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SECURITIES ENFORCEMENT 2014 MID-YEAR REVIEW

If you wish to receive more information on the topics covered in this publication, you may contact your regular Shearman & Sterling contact person or any of the following:

New York

Claudius O. Sokenu
+1.212.848.4838
claudius.sokenu@shearman.com

Stuart J. Baskin
+1.212.848.4974
sbaskin@shearman.com

Matthew L. Craner
+1.212.848.5255
matthew.craner@shearman.com

Agnès Dunogué
+1.212.848.5257
agnes.dunogue@shearman.com

Stephen Fishbein
+1.212.848.4424
sfishbein@shearman.com

Jerome S. Fortinsky
+1.212.848.4900
jfortinsky@shearman.com

Joseph J. Frank
+1.212.848.5254
joseph.frank@shearman.com

Adam S. Hakki
+1.212.848.4924
ahakki@shearman.com

Daniel H.R. Laguardia
+1.212.848.4731
daniel.laguardia@shearman.com

Christopher L. LaVigne
+1.212.848.4432
christopher.lavigne@shearman.com

I. Introduction

While not nearly as transformative and dramatic as the first half of 2013 and the early days of Chair Mary Jo White and Director of Enforcement Andrew Ceresney, the first six months of 2014 was just as busy and productive with major court victories and significant and novel enforcement actions. The SEC obtained a long-awaited and favorable decision from the United States Court of Appeals for the Second Circuit in the Citigroup case in which the SEC's "neither-admit-nor-deny" policy had been taken to task by Judge Rakoff in the Southern District of New York. The Commission secured admissions of wrongdoing from high-profile defendants in connection with five settlements. In addition, the Commission entered into its first non-prosecution agreement with an individual defendant and its first enforcement action for retaliation against a whistleblower. More controversially, the Commission continues to have mixed results at trial. Undeterred, the Enforcement Division has indicated that it intends to keep marching forward with its aggressive stance and keep bringing important cases in each of its priority areas. In May 2014, the Enforcement Division announced that SEC-veteran Stephanie Avakian would return as its new Deputy Director, no doubt to have more leaders focused on the implementation of Chair White's aggressive, all-encompassing enforcement agenda.

Contacts (cont.)

John A. Nathanson
+1.212.848.8611
john.nathanson@shearman.com

Washington DC
Mark D. Lanpher
+1.202.508.8120
mark.lanpher@shearman.com

Philip Urofsky
+1.202.508.8060
philip.urofsky@shearman.com

San Francisco
Stephen D. Hibbard
+1.415.616.1174
shibbard@shearman.com

Patrick D. Robbins
+1.415.616.1210
probbins@shearman.com

Hong Kong
Brian G. Burke
+852.2978.8040
brian.burke@shearman.com

Associate Contributors

New York
Juliana Clay
+1.212.848.5152
juliana.clay@shearman.com

SharryAnn Gonzales
+1.212.848.7176
sharryann.gonzales@shearman.com

Stefan Kuuskne
+1.212.848.5153
stefan.kuuskne@shearman.com

Washington, D.C.
Kristen Hutchens
+1.202.508.8157
kristen.hutchens@shearman.com

Kyle Noonan
+1.202.508.8031
kyle.noonan@shearman.com

Martha Sabo
+1.202.508.8166
martha.sabo@shearman.com

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II. Selected Enforcement Division Initiatives & Developments

A. *SEC v. Citigroup*

On June 4, 2014, a unanimous panel of the Second Circuit Court of Appeals overturned US District Judge Jed Rakoff's controversial 2011 ruling, which had rejected a proposed settlement between the SEC and Citigroup Global Markets, Inc., primarily because Citigroup did not admit any of the alleged facts or liability.

[1] The SEC brought the underlying civil injunctive action against Citigroup alleging violations of the Securities Act of 1933 (the "Securities Act") with respect to Citigroup's structuring and marketing of a collateralized debt obligation ("CDO").[2] Shortly thereafter, the parties proposed a settlement that included disgorgement, prejudgment interest, and penalties amounting to $285 million. Judge Rakoff declined to approve the settlement, stating that the proposal was "neither fair, nor reasonable, nor adequate, nor in the public interest," because, given that Citigroup neither admitted nor denied the allegations, the settlement did not provide an evidentiary basis for the court to know whether the relief was justified.[3]

The Second Circuit unanimously held that Judge Rakoff abused his discretion by failing to apply the correct legal standard and failing to accord the SEC's decision to enter into such a settlement the appropriate level of deference. According to the Second Circuit, district courts are not required to evaluate whether a proposed settlement affirmatively serves the public interest, as Judge Rakoff had done. As the panel wrote, "The job of determining whether the proposed [SEC] consent decree best serves the public interest…rests squarely with the [SEC], and its decision merits significant deference." District courts are only to evaluate whether the public interest would be ***disserved*** by a proposed consent decree. Of particular note, the Second Circuit held that it was an abuse of discretion to insist that the district court needed to know the "truth" of the allegations prior to approving the settlement. Similarly, the panel stated in no uncertain terms that "There is no basis in the law for [a] district court to require an admission of liability as a condition for approving a settlement between the parties."[4]

The Second Circuit's decision is a vindication of the SEC's long standing practice of entering into settlements without requiring that settling parties admit liability. Nevertheless, the policy implications of Judge Rakoff's 2011 decision will continue to reverberate for years to come. Indeed, as we have previously discussed, in the three years since Judge Rakoff's 2011 decision, the SEC has fundamentally changed its approach to settlements, including by demanding admissions in certain cases. Indeed, Ceresney, speaking at a DC Bar event shortly after the

Second Circuit's decision, made clear that the SEC's new policy of seeking admissions in appropriate cases while also permitting certain defendants to settle on a neither-admit-nor-deny basis would continue.[5]

B. Admissions of Liability in Settled Cases

According to the SEC, through the first half of 2014, the Commission had settled eight cases where the defendant admitted liability, five of which were announced in the first half of 2014. The Commission notes that there are more settlements with admissions "in the pipeline."[6] One can only hope that these upcoming settlements will shed more light on the factors that the Commission considers when deciding which cases merit admission of liability because so far there does not appear to be a clearly recognizable policy governing such decisions.

In January 2014, the SEC filed settled administrative proceedings against Scottrade, a privately-owned discount retail brokerage firm headquartered in Missouri.[7] Scottrade was charged with failing to provide the SEC with complete and accurate "blue sheet" data concerning trades executed by Scottrade and its customers, in violation of Section 17(a) of the Securities Exchange Act of 1934 (the "Exchange Act") and Rules 17a-4(j), 17a-25, and 17a-4(f)(3)(v) promulgated thereunder.[8] Scottrade settled the SEC's charges by admitting to inadvertently providing the SEC with inaccurate and incomplete trading data on 1,231 occasions between 2006 and 2012 and paying a civil penalty of $2.5 million. According to the SEC's order, Scottrade has since resolved the deficient computer code responsible for the inaccurate and incomplete reporting.[9]

In February 2014, the SEC filed settled administrative proceedings against a major financial institution. The SEC charged the institution with violations of Section 15(a) of the Exchange Act and Section 203(a) of the Investment Advisers Act of 1940 because it provided brokerage and investment advisory services to US clients, both in person and through e-mails and phone calls, without registering with the SEC.[10] According to the SEC's order, the institution sent relationship managers from Europe to the United States on a number of occasions over several years to provide investment advice to thousands of existing and prospective clients.[11] In connection with the settlement, the institution admitted to the alleged facts and acknowledged that its conduct violated the federal securities laws, agreed to pay a fine of $196 million, and agreed to the issuance of a cease and desist order imposing remedial undertakings.[12]

On March 13, 2014, the SEC filed settled administrative proceedings against Lions Gate Entertainment Corp. ("Lions Gate") alleging that Lions Gate misled investors about the nature of a set of transactions designed to thwart a hostile takeover bid.[13] Lions Gate agreed to the imposition of a cease and desist order and a civil penalty of $7.5 million, and admitted to violating Sections 13(a) and 14(d) of the Exchange Act and Rules 12b-20, 13a-11, and 14d-9 promulgated thereunder.[14] More specifically, Lions Gate admitted that it had falsely characterized a particular series of transactions in its public disclosures in an effort to reduce the company's debt when in fact the transactions were devised to enlist a management friendly director, who would vote against a takeover bid.

