KING & SPALDING

Client Alert

Special Matters

March 4, 2013

SEC Enforcement Update
The SEC Speaks in 2013

The U.S. Securities and Exchange Commission held its annual SEC Speaks program in Washington, D.C. on February 22-23, 2013. In the post-financial crisis, post-Dodd-Frank world, it is clear that the Commission and its staff are attempting to move forward from the tumultuous events of the last several years, which have reshaped not only the financial landscape regulated by the Commission but also some of the basic tools used by the staff to conduct its business. George Canellos, Acting Director of the Division of Enforcement, told the assembled audience that the staff was moving into an era in which the financial markets are rebuilding and recovering, and that the SEC was focusing its resources on ensuring that the recovery was built on a foundation of compliance.

"Creative" Thinking on Remedies and Process; Encouraging Cooperation

Canellos expressed his view that the SEC should be making more "creative use" of the range of enforcement remedies available to the agency rather than following its historical "one size fits all" approach. For example, he mentioned that the SEC has recently been seeking more specific "conduct-based" injunctions in addition to, or in lieu of, the kind of sweeping "obey-the-law" injunctions that have been the hallmark of SEC enforcement for decades (and that have faced occasional but increasing scrutiny from federal judges). Canellos also suggested that the SEC was likely to make more frequent use of its new statutory power to impose monetary penalties in administrative cease-and-desist proceedings, an option now available to the SEC under Section 929P of the Dodd-Frank Wall Street Reform and Consumer Protection Act. He also hinted that the Commission might make greater use of so-called Section 21(a) reports, in which the Commission publicly articulates its views about a case after an investigation is completed, sometimes in tandem with the filing of an enforcement action but often instead of filing formal charges.

David Bergers, the newly-appointed Acting Deputy Director of Enforcement, likewise focused on the division's desire to improve its processes. He alluded to a recently-formed Enforcement Advisory Committee that he said will focus on making more effective use of the division's limited resources, with the goal of "empowering" the enforcement staff and "making things easier" for the staff. (It was unclear

For more information, contact:

Russell G. Ryan
+1 202 661 7984
rryan@kslaw.com

Matthew H. Baughman
+1 404 572 4751
mbaughman@kslaw.com

Laura K. Bennett
+1 202 626 5418
lkbennett@kslaw.com

Andrew Lyness
+1 404 572 4731
alyness@kslaw.com

King & Spalding
Atlanta
1180 Peachtree Street, NE
Atlanta, Georgia 30309-3521
Tel: +1 404 572 4600
Fax: +1 404 572 5100

Washington, D.C.
1700 Pennsylvania Avenue, NW
Washington, D.C. 20006-4707
Tel: +1 202 737 0500
Fax: +1 202 626 3737

www.kslaw.com

whether this advisory committee will include representation or input from outside of the SEC.) Bergers also hinted that the division's areas of focus, reflected by its specialized units, could be tweaked or expanded as the SEC's enforcement priorities evolve.

Eric Bustillo, Director of the SEC's Miami Regional Office, highlighted the successes of the Enforcement Division's cooperation initiative, which was announced in January 2010.[1] He said the SEC has already entered into 51 cooperation agreements with companies or individuals, and that every SEC office has made use of such agreements. He cited in particular the SEC's first corporate non-prosecution agreement with Carter's, Inc. in December 2010,[2] and two subsequent corporate deferred prosecution agreements (with Tenaris S.A. in May 2011 and with Amish Helping Fund in July 2012).[3] Emphasizing the potential benefits of cooperation for individuals, Bustillo specifically cited the SEC's litigation release issued in connection with a March 2012 enforcement action against AXA Rosenberg Group LLC, which provides extensive and unusual detail about why the agency declined to charge a former executive who cooperated.[4]

Enforcement Division Take on Significant Court Decisions

Enforcement Division Chief Counsel Joe Brenner and Chief Litigation Counsel Matthew Martens provided a mostly sanguine view of recent court decisions that could affect the SEC's enforcement program to varying degrees. (The conference preceded the SEC's recent defeat in the Supreme Court on an important statute of limitations issue in *Gabelli v. SEC*.) Brenner said the Supreme Court's 2011 *Janus* decision – which significantly restricted private rights of action under Section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5 against defendants who did not personally create or authorize false or misleading statements – had relatively little effect on the SEC because, unlike private parties, the SEC has a statutory right to charge secondary actors as aiders and abettors or control persons.[5] Brenner emphasized that the SEC does not view such claims as "inferior" or as tools of last resort, adding that the remedies available to the SEC in such cases are essentially identical to those it can obtain against primary violators. He did allow, however, that even though *Janus* dealt with private rights of action and not SEC enforcement cases, the SEC has generally refrained from charging primary liability in cases that would be precluded by the reasoning of *Janus*.

