

Securities Regulation Daily Wrap Up, FRAUD AND MANIPULATION—DDC: SEC Sues Rev. Merger Co. Over Hidden Deals, (Mar. 1, 2013)

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By Mark S. Nelson, J.D.

The SEC has filed a civil suit in the federal court in the District of Columbia charging a Chinese reverse merger company with failing to disclose related party transactions in violation of federal securities laws. Keyuan Petrochemicals, Inc. (Keyuan) is alleged to have made numerous false SEC filings in support of fraudulent offers or sales of securities. The SEC also alleged that Keyuan and its former CFO, Aichun Li, violated books and records and internal accounting controls provisions (*Securities and Exchange Commission v. Keyuan Petrochemicals, Inc., et. al.*, Complaint, Filed February 28, 2013).

Background. Keyuan is a China-based company that is the product of a reverse merger involving an OTC-traded Nevada shell corporation (registered under Exchange Act Section 12(g)) and Ningbo Keyuan Plastics Co., Ltd. (Ningbo). As a result of this deal, Keyuan is a holding company that owns Ningbo, an indirectly, wholly-owned subsidiary. Three shareholders control 74% of Keyuan.

Related party deals. The SEC's complaint alleged that Keyuan repeatedly failed to disclose material related party transactions with the firm's CEO, controlling shareholders, affiliates, and managers and their families. Prior to CFO Li's resignation from Keyuan in October 2011, she allegedly had information about these deals that included red flags. According to the SEC's complaint, Li allegedly still agreed to false disclosures and allegedly signed Keyuan's false Forms S-1 and 10-Q. Keyuan's SEC filings allegedly ran afoul of securities regulations and U.S. GAAP.

The SEC also alleged that an unnamed "Individual A" (Keyuan's former Vice President of Accounting) maintained an off-balance sheet cash account from which Keyuan paid executive bonuses, consulting fees, and travel and living expenses. Keyuan also made payments from this account for gifts to officials in the Chinese government. Keyuan's alleged failure to properly account for payments from the off-balance sheet account allegedly caused the firm to inaccurately state its general and administrative costs.

Keyuan terminated Individual A in August 2011. Individual A is a Chinese national who resides in Ningbo, Zhejiang Province, China, and was not named by the SEC as a defendant in this suit.

According to the SEC's complaint, Keyuan later filed restated Form 10-Qs and made post-effective amendments to its Form S-1. These restatements allegedly detailed the previously undisclosed material related party transactions and payments from the off-balance sheet account.

Relief sought. The SEC's 5-count complaint charges Keyuan and Li with many securities violations. Keyuan is alleged to have made fraudulent offers or sales of securities in violation of Securities Act Sections 17(a)(2) and (3). Both Keyuan and Li are charged with violating the reporting and records provisions of Exchange Act Sections 13(a), (b)(2)(A) and Rules 12b-20 and 13a-13. The SEC also alleged that Keyuan and Li violated the internal accounting controls provisions contained in Exchange Act Sections 13(b)(2)(B) and (b)(5).

The SEC asked the court to permanently enjoin Keyuan and Li from engaging in the conduct alleged in the complaint. The SEC also asked the court to order Keyuan and Li to pay civil monetary penalties.

The case is Civil Action No. [Number not yet assigned].

Attorneys: Fuad Rana for the SEC.

Companies: Keyuan Petrochemicals, Inc.; Ningbo Keyuan Plastics Co., Ltd.

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