In a rare case of an admission by an individual defendant, the SEC, on March 20, 2014, settled its long-standing case against Michael French, former attorney for Samuel and Charles Wyly (who, as discussed below, were French's co-defendants and who subsequently lost at trial against the SEC).[15] The SEC sued French, the Wyly brothers, and other defendants for their alleged roles in a $550 million scheme to conceal stock sales in companies in which the Wylys had an interest.[16] French agreed to disgorge $400,000 and pay prejudgment interest in the amount of $394,608, admitted to assisting the Wylys in setting up and managing offshore trusts in the 1990s that were used to

hide assets, and admitted to participating in hiding those trusts from US authorities.[17] Significantly, French also agreed to cooperate with the SEC in its pending trial against the Wyly brothers, which he did. Thus, this settlement can be viewed as an example of part of the Commission's new admission program and as part of the SEC's cooperation program. As discussed further below, "flipping" French and obtaining admissions from him was a significant success for the SEC, and no doubt contributed to the Commission's subsequent trial win.

Finally, on April 2, 2014, the SEC secured what it has characterized as admissions from two Brazilian brothers who the SEC accused of insider trading in ***SEC v. Certain Unknown Traders in the Securities of H.J. Heinz Co.*** In late 2013, the SEC filed proposed consent judgments in the United States District Court for the Southern District of New York in an insider trading case pending before Judge Rakoff. Judge Rakoff refused to sign off on the settlement because the proposed orders contained the neither-admit-nor-deny language.[18] The parties refiled the proposed judgments a few weeks later with a new clause to clarify that the removal of the neither-admit-nor-deny language from the orders should not be construed as an admission. Again, Judge Rakoff refused to sign off on the proposed orders and instead gave the parties three options: (i) removing the new clause from the revised proposed consent judgments; (ii) having the settling parties admit to the allegations for the limited purpose of the proceedings at hand; or (iii) having an evidentiary hearing.[19] Ultimately, on April 2, 2014, after the SEC submitted evidence purportedly supporting its claims, Judge Rakoff signed off on the settlement without the neither-admit-nor-deny language.[20] Presumably, after the SEC's appellate victory in the ***Citigroup*** appeal, such a situation is unlikely to be repeated.

As we previously highlighted, the Enforcement Division staff has provided little, if any, meaningful guidance as to when it will insist that a settling party admit to the government's factual allegations. And the five cases in which admissions were sought (and received) so far this year do not provide any further insights as to why those cases were singled out for special treatment. With respect to the Scottrade settlement, the SEC's public comments appear to suggest that an admission of wrongdoing was warranted because the inadvertent error was long running, egregious (even though there was no scienter), and impacted data reporting over several years. Such systemic lapses affecting a key function of the SEC (data collection and reporting) apparently merited the stiffest of penalty and resolution the SEC has in its arsenal. As for the ***Lions Gate*** settlement, public comments suggest an admission was required mostly in an effort to send a signal to the markets. For example, in March 2014, Ceresney explained that "Lions Gate withheld material information just as its shareholders were faced with a critical decision about the future of the company. Full and fair disclosure is crucial in tender offers given that shareholders rely heavily on corporate insiders to make informed decisions, especially in the midst of tender offer battles." A few months later, he stated that the admissions sent "an important message to the market about the perils of misleading investors in the midst of a tender offer battle."[21] And with respect to the settlement with the European financial institution, SEC statements suggest an admission was required due to the fact the misconduct occurred over several years and repeatedly, and also because an admission would signal to market participants the failure to identify material weaknesses in internal controls will not be tolerated (something, of course, the SEC has signaled before).[22]

In any event, with or without such guidance, the SEC will clearly continue to seek admissions from certain defendants in future cases. Indeed, Ceresney recently explained that, once the Enforcement Division has determined that a given case is appropriate for the new admissions policy, that decision is non-negotiable.[23] In other words, the SEC will not agree to forego an admission in lieu of additional monetary penalties or remedial

measures. We expect to see this policy develop in the coming months, and we will continue to monitor how the Commission administers its policy of seeking admissions of liability in the appropriate cases.

C. SEC Enters into First Individual Non-Prosecution Agreement

The Enforcement Division has a relatively recent program (launched in 2010) that over the last few years has developed and implemented a series of measures designed to encourage greater cooperation by individuals and companies in SEC investigations and enforcement actions.[24] When the program was announced, Robert Khuzami (then Director of the Enforcement Division) stated that, "There is no substitute for the insiders' view into fraud and misconduct that only cooperating witnesses can provide. That type of evidence can expand our ability to conduct our investigations more swiftly, and to act quickly to file charges, freeze assets, and protect investors."[25] As part of this program, the SEC has entered into a number of cooperation agreements, deferred prosecution agreements, and non-prosecution agreements.

On April 25, 2014, the SEC announced its first non-prosecution agreement with an individual, a further step in the Enforcement Division's development of the cooperation program it first announced in January 2010. Like the SEC's November 2013 announcement of its first deferred prosecution agreement with an individual (Scott Herckis), this is another signal that the SEC is pushing hard, in the pre-litigation phase of its investigations, to encourage cooperation.[26] In both cases, the SEC lauded the individual's early and exemplary cooperation as the basis for entering into the agreement. But unlike the 2013 announcement, in this case the SEC did not disclose the individual's name or any further details about the agreement itself. The SEC reported only that the individual "provided early, extraordinary, and unconditional cooperation" in connection with the *Saridakis* insider trading case, which is discussed in greater detail below.[27] Unlike Scott Herckis, this individual apparently was not required to admit to any facts or wrongdoing. Indeed, it is somewhat unclear how this non-prosecution agreement differs from a simple declination. However, because the related Saridakis investigation is ongoing and could result in further litigation, we may learn more if the individual is called upon for further cooperation in a public setting.

D. SEC Enters into Fourth Corporate Deferred Prosecution Agreement

On June 25, 2014, the SEC announced a deferred prosecution agreement with Regions Financial Corporation ("Regions") and the institution of administrative proceedings against three former Regions managers, namely Thomas A. Neely Jr. (Head of Risk Analytics Groups), Jeffrey C. Kuehr (Head of Special Assets), and Michael J. Willoughby (Chief Credit Officer).

