in support of that claim. n7 MFS raises no objection to our previous imposition of censure.

The Division of Enforcement contends that MFS should be censured and assessed an $ 85,000 civil money penalty, $ 5,000 for each of the seventeen IPO allocations that MFS made to the three Director-Clients, but the Division does not seek imposition of a cease and desist order. It asserts that its proposed sanctions are in the public interest in light of the nature of MFS's misconduct, MFS's lack of appreciation of its fiduciary duty as an investment adviser, the potential for abuse created by MFS's IPO allocations, and the deterrent effect of a penalty. The Division states that MFS has never acknowledged its failure to honor its fiduciary obligations, and cites MFS's "persistent lack of recognition" of its duties as an adviser.

In addition to the contentions of the parties, we have also considered the Court of Appeals' assessment of this matter. The Court cited a number of considerations that "suggest that the sanctions [the Commission had imposed on MFS] are excessive": (1) MFS's conduct was "not particularly egregious," it did not appear that its IPO allocations were inequitable, and no rule expressly required their disclosure; (2) the allocations occurred more than ten years ago over an eight-month period, making it "a fairly isolated occurrence and suggesting that the likelihood of a future violation is slight"; and (3) MFS voluntarily ceased the allocations and no longer has individual clients, "also making the possibility of a future violation more remote." The Court further stated that, in its view, the Commission had not sufficiently explained the imposition of "the same sanctions as the ALJ despite the [Commission's] dismissal [on appeal] of the majority of the charges." n8

We have weighed those aspects of MFS's misconduct that give rise to serious concerns and the need for deterrence, on the one hand, against those circumstances that tend to mitigate the seriousness of MFS's violations, on the other. Based on our evaluation of the case on remand, we determine that the public interest requires that a civil monetary penalty be imposed on MFS that will fit its misconduct and serve to deter this kind of misconduct in the future. We also impose a censure, which MFS does not contest, but do not issue a cease and desist order.

The statutory violation in this case is serious in terms of its nature and potential for abuse. The misconduct implicates fundamental and well-established duties of an investment adviser. An adviser has "an affirmative duty of utmost good faith and full and fair disclosure of all material facts." n9 Here, MFS created a conflict of interest, and failed to make the requisite disclosure. Its breach of its fiduciary duty to those entitled to its loyalty and good faith involved fraud or deceit.

This breach occurred in a situation that was fraught with the potential for abuse. As the Court explained, "Opportunities to invest in IPO shares are rare and therefore valuable to investors. . . . Thus, when MFS allocated some shares of the IPOs to its director-clients, it did so at the expense of the fund clients, as the funds were thereby allocated a smaller number of shares. In effect, MFS's allocation to both director-clients and fund clients placed the parties in competition for the same shares . . . .This is particularly troublesome since MFS had an incentive to favor the director-clients over the fund clients when allocating the shares, given the directors' duty to monitor and police the fund's relationship with its investment adviser." n10 Thus, MFS's IPO allocations to the Director-Clients, and particularly to Russo, an independent trustee of the Monetta Trust, created the potential that the Director-Clients would favor MFS's interests over those of their funds, which could have subverted oversight of the adviser and allowed the adviser to act in its own self-interest at the expense of the funds. n11 Moreover, through these undisclosed allocations, MFS could have unfairly deprived the Fund Clients of lucrative investment opportunities.

Additionally, there is some cause to be concerned about MFS's future compliance with its obligations. Given the nature of the violations and risk of harm, and in light of MFS's insistence that it had no duty to disclose its Director-Client IPO allocations, we found that MFS evidenced a troubling "lack of appreciation for [its] obligations as an adviser to an investment company." n12 The law judge found that Robert Bacarella, MFS's president and majority owner, gave false testimony with respect to his asserted reliance on counsel in allocating IPO shares to Valiant and Russo. And we found that Bacarella exhibited a similar lack of candor when questioned by Commission examiners as to how Valiant obtained his IPO shares. n13 More generally, even assuming (as MFS suggests) that industry participants are aware of their obligations in the IPO area, the assessment of a penalty will serve to reinforce industry awareness of, and adherence to, those obligations.