Brenner also pointed to the SEC's litigation success in recent "clawback" cases against CEOs and CFOs under Section 304 of the Sarbanes-Oxley Act of 2002.[6] He noted that the Commission has brought approximately 50 clawback cases so far, approximately 15% of which have been against CEOs or CFOs who were charged with no personal wrongdoing. Brenner confidently observed that the Commission has generally prevailed in court with respect to its controversial interpretations of Section 304, including most notably its view that it need not allege or prove any personal culpability on the part of the CEO or CFO to obtain a clawback.

---

[1] *See* SEC Release No. 2010-6, available at http://www.sec.gov/news/press/2010/2010-6.htm.
[2] *See* SEC Release No. 2010-252, available at http://www.sec.gov/news/press/2010/2010-252.htm.
[3] *See* SEC Release No. 2011-112, available at http://www.sec.gov/news/press/2011/2011-112.htm; SEC Release No. 2012-138, available at http://www.sec.gov/news/press/2012/2012-138.htm.
[4] *See* SEC Release No. LR-22298, available at http://www.sec.gov/litigation/litreleases/2012/lr22298.htm.
[5] *Janus Capital Group, Inc. v. First Derivative Traders*, 131 S.Ct. 2296 (2011).
[6] Sarbanes-Oxley § 304, codified at 15 U.S.C. § 7243.

Martens touted the SEC's overall litigation success rate in 2012, claiming a 23-1 record in contested cases (as compared with the agency's historical success rate of closer to 80%). He expressed confidence that the SEC would ultimately prevail in its Second Circuit appeal from a district court decision in the *Citigroup* case that rejected a settlement with the usual "neither admit nor deny" protection for the defendant, and he said the SEC has not made any determination to rely more on administrative proceedings to avoid potential judicial scrutiny of its settlements.[7] Martens acknowledged mixed results in court concerning the applicability to SEC enforcement of the Supreme Court's 2010 *Morrison* case – which significantly curtailed the extraterritorial reach of the federal securities laws – but noted that Dodd-Frank had largely "fixed" any problems going forward.[8]

Continued Focus on Gatekeepers

Perhaps no word was more often uttered by more conference participants than "gatekeeper." Beginning with Cannellos, and followed by a long line of other Enforcement officials, the staff repeatedly referenced the SEC's focus on corporate gatekeepers, including accountants and lawyers, as key to ensuring a sustainable recovery. Philadelphia Regional Office Director Dan Hawke, who heads the Enforcement Division's Market Abuse specialized unit, also specifically mentioned the securities exchanges and self-regulatory organizations as gatekeepers. New York Regional Director Andrew Calamari later added that one of the key types of cases the SEC is pursuing in the accounting area – in addition to cross-border cases and cases involving valuations of loans and other instruments by banks – are those involving gatekeepers such as auditors and directors. In the asset management space, specialized unit chief Bruce Karpati mentioned the unit's intention to focus on board-level oversight of mutual fund fee arrangements, sub-adviser relationships, asset valuations, and other issues. Unit deputy chief Julie Riewe predicted more focus on fees, marketing practices, and conflicts of interest in the private equity space.

Charles Wright, Counsel to the Chief Accountant of Enforcement, discussed the focus on accountants as corporate gatekeepers, and noted in particular the SEC's interest in accountants who audit foreign companies or subsidiaries whose securities trade in the U.S. markets. Wright observed that there had been much publicity regarding cases involving Chinese companies or subsidiaries, but said that the Commission's focus on accountants was much more wide-ranging. He cited as an example the SEC's December 2012 auditor independence case against the South African affiliate of a Big Four accounting firm, in which the SEC found the firm's independence to be impaired due to the employment, by the firm's consulting practice, of an individual who became a director of one of the firm's audit clients.[9] Without admitting or denying the SEC's charges, the firm agreed, among other things, to pay disgorgement and prejudgment interest of almost $250,000.