Since 2010, the SEC has entered into, and announced, only three other corporate deferred prosecution agreements. According to the SEC, the three managers allegedly took steps beginning in March 2009 to circumvent internal accounting controls and misclassify "$168 million in commercial loans as performing so Regions could avoid recording a higher allowance for loan and lease losses."[28] The SEC continues to litigate against Neely, who is charged with violations of the antifraud, reporting, books and records, and internal controls provisions of the federal securities laws. The SEC, however, has settled its allegations against Kuehr and Willoughby. Without admitting or denying liability, Kuehr and Willoughby consented to the entry of a cease-and-desist order finding that they violated or caused violations of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, in addition to the reporting, books and records, and internal controls provisions of the

federal securities laws. Kuehr and Willoughby agreed to each pay a $70,000 civil penalty, and to be barred from serving as an officer or director of a public company for a period of five years.

According to Director Ceresney, Regions demonstrated "extraordinary cooperation and remediation," including the "creation of a new problem asset division with entirely new management and significantly enhanced procedures." The two-year, deferred prosecution agreement requires Regions to cooperate fully and truthfully in the SEC's investigation and related enforcement proceedings, to pay a $26 million civil penalty, to refrain from violating Section 17(a) of the Securities Act and Sections 10(b), 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rules 10b-5, 12b-20, 13a-11, and 13a-13 thereunder, and to periodically certify compliance with the terms of the deferred prosecution agreement. The $26 million penalty will be offset by a $46 million penalty that Regions will pay to the Federal Reserve Board. Regions also agreed to pay a $5 million penalty to the Alabama State Banking Department. In light of the fact that the case against Neely remains pending, it is possible that the public may learn more about the details of Regions' cooperation.

E. The SEC's Renewed Focus on Section 20(b)

In ***Janus Capital Group, Inc. v. First Derivative Traders***, 131 S. Ct. 2296 (2011), the US Supreme Court held that only the maker of a statement may be liable for a fraudulent statement under Section 10(b) of the Exchange Act and that a maker is the person or entity with "ultimate authority" over that statement, yet left open the possibility of liability under Section 20(b)—which establishes liability for defendants who, directly or indirectly, do anything "by means of any other person" that would be unlawful for that person to do on his or her own. On February 21, 2014, Joseph Brenner, the Enforcement Division's Chief Counsel, stated that, following ***Janus***, the SEC had been thinking a great deal about the potential of bringing claims under Section 20(b) of the Exchange Act.[29] And in May 2014, Chair White said that the Commission is focusing on Section 20(b) charges where—as is frequently the case in microcap and other frauds—individuals have engaged in unlawful activity but attempted to insulate themselves from liability by avoiding direct communication with the defrauded investors."[30] If the SEC files an enforcement action under 20(b) this year (which Brenner indicated would happen), there no doubt will be considerable interest in that proceeding, particularly because there is little discussion by the federal courts about the scope of liability under Section 20(b) in SEC enforcement cases.[31]

F. Continued Use of Technology and Data Analytics to Police the Financial Markets

2014 has already seen the SEC continue its push for improved technology to keep up with the complexities of the financial markets. For example, in January 2014, the Enforcement Division announced the rollout of a new program designed to identify fraudulent behavior by analyzing huge amounts of trading data.[32] The program, known as NEAT (National Exam Analytics Tool), was developed by the Quantitative Analytics Unit in the Enforcement Division's National Exam Program. According to Chair White, the program recently analyzed, in 36 hours, 17 million transactions executed by a single investment advisor.[33] The SEC indicated that it will use NEAT to search for evidence of insider trading, for instance, by analyzing how registered traders behaved at the time of significant corporate events such as mergers.[34] The SEC also hopes to use NEAT to identify other types of misconduct, including front running (***i.e.***, entering into a trade with advance knowledge of a client's block transaction that will influence the price of the underlying security) and "window dressing" (***i.e.***, trading activity near the end of a reporting period that is designed to improve the appearance of a portfolio).[35] As of, the end of June 2014, SEC has yet to issue a press release announcing any enforcement actions in which the underlying misconduct

was discovered through use of NEAT, and it remains to be seen how the new tool will be employed. But it is a clear indication of the SEC's embrace of "big data" and related technology.

G. Cybersecurity Roundtable & Focus

On March 26, 2014, the SEC held a roundtable to address cybersecurity issues relevant to market participants and public companies.[36] The roundtable was attended by Chair White, all four SEC Commissioners, and senior SEC staff, as well as representatives from such entities as the National Security Council of the White House, the Department of Homeland Security, the Department of the Treasury, the Financial Industry Regulatory Authority ("FINRA"), Bank of America/Merrill Lynch, and PricewaterhouseCoopers LLP. The panelists' discussion focused on the current cybersecurity landscape, cybersecurity disclosure issues faced by public companies, cybersecurity issues in market systems, and cybersecurity issues faced by broker-dealers, investment advisers, and transfer agents.[37] While no one from the Enforcement Division was on the panel, we expect that the Enforcement Division will pursue an increasing number of investigations in the coming months related to alleged violations of cybersecurity-related rules and regulations (*e.g.*, Regulation S-P (17 C.F.R. § 248.30(a)).

Consistent with the theme of the roundtable, one month later, on April 15, 2014, the SEC's Office of Compliance Inspections and Examinations ("OCIE") released a risk alert announcing that the SEC will be examining 50 registered broker-dealers and investment advisers to assess their cybersecurity preparedness.[38] According to OCIE, the examinations will focus on "cybersecurity governance, identification and assessment of cybersecurity risks, protection of networks and information, risks associated with remote customer access and funds transfer requests, risks associated with vendors and other third parties, detection of unauthorized activity, and experiences with certain cybersecurity threats."[39] As with all OCIE sweep examinations, this one will heighten the risk of enforcement in the area.

H. Update on Task Forces Launched in 2013

In addition to revising the admissions policy last year, the SEC launched three new task forces, specifically the Financial Reporting and Audit Task Force, the Broker-Dealer Task Force, and the Microcap Fraud Task Force. While few developments were publicly reported in the first six months of 2014, all indications are that these task forces remain a priority for the SEC.

1. Financial Reporting and Audit Task Force

In July 2013, the SEC announced the creation of the Financial Reporting and Audit Task Force ("FRATF") and explained that the SEC-wide team of attorneys and accountants "will focus on identifying and exploring areas susceptible to fraudulent financial reporting, including on-going review of financial statement restatements and revisions, analysis of performance trends by industry, and use of technology-based tools such as the Accounting Quality Model."[40] Since then, Director of the Fort Worth Regional Office and FRATF Chair David Woodcock has reported that, with approximately 14 task force members, the FRATF has been working the last several months with a number of divisions and units within the SEC (such as the Division of Economics and Risk Analysis), as well as with the Public Company Accounting Oversight Board and various foreign counterparts to obtain a "deep understanding" of the current state of financial reporting fraud (*i.e.*, how and where financial reporting fraud happens), and to develop a state-of-the-art methodology for identifying and investigating financial fraud.[41] To date, there is little (public) evidence of enforcement cases being filed specifically due to the FRATF's efforts,[42] but

according to Woodcock, the FRATF is focusing on specific industries and accounting issues that are prevalent in those industries, as well as auditors who do not fulfill their gatekeeping role.[43] Woodcock has declined to identify those industries and issues by name, though has specifically noted that revenue recognition is always an issue. The FRATF will be referring cases to investigation teams for further review.[44]