However, there are a number of countervailing considerations that suggest that, overall, MFS's conduct was, as the Court described it, not "particularly" egregious. MFS has no prior disciplinary record of which we are aware. The Court noted that, although the potential for inequitable allocations existed, "there was little indication that the allocations were inequitable." Indeed, in previously dismissing most of the charges against MFS, we found that "there is insufficient evidence on the record before us to make a determination as to whether the Director-Clients received treatment that was any different from MFS' other individual adviser clients." n14

Furthermore, regarding the age and scale of the misconduct, the Court observed that "the allocations took place a decade ago" and the "director-clients earned a total of approximately $ 50,000 from the IPOs." Alluding to the form of the 206 violation in this case, the Court pointed out that MFS "no longer has individual clients." While recognizing MFS's fiduciary duties in the matter, the Court noted that "no rules expressly required disclosure." n15

Taking all of these factors into account, we conclude that the public interest requires that a monetary penalty be imposed on MFS, albeit a substantially lesser one than the $ 200,000 penalty we initially imposed. In determining the penalty amount in this case, we consider it relevant that MFS's misconduct involved fraud or deceit directed at two Fund Clients. We also note that Advisers Act Section 206(2) is a non-scienter fraud provision. n16

Accordingly, the public interest would be served in this case by imposing two penalties that are significant enough to fit the misconduct and serve the goal of deterrence, but that are toward the lower end of the scale. We have determined that the imposition of a censure and a $ 40,000 civil money penalty -- $ 20,000 for each Fund Client whose directors received IPO allocations from MFS -- is appropriate in the public interest. n17

To help place these sanctions in context, we note that each of the seventeen undisclosed IPO allocations to a Director-Client could be considered a separate violation of Section 206(2). n18 We also note that the penalty we are imposing is less than the statutory maximum for a single first-tier violation, a tier that applies to any willful violation of the Advisers Act whether or not it involves fraud. n19 As discussed above, at the time of MFS's misconduct the maximum second-tier penalty, applicable to an act or omission involving fraud or deceit, was $ 250,000. n20

An appropriate order will issue. n21

By the Commission (Commissioners GLASSMAN, ATKINS, and CAMPOS); Chairman COX and Commissioner NAZARETH not participating.

ORDER IMPOSING REMEDIAL SANCTIONS

On the basis of the Commission's opinion issued this day, it is

ORDERED that Monetta Financial Services, Inc. be, and it hereby is, censured; and it is further

ORDERED that Monetta Financial Services, Inc. be, and it hereby is, assessed a civil money penalty in the amount of $ 40,000.

Payment of the civil money penalty 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) delivered by hand or courier to the Office of Financial Management, Securities and Exchange Commission, 6432 General Green Way, Alexandria VA 22312; and (d) submitted under cover letter that identifies the respondent in this proceeding, as well as the Commission's administrative proceeding file number. A copy of the cover letter and money order or check shall be sent to Sunil R. Harjani, Securities and Exchange Commission, Midwest Regional Office, 175 West Jackson Boulevard, Suite 900, Chicago, Illinois 60604.

By the Commission.

Footnotes

n1 15 U.S.C. § 80b-6. Section 206(2) makes it unlawful for any investment adviser "to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client."

n2 Monetta Financial Services, Inc., Securities Act Rel. No. 8239, 80 SEC Docket 1437.

n3 Monetta Financial Services, Inc. v. SEC, 390 F.3d 952 (7th Cir. 2004).

n4 Id. at 956.

n5 The third tier provided for a maximum corporate penalty of $ 500,000 for violations that involved fraud or deceit and resulted in substantial losses to other persons or substantial pecuniary gain to the respondent.

n6 15 U.S.C. § 80b-3(i). In determining whether administrative sanctions serve the public interest in other contexts, we are guided by the following factors: the egregiousness of a respondent's actions, the isolated or recurrent nature of the violation, the degree of scienter, the sincerity of a respondent's assurances against future violations, the respondent's recognition that the conduct was wrongful, and the likelihood of recurring violations. See Steadman v. SEC, 603 F.2d 1126, 1140 (5th Cir. 1979), aff'd, 450 U.S. 91 (1981).