Wright also discussed the Commission's January 2012 action against both in-house accountants and two auditors from the British office of another Big Four firm, alleging violations in connection with a three-year fraud that occurred at the UK subsidiary of Symmetry Medical, Inc.[10] Symmetry was alleged to have understated expenses and overstated assets and revenues since at least its December 2004 initial public offering. The Commission charged the company's Finance Director, Controller, and Management Accountant, each of whom agreed to sanctions that

[7] *SEC. v. Citigroup Global Markets Inc.*, 827 F.Supp.2d 328 (S.D.N.Y. 2011).
[8] *Morrison v. National Australia Bank Ltd.*, 130 S.Ct. 2869 (2010).
[9] *See* SEC Release No. 34-68432, available at http://www.sec.gov/litigation/admin/2012/34-68432.pdf.
[10] *See* SEC Release No. 2012-21, available at http://www.sec.gov/news/press/2012/2012-21.htm.

included being permanently barred from appearing or practicing before the Commission as accountants under SEC Rule of Practice 102(e). The two outside auditors agreed to a two-year suspension from practicing before the Commission.

Los Angeles Regional Office Director Michele Layne contended that the Commission must concentrate on gatekeepers because if the SEC tried to focus on generalized "issues" – for example, offering fraud or market manipulation – it would be like trying to "boil water in the ocean." Layne emphasized that the SEC continues to believe that in-house and outside lawyers are key gatekeepers who have the ability to detect and stop fraud in the course of their duties, and that the Commission will bring actions against counsel who fail in that responsibility in appropriate matters.

Layne cited the recent case brought against an in-house counsel at We The People, Inc., a purported charitable organization based in Florida that the Commission alleged operated as a continuous offering fraud.[11] In its complaint, the SEC alleged that the in-house lawyer reviewed We The People's marketing and promotional materials, but failed to conduct reasonable due diligence to ensure that the materials were accurate or to exercise appropriate oversight over the organization's principals. As a result, the Commission charged the in-house counsel with negligence-based offering fraud under Sections 17(a)(2) and (3) of the Securities Act of 1933, as well as participating in the illegal offering of unregistered securities. Layne noted that the in-house attorney had settled with the Commission and was now cooperating with respect to the SEC's prosecution of others involved in the alleged scheme.

Update on Whistleblower Rules

In tandem with scrutinizing gatekeepers, the SEC is also attempting to leverage the wealth of information being provided by corporate whistleblowers. Jane Norberg, Deputy Director of the Office of the Whistleblower, said that in fiscal 2012 the SEC received 3,001 whistleblower tips, which came from all 50 states as well as 49 foreign countries. The most common whistleblower tips related to corporate disclosures, alleged offering fraud, and manipulation. Norberg said that in 2013, the Whistleblower Office will be focusing on continuing to use to the greatest advantage the information and assistance that can be provided by both whistleblowers and their counsel. She stated that the Office responds to all calls that are made to the SEC's whistleblower hotline, and that the Office has a goal of returning calls within 24 hours of receipt.

Norberg also warned that the staff has concerns that employees were being retaliated against because of their provision of information to the Commission, and noted that Section 922 of Dodd-Frank contains a provision explicitly prohibiting any employer from retaliating or discriminating against any employee who provides information to the SEC or otherwise assists in the Commission's investigation.[12] Norberg said that the staff has received reports that certain employers have attempted to persuade employees to "sign away" their right to report securities law violations to the Commission or, if the employees did make such a report, their right to receive a whistleblower award. Norberg expressed a concern that any such agreements would have a "chilling affect" on the employee-reporting encouraged by Dodd-Frank, and reminded the audience that in addition to the statutory anti-retaliation provisions, the

[11] *See* SEC Release No. LR-22608, available at http://www.sec.gov/litigation/litreleases/2013/lr22608.htm.
[12] Dodd-Frank § 922, codified at 15 U.S.C. § 78-u6(h).