2. *Broker-Dealer Task Force*

In December 2013, the Enforcement Division announced a new task force focused on current issues and practices within the broker-dealer community. At that time, the SEC stated the task force would be developing "national initiatives for potential investigations," and "will coordinate these broker-dealer related initiatives across the [Commission], and centralize information and expertise regarding ongoing investigations and examinations, industry practices and trends, to generate quality referrals and investigations".[45] Midway through 2014, the task force's work appears to remain in its early stages. However, Ceresney reported in May 2014 that, "The group is liaising closely with the broker-dealer program within OCIE [Office of Compliance Inspections and Examinations], as well as the Division of Trading and Markets, to develop initiatives that can be implemented division-wide. Their early efforts include initiatives relating to anti-money laundering regulations and recidivist brokerage firms that shelter rogue brokers and engage in abusive activities."[46] SEC Commissioner Daniel Gallagher also reported that the task force "will coordinate with OCIE and FINRA to target misconduct by 'rogue' registered representatives with prior disciplinary histories or customer complaints."[47]

3. *Microcap Fraud Task Force*

Finally, the SEC launched the Microcap Fraud Task Force ("MFTF") in July 2013 to target fraud in the over-the-counter market for "microcap" securities—*i.e.*, those securities that are too thinly traded and too low-valued to be listed on national exchanges.[48] The MFTF is focusing its investigative efforts on gatekeepers (*e.g.*, attorneys, auditors, transfer agents, broker-dealers, and shell purveyors), and its work is already evident.[49] For instance, in February 2014, the SEC suspended trading in 255 companies that the SEC believed could be vehicles for pump-and-dump stock manipulation.[50] In March 2014, the SEC announced fraud charges and an emergency asset freeze against a promoter behind a platform of promotional websites for microcap stocks.[51]

I. Update on the SEC's Whistleblower Program

In 2012, the SEC created its Office of the Whistleblower to reward individuals who report certain securities law violations with anywhere between 10% and 30% of the funds collected.[52] In the first six months of 2014, awards were issued to two more whistleblowers, bringing the total number of awards to date to six. Specifically, in June 2014, the SEC announced that two whistleblowers were each awarded an equal share of $875,000, an amount that reflected 15% of the amount the SEC collected due to their tips.[53] Because the whistleblowers' identities were protected, no further details were available about the nature of the tips provided or the violations exposed.[54] In addition, in April 2014, the SEC awarded an additional $150,000 to a whistleblower previously awarded $50,000 for identifying a multimillion dollar fraud.[55] The payout came because the SEC was able to collect an additional $500,000 from a defendant in the case, and the whistleblower (who chose to remain anonymous) has now received 30% of the total amount collected by the SEC.[56]

In addition, the SEC brought its first anti-retaliation enforcement action. Specifically, on June 16, 2014, the SEC filed a settled administrative proceeding against a hedge fund advisory firm, Paradigm Capital Management, Inc.

("Paradigm"), and its chief investment officer, Candace King Weir. The SEC accused Paradigm of retaliating against its former head trader for reporting certain transactions to the SEC that violated Section 206(3) of the Investment Advisers Act of 1940 (which prohibits an investment adviser from acting as principal for the adviser's account) and Section 207 of the Advisers Act (which makes it unlawful for material facts to be willfully omitted from a registration application filed under the Advisers Act). Such retaliation was, according to the SEC, in violation of Section 21F(h) of the Exchange Act (which prohibits an employer from discharging, demoting, suspending, threatening, harassing, directly or indirectly, or in any other manner discriminating against, a whistleblower in the terms and conditions of employment because of any lawful act done by the whistleblower in, among other things, providing information to the SEC). The SEC further alleged that Weir caused Paradigm's violations of Section 206(3) of the Advisers Act. Without admitting or denying the allegations, Paradigm and Weir agreed to cease and desist from future violations and to jointly and severally pay disgorgement of $1.7 million, prejudgment interest of $181,771, and a penalty of $300,000. In addition, Paradigm agreed to retain an independent compliance consultant to conduct a comprehensive review of Paradigm's supervisory, compliance, and other policies and procedures designed to prevent and detect prohibited principal transactions.[57]

J. Enforcement Cooperation Initiative for Municipal Issuers and Underwriters

The Enforcement Division announced in March 2014 the Municipalities Continuing Disclosure Cooperation ("MCDC") Initiative in an effort to encourage municipal issuers and underwriters to self-report violations of certain securities laws.[58] Under the MCDC Initiative, such issuers and underwriters have until September 10, 2014 to self-report certain types of inaccurate statements to the SEC in exchange for "favorable settlement terms".[59] Notably, the offer applies to a fairly narrow category of misconduct, specifically inaccuracies concerning prior compliance with the continuing disclosure obligations specified for municipal issuers in Rule 15c2-12 under the Exchange Act.[60] Also of note is that the MCDC Initiative does not extend to individuals involved in these transactions, ***i.e.***, municipal officers or employees who signed the official statements or certified the issuer's disclosures. In structuring the MCDC Initiative this way, the SEC created an incentive (which will encourage municipal issuers and underwriters to self-report) and a means for gathering the information necessary for the SEC to pursue cases against personally culpable municipal officers and employees. We will continue to watch this initiative and report on any new developments.[61]

III. Selected Significant Judicial Developments

During first half of 2014, there have been a number of important judicial developments potentially impacting the work of the Enforcement Division.

A. Supreme Court Update

On February 26, 2014, the United States Supreme Court decided ***Chadbourne & Parke LLP v. Troice*** (2014), an important decision that impacts the work of the SEC. On the heels of ***Chadbourne & Parke LLP v. Troice***, the Supreme Court on June 23, 2014, decided ***Halliburton Co. v. Erica P. John Fund, Inc.***, 134 S. Ct. 2398 (2014), a decision that, while significant to civil class actions, will likely have limited impact on the Commission's enforcement program given its narrow reasoning.[62]

1. Chadbourne & Parke LLP v. Troice

In ***Chadbourne & Parke LLP v. Troice***, the Supreme Court allowed state law claims to proceed against accused participants in a Ponzi scheme and rejected the defendants' argument that the state law claims were preempted by the Securities Litigation Uniform Standards Act of 1998 ("SLUSA").[63] SLUSA bars state law class actions that allege fraud "in connection with" the purchase or sale of a "covered security," ***i.e.***, as relevant here, securities traded on a US exchange. At issue in ***Troice*** was whether plaintiffs had purchased "covered securities" under SLUSA, when they had purchased uncovered securities (certificates of deposit) that the fraudsters falsely represented were backed by covered securities. In a 7-2 opinion delivered by Justice Stephen Breyer, the Supreme Court concluded that the fraudsters' misrepresentation that the uncovered securities were backed by covered securities was too remote to satisfy the "in connection with" requirement under SLUSA. The "in connection with" requirement of SLUSA, the Court held, requires "a connection that matters," meaning a connection that "makes a significant difference" to someone's (other than the fraudster's) decision to purchase or sell a covered security.[64] Because the plaintiffs alleged, at most, misrepresentations about the fraudsters' ownership of covered securities, plaintiffs did not purchase or sell a covered security and therefore SLUSA does not bar the plaintiffs' state law claims. The Supreme Court's narrow reading of the "in connection with" requirement in ***Troice*** may impact the SEC's enforcement powers, because the same "in connection with" language appears in Section 10(b) of the Exchange Act, a key tool for the Enforcement Division. The majority dismissed this concern, however, by pointing out that the SEC's reach under Section 10(b) extends to a much broader range of "securities" beyond those traded on US exchanges.[65]

In dissent, Justice Anthony Kennedy (joined by Justice Samuel Alito) warned that the majority's narrow interpretation of SLUSA "will inhibit the SEC and litigants from using federal laws to police frauds and abuses that undermine confidence in the national securities markets" and will subject many securities investment advisors and their associates "to complex and costly state-law litigation based on allegations of aiding or participating in transactions that are in fact regulated by the federal securities laws".[66] If Justice Kennedy's warning plays out, then investment advisors and associated persons and entities can expect to defend an increasing number of state-law class action suits.