n7 MFS asserts that a penalty may be unconstitutional under the Excessive Fines Clause of the Eighth Amendment if it is grossly disproportionate to the underlying conduct. As the Supreme Court has held, in determining whether a fine is excessive under the Eighth Amendment, substantial deference is granted to the legislature. See United States v. Bajakajian, 524 U.S. 321, 336 (1998). Here, Congress has established the guidelines for the assessment of penalties.

n8 Monetta Financial Services, Inc. v. SEC, 390 F.3d at 957-958.

n9 SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 194 (1963).

n10 Monetta Financial Services, Inc. v. SEC, 390 F.3d at 955.

n11 Section 15(c) of the Investment Company Act of 1940, 15 U.S.C. § 80a-15(c), requires that a majority of fund directors, including a separate majority of the fund's independent directors, must approve the contracts between a fund and its investment adviser.

n12 Monetta Financial Services, Inc., 80 SEC Docket at 1459.

n13 Id. at 1451-1453.

n14 Id. at 1455.

n15 The Court also reasoned that the need for specific deterrence of this respondent is lessened by the fact that MFS "voluntarily ceased the allocations" after "an eight-month period," several months before "the SEC conducted a routine examination of MFS" and several years before the Order Instituting Proceedings ("OIP") was issued. See Monetta Financial Services, Inc. v. SEC, 390 F.3d at 954, 957-958. As noted in our earlier opinion, "Bacarella stopped allocating shares in IPOs to Valiant and Henry in July 1993. From the record, it appears that Bacarella became concerned that these allocations contravened the National Association of Securities Dealers, Inc. ("NASD") Free-Riding and Withholding Interpretation. Bacarella stopped allocating IPOs to Russo in September 1993 after he became aware of adverse publicity about investment company insiders trading in the same securities as their funds." Monetta Financial Services, Inc., 80 SEC Docket at 1447 (footnote omitted).

n16 Scienter, which includes recklessness, is an element of a Section 206(1) violation, but need not be found to establish a Section 206(2) violation. See Steadman, 603 F.2d at 1134; Howard v. Everex Systems, Inc., 228 F.3d 1057, 1063 (9th Cir. 2000).

n17 With respect to MFS's claims based on the penalties assessed in various settlements, we have repeatedly pointed out that the sanctions assessed in settlements do not provide a reliable guide to those in litigated cases since they reflect pragmatic considerations such as the avoidance of time- and manpower-consuming adversary litigation. See, e.g., Anthony A. Adonnino, Securities Exchange Act Rel. No. 48618 (October 9, 2003), 81 SEC Docket 981, 999, aff'd, No. 03-41111 (2d Cir. 2004); Richard J. Puccio, 52 S.E.C. 1041, 1045 (1996). We also note that, while MFS focuses on the civil penalties imposed in those matters, it ignores the other sanctions also assessed.

n18 Contrary to MFS's contention that this case involves nothing more than a "unitary" violation, the OIP focused on the actual allocations of IPOs in addition to MFS's IPO allocation procedure. As the Court stated, 390 F.3d at 955, "when MFS allocated some shares of the IPOs to its director-clients, it did so at the expense of the fund clients, as the funds were thereby allocated a smaller number of shares," action which "placed the parties in competition for the same shares." Each IPO allocation to a Director-Client by MFS thus can constitute a separate violation of Section 206(2). In prior actions, we have considered each violative action deserving of a separate penalty. See, e.g., Mark David Anderson, Securities Act Rel. No. 8265 (August 15, 2003), 80 SEC Docket 3250, 3270; New Allied Development Corporation, 52 S.E.C. 1119, 1130-1131 (1996).

n19 Section 203(i)(2)(A) of the Advisers Act. 15 U.S.C. § 80b-3(i)(2)(A).

n20 Section 203(i)(2)(B) of the Advisers Act. 15 U.S.C. § 80b-3(i)(2)(B).

n21 We have considered all of the contentions advanced by the parties. We reject or sustain them to the extent that they are inconsistent or in accord with the views expressed in this opinion.