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SEC in initial probe on private tech stocks

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Trading in stock of private technology companies such as Facebook and Twitter is booming on a loosely regulated secondary market, leading the US Securities and Exchange Commission to open an initial inquiry this week.

According to sources close to the SEC, one point of concern is that because there is no structured marketplace for these securities, naive investors eager to have pre-IPO Facebook stock might be duped by con artists who sell fake stock certificates.

Such scams may be already under way. On Monday a man was charged with swindling nearly $8m out of amateur investors by allegedly selling them fake shares in companies including Facebook, Google and Rosetta Stone. Randy Cho was charged in Chicago with wire fraud and filing false tax returns after he allegedly convinced investors they were buying shares in popular technology companies.

He is said to have “held himself out as a self-employed securities trader” who “offered and sold more than $9,642,507 of shares of stock in well-known companies to more than 50 US and foreign investors”.

Part of the scam allegedly involved Mr. Cho falsely claiming that he had a “special relationship with Goldman Sachs” that allowed him to “purchase discount shares” in these companies, which he then offered to a “friends and family pool”.

In one incident in 2008, Mr. Cho allegedly induced one victim to invest $20,000 by saying that he had Google stock available for $1 a share, when he knew it was at the time trading publicly for $425 a share. “Fraudsters are going to be fraudsters whether it’s the primary or the secondary market,” said Mitchell Littman, an attorney who has worked with buyers of private company stock. “People should do their due diligence if they’re buying into an IPO or a private company. The onus is still ‘buyer beware’.”

The charges against Mr Cho allege that his scam also involved a Ponzi scheme, in which he would cash out previous investors with money from new investors.

In one case, he allegedly used $1.5m in new investor funds to pay previous investors while saying he had sold their stock. During the scheme, which had allegedly gone on since 2001, Mr Cho is said to have sent his victims forged e-mails and documents from the companies they were supposedly invested in.

The case highlights the degree to which amateur investors are eager to gain exposure to pre-IPO stock in popular technology companies. Based on trades on the secondary market, Facebook’s implied value has risen more than 50 per cent in the past five months and more than doubled this year, as investors bid up the small number of shares that are being traded.

The SEC’s initial inquiry, which was revealed this week, is said to be informational and not accusatory at this point, and is also focused in part on how these private companies are valued on the secondary market, when they do not publicly disclose any financial information.