2. Halliburton Co. v. Erica P. John Fund, Inc.

On June 23, 2014, the Supreme Court decided ***Halliburton Co. v. Erica P. John Fund, Inc.*** ("***Halliburton II***"), a decision that, although highly anticipated for its potential to influence securities class action litigation, will likely have minimal impact on SEC enforcement.

In ***Halliburton II***, the Supreme Court was asked to revisit its 1988 holding in ***Basic Inc. v. Levinson***[67] that a private securities fraud class action suit can proceed based on a "fraud-on-the-market" reliance theory. This theory created a rebuttable presumption that any material public misrepresentation affects the price of a publicly traded stock; under ***Basic***, securities class action plaintiffs have been able to proceed past the class certification stage without showing that they individually relied on alleged public misrepresentations. In addition, the Supreme Court was asked to decide "[w]hether, in a case where the plaintiff invokes the presumption of reliance to seek class certification, the defendant may rebut the presumption and prevent class certification by introducing evidence that the alleged misrepresentations did not distort the market price of its stock." Notably, a group of former SEC officials submitted an amicus brief with the Court arguing that actual individual reliance on a misrepresentation should be required to bring such actions.[68]

The Court rejected Halliburton's numerous arguments for why ***Basic*** should be overruled, stating that Halliburton had not shown a "special justification," ***Dickerson v. United States*** (530 US 428, 433 (2000)), for overruling ***Basic's*** presumption of reliance. The Court, however, determined that ***Basic***'s fraud-on-the-market presumption could be rebutted "in a number of ways, including by showing that the alleged misrepresentation did not actually affect the stock's price—that is, that the misrepresentation had no 'price impact'." The Court further stated that "***Basic*** recognized that market efficiency is a matter of degree and accordingly made it a matter of proof." ***Basic*** thus "affords defendants an opportunity to rebut the presumption by showing, among other things, that the particular misrepresentation at issue did not affect the stock's market price."

The ***Halliburton II*** decision continues to allow plaintiffs to meet their burden in establishing the fraud-on-the-market presumption through indirect methods and to rely on tests set forth in ***Cammer v. Bloom***[69] and ***Krogman v. Sterritt***[70] (which address whether market efficiency sufficient to invoke the fraud-on-the-market presumption has been shown) to bring their motions for certification. ***Halliburton II*** also makes clear that defendants can rebut that presumption by focusing on the impact of specific, alleged misrepresentations rather than merely challenging the efficiency of the market for the securities more broadly.[71] How that impact (if any) is to be analyzed is unclear. The Court clearly endorses the use of event studies.[72]

Halliburton II also raises new issues. The Court rejected an all-or-nothing view of efficiency in favor of more situational analysis.[73] This more rigorous approach may well affect the adjudication of other aspects of securities litigation—such as loss causation and the truth-in-the-market defense. Furthermore, the Court expressly noted that even material information disclosed in an efficient market might not affect a security's price,[74] and the Court reasoned that even investors who believe that information is not properly reflected in a security's price when they invest in the security (such as so-called value investors) can be entitled to the presumption because they implicitly believe that the information will be fully incorporated at some point in the future.[75] The added uncertainty created by such acknowledgments will raise issues that will be addressed again and at length in future class certification litigation. In any event, had the Court overruled ***Basic***, the SEC may well have felt pressure to account for any new hurdles to private plaintiffs vindicating their own interests. But there is little reason to think the decision will meaningfully impact SEC enforcement practices. For a fuller discussion of ***Halliburton II*** and its implications for securities class action litigation, please see our publication titled ***Supreme Court Preserves "Fraud-on-the-Market" and Validates Use of "Price Impact" Defense Against Class Certification in Securities Class Actions.***[76]

B. Courts of Appeals Update

1. *SEC v. Contorinis*

In ***SEC v. Contorinis***,[77] a divided panel of the Second Circuit embraced an expansive and controversial theory of disgorgement, which will help the SEC pursue large awards beyond the amount of proceeds received personally by defendants, effectively rendering the SEC's disgorgement power more punitive than remedial. Defendant Joseph Contorinis was a managing director at Jeffries & Company, Inc. who allegedly traded stock in the supermarket chain Albertson's, Inc. based on inside information he had received regarding Albertson's acquisition. These trades primarily benefited Jeffries, not Contorinis personally. In a parallel criminal case against Contorinis, the Second Circuit ordered that only Contorinis' personal profit of approximately $400,000 could be forfeited.[78] In the corresponding civil case brought by the SEC, however, the SEC sought and the district court ordered disgorgement

of $7.2 million, the amount obtained by Jeffries' Paragon Fund—and not just Contorinis personally—as a result of the trades.[79]

On appeal, Contorinis argued that the order was a misapplication of the disgorgement principle, because Contorinis did not personally enjoy the profit that accrued to the Jeffries fund. The Second Circuit disagreed. The Court acknowledged first that civil disgorgement is a discretionary and equitable remedy intended to deprive securities law violators "of the fruits of their illegal conduct,"[80] but further explained that in the tipper-tippee context the Court has long required disgorgement of the "benefit that accrues to third parties whose gains can be attributed to the wrongdoer's conduct" in addition to the unlawful gains that accrue directly to the wrongdoer.[81] A potential tipper can thus be forced to disgorge profits regardless of whether he trades on the information himself and passes along the profit to a beneficiary or passes information to a beneficiary who then receives the profits. In this instance, the Second Circuit concluded that disgorgement was particularly appropriate because Contorinis, though not a tipper, controlled the trades and thus was positioned to know the potential risk of his wrongdoing.[82]

Judge Denny Chin's strong dissent highlighted, however, that disgorgement "should have the effect of returning a defendant to his status quo prior to the wrongdoing," and not of punishing the defendant by requiring him to disgorge funds he never had or to return profits he never received.[83] Judge Chin argued that, because disgorgement is remedial rather than punitive in nature, the majority acted improperly in ordering Contorinis to disgorge more than the amount of money he acquired through wrongdoing.[84]

Contorinis is significant not only for its impact on insider trading defendants but also for its potential far-reaching application to any securities fraud scheme, because the Second Circuit's conclusions were not strictly limited to insider trading cases. Logically, Contorinis could potentially be applied, for example, to require corporate officers to disgorge the full profits received by their company as a result of accounting fraud or for a Ponzi-scheme defendant to disgorge fund stolen by his co-defendants.[85] We will be closely monitoring the repercussions of this decision.