Commission had also adopted Rule 21F-17.[13] That rule states that "[n]o person may take any action to impede an individual from communicating directly with the Commission staff about a possible securities law violation, including enforcing, or threatening to enforce, a confidentiality agreement . . .with respect to such communications."

Subject Matter Areas of Focus

In addition to discussing the Commission's processes, initiatives, and focus on gatekeepers and whistleblowers, the staff also provided updates on investigations and prosecutions in cases involving mortgage-backed securities, the Foreign Corrupt Practices Act, insider trading, municipal securities, and subpoena enforcement.

Mortgage-Backed Securities. Structured and New Products Unit Assistant Director Laura Metcalfe lauded the work of the Residential Mortgage-Backed Securities Working Group of the interagency Financial Fraud Enforcement Task Force, which is co-chaired by the SEC's Director of Enforcement, the New York Attorney General, representatives from the Criminal and Civil Divisions of the Department of Justice, and the U.S. Attorney for the District of Colorado. She said that the coordination enabled by the Task Force has strengthened joint enforcement efforts in the mortgage-backed securities area, and discussed in particular the SEC's recent cases brought against two large investment banks.[14]

In those cases, the two firms agreed to pay a combined total of more than $400 million. The SEC alleged that both firms engaged in an undisclosed practice of obtaining cash settlements from mortgage loan originators with respect to problem loans that had been purchased from the originators and then sold by the firms into residential mortgage-backed securities trusts, the securities of which were then sold to investors. The cash settlements were alleged to have been kept by the firms, which allegedly did not pay them into the trusts for the benefit of investors who were actually harmed by the defaulting loans. The Commission further alleged that one of the firms misstated information concerning the delinquency status of mortgage loans that provided the collateral for one offering of residential mortgage-backed securities.

Foreign Corrupt Practices Act ("FCPA"). Kara Brockmeyer, chief of the Enforcement Division's FCPA specialized unit, provided a general overview of the recent FCPA Resource Guide that was jointly published by the SEC and DOJ in November 2012.[15] She explained that the agencies had tried to write the Guide in plain English fashion, so that it could be a reference for both lawyers and non-lawyers. Brockmeyer said that the Guide dispels common FCPA myths by affirmatively stating, for example, that providing coffee or a bottle of wine to a foreign official is generally not problematic under the FCPA. Furthermore, she noted that companies can generally provide appropriate travel to foreign officials, including business class airfare, if that type of travel is provided to the company's own employees.

Brockmeyer also stated that the Guide emphasizes the need for appropriate corporate compliance programs, but noted that compliance programs are not "one size fits all." A company's compliance program should be designed to minimize risks specific to the company's business and should evolve over time. She also stated that the best programs are integrally intertwined with a company's financial controls. She said that she and her colleagues are struck by how

[13] 17 CFR § 240.21F-17.
[14] *See* SEC Release No. 2012-233, available at http://www.sec.gov/news/press/2012/2012-233.htm.
[15] *A Resource Guide to the U.S. Foreign Corrupt Practices Act*, available at http://www.sec.gov/spotlight/fcpa/fcpa-resource-guide.pdf.

often companies discover FCPA violations when investigating employees for financial crimes like embezzlement. These situations typically occur, Brockmeyer added, when companies lose control of their assets and financial books and records.

Brockmeyer also noted that effective compliance programs are a common theme in the anonymous declination examples provided in the Guide. The central themes across examples are that the companies had strong compliance programs, caught the problem that implicated the FCPA, and cooperated with the government in its investigation. Finally, Brockmeyer mentioned three recent litigated FCPA cases: the Nobel case, the Magyar case, and the Siemens case. She added that the SEC is closely watching an Eleventh Circuit FCPA case addressing the scope of the term "instrumentality."[16]

Insider Trading. Senior Associate Director of the New York Regional Office Sanjay Wadhwa – who has been at the forefront of the SEC's well-publicized insider trading cases against former Galleon Group hedge fund manager Raj Rajaratnam and former McKinsey & Company Chairman Rajat Gupta – said that with 175 enforcement actions brought against 425 defendants since October 2009, the SEC staff members involved in the *Galleon* and expert network lines of cases have been "busy." Wadhwa reported that the staff remains focused on possible insider trading at hedge funds, citing cases brought against a former portfolio manager at CR Intrinsic Investors LLC, and the manager of two funds, Tiger Asia Management and Tiger Asia Partners, in November and December of last year.[17]