2. SEC v. Shields

As in ***Contorinis***, on February 24, 2014, the Tenth Circuit Court of Appeals vindicated the SEC's position in ***SEC v. Shields***. In ***Shields***, the Tenth Circuit took a broad approach to the definition of "securities" for purposes of the federal securities laws, emphasizing the substance of a particular arrangement over its label.[86] At issue in ***Shields*** was whether investments sold under the label of a "general partnership" were in fact "investment contracts" and thus "securities" subject to federal securities regulation. In making this determination, the Tenth Circuit stated the focus should be on "economic realities underlying a transaction and not on the name appended thereto."[87] Although an interest in a general partnership is presumed not to be a security, the Tenth Circuit held that this presumption could be rebutted by evidence that the general partners were effectively incapable of exercising their partnership powers.[88] In this case, the Tenth Circuit concluded that the SEC successfully rebutted the presumption by raising factual issues to support the conclusion that investors here lacked the type of control and access to information usually afforded to general partners.[89]

3. United States v. Esquenazi

On May 16, 2014, the Eleventh Circuit issued a decision that serves as an important development in FCPA cases involving "government instrumentality" or the definition of who qualifies as a "foreign official" for the purposes of the FCPA.[90] In ***United States v. Esquenazi***, Joel Esquenazi and Carlos Rodriguez were appealing from conspiracy,

FCPA, wire fraud, and money laundering convictions for bribing officials at the state-owned Telecommunications D'Haiti, S.A.M. ("Teleco"), which provides telecommunications services in Haiti, between 2001 and 2005.[91] Esquenazi and Rodriguez argued that the bribed officials were not "foreign officials" under the FCPA because Teleco was not part of a foreign government but rather a commercial enterprise, which could not qualify as an "instrumentality" of a foreign government.

Rejecting Esquenazi's and Rodriguez's arguments, the Eleventh Circuit instead embraced its own broad definition of "government instrumentality" by defining it as (1) an entity controlled by the government of a foreign country that (2) performs a function the controlling government treats as its own.[92] The Eleventh Circuit further listed a non-exhaustive set of factors to consider in assessing the "control" and "function" elements.[93] Following its newly adopted definition, the Eleventh Circuit affirmed the convictions and determined that Teleco was indeed an instrumentality of the Haitian government, being controlled by the Haitian government and performing a function that Haiti treated as its own.[94]

While not necessarily settling the debate, this decision will make it harder for defendants to argue that the concept of "instrumentality" remains undefined in future in FCPA cases. Moreover, in light of ***Esquenazi***, the SEC no doubt will alter its approach to investigations and enforcement actions in "instrumentality" cases. For instance, the SEC most likely will seek to collect additional, detailed information during the investigation stage about the nature and operations of the alleged instrumentality, and such information probably will be included in the SEC's pleadings. In addition, the SEC probably will focus even more on engaging experts who can opine on "whether the public or the government of that foreign country" perceives the alleged instrumentality to serve a government function.

C. District Court Update

1. *Chau v. SEC*

The SEC is facing another challenge to its administrative authority in a lawsuit filed by Wing Chau, a money manager named in Michael Lewis' popular book, ***The Big Short***.[95] On March 18, 2014, Chau filed a lawsuit in the Southern District of New York claiming the SEC is violating his constitutional rights by initiating an administrative proceeding against Chau and his firm Harding Advisory LLC for allegedly defrauding investors. Chau alleges in the complaint that he is being "singled out for disparate treatment"[96] by being forced to respond to charges in an administrative proceeding that would deny his right to a jury trial, use of certain discovery procedures such as depositions, and procedural protections available to defendants in federal court. Chau is seeking to permanently enjoin the SEC's administrative proceeding.[97]

The ***Chau*** case is similar to a case filed by Rajat Gupta, a former Goldman Sachs director, against the SEC in 2011. Like Chau, Gupta challenged the SEC's decision to bring administrative charges against him for alleged insider trading rather than proceed in a federal district court. The SEC moved to dismiss Gupta's case on jurisdictional and other grounds, but Judge Rakoff of the Southern District of New York ruled that Gupta's case could continue.[98] The SEC dropped its administrative charges against Gupta shortly thereafter,[99] which may have encouraged administrative defendants such as Chau to similarly challenge the SEC's forum selection.

On May 12, 2014, the SEC sought dismissal of Chau's complaint on jurisdictional grounds.[100] The Southern District of New York's decision remains pending and, if favorable to Chau, could send a strong signal to the SEC that its forum decisions are now open to greater scrutiny. Of note, the United States District Court for the District of

Columbia recently dismissed similar allegations filed by a defendant in an SEC administrative proceeding, finding it lacked subject matter jurisdiction over the plaintiff's claims.[101]

2. *SEC v. Graham*

On January 30, 2013, the SEC filed claims in the United States District Court for the Southern District of Florida against five defendants (all of whom were executives or directors at a Florida-based real estate development company), alleging that they violated the registration and antifraud provisions of the federal securities laws. In short, after a seven-year investigation, the SEC accused the defendants of having engaged in a classic Ponzi scheme in which they promised wealth-creating returns to individuals who purchased condominium units. In response, the defendants asserted that the five-year statute of limitations set forth in 28 U.S.C. § 2462 barred the SEC's claims against the defendants for injunctive relief, declaratory relief, and disgorgement.

In ***Graham***, the Southern District of Florida had to decide whether claims for injunctive relief, declaratory relief, and disgorgement fall within Section 2462 and are therefore subject to its rigid five-year statute of limitations. On May 12, 2014, the District Court dismissed the claims against the defendants with prejudice on the grounds that Section 2462 applied to the SEC's claims and the claims were time-barred.[102] The District Court reasoned that, "the long-held policies and practices that underpin the Supreme Court's unanimous opinion in ***Gabelli***, as well as the text of the statute itself, require the conclusion that § 2462 does reach all forms of relief sought by the SEC in this case."[103] In ***Gabelli v. SEC***, 133 S. Ct. 1216 (2013), the Supreme Court held that Section 2462 barred the SEC's claims for civil monetary penalties, which the SEC filed more than five years after the relevant conduct. Though it remains to be seen how many federal courts will follow the reasoning in ***Graham***, the ***Graham*** holding will likely force the SEC to be more efficient in investigating and bringing enforcement actions within the five year statute of limitations.

IV. SEC Trial Update

During the first half of 2014, the SEC won two outright trial victories (***i.e.***, in which the SEC won all of its claims against defendants), four complete losses, and four mixed verdicts (***i.e.***, which the SEC won some, but not all claims against defendants).[104] While we categorize these cases into "wins" and "losses" below for ease of discussion, we recognize that certain of the cases are too nuanced to categorize so cleanly.

A. Trial Wins

The SEC's biggest courtroom victory so far in 2014 came on May 12, 2014 when a jury in the Southern District of New York found former Michael's Stores Inc. chairman Sam Wyly and the estate of the late Charles Wyly Jr. liable for fraud over the Wylys' concealment of their control over offshore trusts that sold shares of four public companies for which they were board members.[105] The SEC accused the Wylys of engaging in a "scheme of secrecy"[106] by failing to publicly disclose the stock sales, which earned over $550 million in profits over 13 years. SEC disclosure rules require public company directors to disclose their ownership and trading of company shares if they are beneficial owners of more than five percent of the company. According to the SEC, the Wylys allegedly flouted this duty by failing to disclose their beneficial ownership of the securities held in the trust, which deprived investors of material information about those companies.[107] Although the case was initially filed in 2010 and related to conduct occurring between 1992 and 2004, the SEC was still able to secure victory.

One of the keys to the SEC's trial win was that it had an "insider" testifying on its behalf. The Wylys argued that they genuinely believed that for reporting purposes they were not the beneficial owners of the securities held in the trusts and that the offshore trustees had remained independent.[108] But the SEC's star witness at trial was Michael French, a former Wyly attorney who—as discussed above—settled with the SEC shortly before trial in an arrangement that Samuel Wyly called a "deal with the devil".[109] In contrast to Samuel Wyly's testimony that he never attempted to hide the offshore trusts from regulators,[110] French testified that he participated in concealing the Wylys' appearance of control over the trusts, and admitted that the conduct was wrong.[111] Such cooperator testimony—generally the hallmark of criminal white collar fraud prosecutions—has often been elusive to the SEC. But it unquestionably impacted the jury's verdict.

The SEC secured its second outright victory of the year on February 6, 2014, when a jury in the United States District Court for the Middle District of Florida found the CEO of Radius Capital Corporation ("Radius"), Robert DiGiorgio, liable for engaging in a fraudulent scheme and making materially false statements in connection with the issuance of $23 million in guaranteed mortgage-backed securities.[112] The lawsuit involved mortgage loans that Radius issued to low income borrowers and then pooled into mortgage-backed securities that were backed by Ginnie Mae. The SEC alleged that to induce Ginnie Mae to guarantee the securities, Radius represented to Ginnie Mae and investors that all loans backing the securities were or would be insured by the Federal Housing Administration when, in fact, approximately 70% of the loans were not FHA insured and most fell below FHA requirements.[113] When the loans backing the securities became delinquent and Radius defaulted on its payments to investors, Ginnie Mae had to pay investors the remaining principal balance on each uninsured loan, incurring several million dollars in losses.[114] After a ten day trial, the jury found DiGiorgio to have violated Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.[115] DiGiorgio, who represented himself, accused the SEC of using "perjured testimony and false documentation to achieve these results".[116] A decision on the SEC's motion for a final judgment imposing monetary and injunctive relief against Radius and DiGiorgio has been deferred pending appeal. The SEC had sought the disgorgement of gains obtained from the fraud and civil penalties.[117]

Also in February 2014, the SEC scored a partial victory when a Minneapolis jury found hedge fund manager Marlon Quan and his firms liable for assisting a $3.65 billion Ponzi scheme.[118] The SEC alleged that Quan, along with several firms he controlled, invested millions of dollars with Thomas Petters, a Minnesota businessman convicted in 2009 of running a Ponzi scheme. Quan,[119] by investing hedge fund assets with Petters, pocketed millions in fees while falsely assuring investors that their money would be protected by safeguards such as a "lock box account" that Quan purportedly monitored against defaults.[120] The SEC further alleged that when Petters' scheme fell apart, Quan executed "a series of convoluted transactions" to hide the scheme from investors.[121] The jury found that Quan, Stewardship Investment Advisors LLC, Acorn Capital Group LLC, and ACG II LLC violated Sections 17(a)(2) and 17(a)(3) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Section 206(4) of the Investment Advisers Act of 1940 and Rule 206-4(8) thereunder, while finding the defendants not liable under Securities Act Section 17(a)(1).[122] Quan's attorney, Bruce Collidge, noted that "[s]ince unanimity is required for liability, the effect of the two inconsistent findings is that the SEC has failed to sustain its claim of securities fraud against Mr. Quan".[123] Notwithstanding that, the SEC filed a motion dated April 25, 2014, seeking entry of a final judgment against Quan and his firms enjoining them from further violations of the federal securities laws, ordering

them to disgorge all ill-gotten fees (with prejudgment interest applied), and imposing a civil monetary penalty as to each defendant.[124] As of publication, the motion remains pending.

In March 2014, an Ohio federal jury found defendants Andrew and Leslie Jacobs liable on insider trading charges under Section 14(e) of the Exchange Act and Rule 14e-3 thereunder in connection with the December 2009 tender offer for Chattem Inc., a Tennessee-based pharmaceutical distributer.[125] The SEC alleged that Andrew learned of the pending tender offer during a confidential conversation with his brother-in-law, who was a Chattem executive.[126] Despite his brother-in-law's admonitions to keep the discussion confidential, Andrew allegedly shared the information with his brother Leslie, who then purchased 2,000 shares of Chattem, earning him over $49,000 in illicit profits after the public announcement of the tender offer.[127] After a six-day trial, the jury found liability under Section 14(e), which prohibits insider trading specifically with respect to tender offers, while finding the defendants not liable under Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. On March 19, 2014, the SEC filed a motion seeking entry of an order enjoining the Jacobs from future securities violations and barring Andrew from serving as an officer or director of a public company, and also requiring the Jacobs to disgorge the profits of their insider trading and to pay a civil penalty in an amount equal to three times the disgorgement amount.[128] As of publication, this motion remains pending.

B. Trial Losses

Notwithstanding the high-profile win in the *Wyly* case, the first half of 2014 has been a rocky stretch for the SEC's trial unit—particularly with respect to insider trading cases. This is in sharp contrast to the record set by the US Attorney's Office for the Southern District of New York that won virtually every one of the insider trading cases it has brought to trial in the last five years.

With ***SEC v. Schvacho***, the SEC started January 2014 with a loss in an insider trading case that relied heavily on circumstantial evidence.[129] In *Schvacho*, the SEC alleged that Larry Schvacho, a retired employee of Cisco Systems, used inside information regarding the pending acquisition of Comsys IT Partners Inc. to reap over $500,000 in illicit profits thereby allegedly violating Sections 10(b) and 14(e) of the Exchange Act and Rules 10b-5 and 14e-3 thereunder.[130] At trial, however, the SEC presented only circumstantial evidence, including telephone call and text message records and evidence of several meetings between Schvacho and his alleged tipper, the Comsys CEO. The United States District Court for the Northern District of Georgia found for Schvacho, concluding that the circumstantial evidence the SEC offered at trial, though "facially interesting," was insufficient to prove insider trading. The court criticized the "overreaching, self-serving interpretation that the SEC imposed on the evidence presented at trial," concluding that "[p]otential access…to material, nonpublic information, without more, is insufficient to prove the defendant actually possessed such information."[131]

In ***SEC v. Yang***, the SEC alleged that investment advisor Siming Yang used inside knowledge about the upcoming buyout of pork processor Zhongpin Inc. to earn $7.6 million for his investors and over $600,000 for himself in trading profits.[132] Again, the SEC presented no direct evidence of an inside tip, relying instead primarily on suspiciously timed trades. Yang's attorneys argued that the perfect timing of Yang's trades were the result of Yang's exhaustive "homework" on Zhongpin done "the old fashioned way"—by visiting slaughterhouses and analyzing data on swine flu rates.[133] After only a few hours of deliberation, on January 13, 2014, the jury rejected the SEC's insider trading claims.[134] However, the jury did find Yang liable of "front running" and filing a false SEC disclosure form.[135]

On January 27, 2014, an Illinois jury rejected the SEC's insider trading claims against Rex C. Steffes, Cliff M. Steffes, Bret W. Steffes and Rex R. Steffes, employees of Florida East Coast Industries Inc., whom the SEC accused of trading on inside information when they purchased shares of their company before a pre-merger announcement.[136] Notably, the SEC does not view this matter as a complete loss because in April 2012 (almost two years before the trial loss), the SEC obtained a consent judgment against Defendant W. Gary Griffiths, Rex C. Steffes' brother-in-law. Griffiths did not admit liability, but did agree to pay a civil penalty of $120,000 to settle the SEC's claims that he tipped Rex C. Steffes about the upcoming acquisition of Florida East Coast Industries, Inc. And before that, Robert J. Steffes (the brother of Rex C. Steffes) consented to a court order that permanently enjoined him from violating Section 10(b) and Rule 10b-5 and required him to pay over $200,000 in civil penalties.[137]