In *CR Intrinsic*, the Commission alleged that the portfolio manager illegally obtained confidential details about clinical trials being conducted at two pharmaceutical companies from a physician involved in the clinical trials, who also moonlighted as an expert network consultant. The SEC settled a parallel action brought against the physician, who Wadhwa said is now cooperating in the Commission's prosecution of the portfolio manager. In *Tiger Asia*, the SEC alleged that the hedge fund manager used confidential information obtained when purchasing privately placed shares of three Chinese banks to also take short positions in the bank stocks and obtain illegal profits through those positions.

Wadha said that the SEC is aggressively pursuing emergency asset freezes to maintain the status quo in cases of questionable trading. He cited the February 2013 action brought in the Southern District of New York to freeze more than $1.7 million in a Zurich, Switzerland-based trading account, which the Commission alleged to be the proceeds of suspicious trading by unnamed individuals in H.J. Heinz Company securities.[18] In its complaint, the SEC alleged that one day prior to the public announcement that Berkshire Hathaway and 3G Capital had agreed to acquire Heinz for $28 billion, unknown traders purchased out-of-the-money call options in the stock, and then profited the next day when the public announcement of the acquisition sent the share price soaring almost 20 percent.

Municipal Securities. Municipal Securities and Public Pensions Unit chief Elaine Greenberg said that in the area of municipal securities, the Commission is focusing on potential offering fraud by municipal issuers and broker-dealers, tax-driven fraud that can affect the tax deductibility of municipal instruments, public pension accounting, and "pay to play" kickback schemes. Greenberg mentioned, in particular, the SEC's case brought in August 2012 against one

[16] *U.S. v. Esquenazi and Rodriguez*, Crim No. 1:09-CR-21010-JEM.
[17] *See* SEC Release No. 2012-237, available at http://www.sec.gov/news/press/2012/2012-237.htm; SEC Release No. 2012-264, available at http://www.sec.gov/news/press/2012/2012-264.htm.
[18] *See* SEC Release No. 2013-24, available at http://www.sec.gov/news/press/2013/2013-24.htm.

large broker-dealer for allegedly improper sales of asset-backed commercial paper, structured with mortgage-backed securities and collateralized debt obligations, made to municipalities, non-profit institutions, and other customers with conservative investment objectives.[19] The Commission alleged that the broker-dealer's representatives recommending these products relied only on the products' credit ratings, and failed to review the actual private placement memoranda or make other efforts to understand the true nature, risks, and volatility of the products. Without admitting or denying the SEC's allegations, the broker-dealer agreed to pay more than $6.5 million to settle the charges.

Greenberg also cited the SEC's September 2012 case against another firm for "pay to play" violations involving alleged undisclosed in-kind campaign contributions by a firm Vice President located in the Boston office to the then-Massachusetts state treasurer.[20] According to the Commission's settled order, the Vice President performed campaign activities from the firm's offices for the then-treasurer, which constituted valuable in-kind campaign contributions, and the firm thereafter participated in municipal underwritings from which the firm should have been disqualified due to the Vice President's contributions. Without admitting or denying the Commission's allegations, the firm agreed to pay almost $12 million in disgorgement, prejudgment interest, and penalties.

Subpoena Enforcement. Finally, David Bergers, Acting Deputy Director of Enforcement, warned the audience that the staff had experienced problems with companies' compliance with the SEC's subpoenas for documents and information, including the failure to produce documents in electronic format and to timely produce responsive materials, resulting at times in key documents being produced only the day prior to a relevant witness's testimony. Bergers expressed concern that such activities impeded the staff's investigative efforts, and said that the staff has been bringing and will continue to pursue subpoena enforcement actions in court if necessary.

If you would like to discuss any of these issues, or if you have other questions about the SEC or its Enforcement program, please do not hesitate to contact us.

[19] *See* SEC Release No. 2012-155, available at http://www.sec.gov/news/press/2012/2012-155.htm.
[20] *See* SEC Release No. 2012-199, available at http://www.sec.gov/news/press/2012/2012-199.htm.