On February 3, 2014, a Texas jury cleared two executives of Life Partners Holdings Inc. ("Life Partners") of insider trading and securities fraud charges under Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.[138] The jury did, however, find some of the defendants, including Life Partners itself, liable for misleading shareholders in SEC filings and failing to comply with accounting practices under Section 17(a) of the Securities Act and Sections 13(a) of the Exchange Act and certain Rules 12b-20, 13a-1, 13a-13, and 13a-14 thereunder.[139] Following this mixed verdict, ***The Wall Street Journal*** reported that "In a battle of news releases, the SEC's enforcement director, Mr. Ceresney, announced that he was 'very pleased the jury found Life Partners and its executives liable for knowingly or recklessly defrauding shareholders and filing false SEC filings," while one defendant's attorney announced that the "verdicts against his client were for 'inadvertent technical violations'."[140]

In May 2014, a Manhattan jury found hedge fund manager, Nelson Obus, and two other individuals not liable for insider trading under Section 10(b) of the Exchange Act and Rule 10b-5.[141] In this case, filed in 2006, the SEC alleged that Obus had traded on inside information in connection with Allied Capital's 2001 acquisition of SunSource, a company in which Obus' hedge fund owned stock. This was Obus' second win at the trial court level: the Southern District of New York had previously granted summary judgment in the defendants' favor, but in 2012 the Second Circuit vacated the judgment, finding that genuine issues of material fact existed as to whether the elements of insider trading were satisfied.[142] Following the verdict, Obus told the press that he was "gratified that the jury saw through the SEC's 12-year campaign of regulatory overreach and recognized that we have told the truth" and that "[t]his is about systematic regulatory overreach without accountability."[143]

Most recently, in June 2014, the SEC lost another insider trading case in Santa Ana, California, against Manouchehr Moshayedi, founder and CEO of storage device maker sTec Inc.[144] The SEC alleged that Moshayedi had learned in mid-2009 that EMC Corp., one of sTec's main customers, would be cutting back its orders. The news came just ahead of an August 2009 secondary offering, at which Moshayedi and his brother had planned to sell significant portions of their company stock. The SEC alleged that, despite having full knowledge that sTec's stock would plummet once the EMC news became public, Moshayedi went ahead with the offering and stock sale, earning over $267 million for himself and his brother in the offering. Moshayedi allegedly further engaged in a cover-up prior to the offering, secretly giving EMC a substantial discount to inflate its demand. This conduct, according to the SEC, violated Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act, and Rule 10b-5. Moshayedi contended that the SEC claims "[were] an egregious case of fraud by hindsight."[145] Following a two-week trial, the jury returned its verdict for Moshayedi within a day of beginning deliberations.[146]

As some commentators have noted, the SEC's insider trading losses "are a warning that the government should tread carefully in pursuing a case absent testimony from an individual involved in the trading or other credible evidence to show how confidential information was misused."[147] Indeed, these trials are a stark contrast to the ***Wyly*** verdict, where the SEC was able to use the testimony of an insider to help secure the victory.

V. Selected Significant Investigations and Cases

In addition to the programmatic initiatives and trials discussed above, the SEC has already announced or resolved significant investigations and cases so far this year addressing each of its core areas of focus. We highlight certain key cases below.

A. Financial Reporting, Accounting, and Audit

The SEC has filed a number of cases in the last six months to address alleged financial reporting and accounting fraud. For example, on January 9, 2014, the SEC filed separate civil injunctive actions in the United States District Court for the Northern District of California against San Francisco-based, snack food company Diamond Foods, Inc. ("Diamond Foods") and its former CFO Steven Neil for purportedly falsifying financial accounting reports in violation of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, as well as Section 17(a) of the Securities Act.[148] According to the SEC, Diamond Foods allegedly underreported the fees it paid to walnut growers, thereby causing the company's financials to reflect 2010 and 2011 earnings in excess of street estimates.[149] In 2011, after restated financial results were posted (to reflect the true fees), Diamond Foods' share price dropped from $90 to $17.[150] In accordance with the settlement between the SEC and Diamond Foods (in which the company neither admitted nor denied liability), the court entered a judgment dated January 21, 2014 requiring Diamond Foods to pay a civil penalty in the amount of $5 million. According to the SEC, the settlement terms reflect Diamond Foods' cooperation with the SEC's investigation and remedial efforts.[151] The SEC's case against Neil is being litigated. In addition, the SEC filed settled administrative proceedings against the former CEO of Diamond Foods, Michael Mendes ("Mendes"), for his involvement in the inaccurate accounting of costs related to Diamond Foods' walnut business.[152] Without admitting or denying liability, Mendes agreed to pay a civil penalty of $125,000 and to cease and desist from committing future violations of the federal securities laws. Mendes also voluntarily forfeited more than $4 million in bonuses and other benefits.

On March 6, 2014, the SEC filed a complaint in the Southern District of New York against five executives and finance professionals at Dewey & LeBoeuf LLP, alleging that they facilitated a $150 million fraudulent bond offering on behalf of their law firm.[153] The SEC's complaint alleges that chairman Steven Davis violated Section 17(a) of the Securities Act, Section 10(b) and Rule 10b-5 of the Exchange Act, and that executive director Stephen DiCarmine, CFO Joel Sanders, finance director Frank Canellas, and controller Tom Mullikin violated Section 17(a) of the Securities Act and aided and abetted Dewey LeBoeuf's and Davis' violations of Section 10(b) of the Exchange Act and Rule 10b-5(b).[154] In short, according to the SEC, these five individuals allegedly inflated the financial performance of Dewey & LeBoeuf and then sought to raise cash through a private bond offering based on inflated numbers. Parallel criminal proceedings were brought against Davis, DiCarmine, and Sanders by the Manhattan District Attorney's Office.[155] On June 2, 2014, the Southern District of New York entered a stay in the SEC proceeding that requires the SEC to update the court every 60 days on the related criminal proceedings and to

notify the court not later than one week after the end of the criminal proceedings against Davis, DiCarmine, and Sanders.[156]

On May 27, 2014, the SEC filed a settled injunctive action in the United States District Court for the Northern District of Texas against DGSE Companies, Inc. and its former Chief Financial Officer, I. John Benson.[157] According to the SEC, since at least 2009, DGSE allegedly "failed to maintain appropriate accounting systems, policies, procedures, and controls" and thus "created and filed with the Commission materially inaccurate financial statements." To address that conduct, the SEC brought charges under Sections 10(b) and 13(b)(5) of the Exchange Act and Rules 10b-5 and 13b2-2(a) thereunder against Benson, as well as charges against Benson and DGSE Companies, Inc. under Section 17(a) of the Securities Act and Sections 13(a) and 13(b)(2)(A)-(B) of the Exchange Act and Rules 12b-20, 13a-1, 13a-13, 13a-14, and 13b2-1 thereunder. In his settlement with the SEC, Benson agreed (without admitting or denying the allegations) to pay a $75,000 civil penalty, be permanently barred from serving as an officer or director of a public company, and be suspended from practicing as an accountant. In its settlement, DGSE Companies, Inc. (without admitting or denying the allegations) agreed to be enjoined from committing future violations of the securities laws, and to retain an independent consultant to conduct a review of the company's corporate governance reforms.

Separately, the SEC filed two cases in the first half of 2014 to address alleged auditor independence violations. For example, on January 24, 2014, the SEC filed settled administrative proceedings against KPMG alleging that KPMG violated Rule 2-02(b) of Regulation S-X and Rule 10A-2 of the Exchange Act, caused violations of Section 13(a) of the Exchange Act and Rule 13a-1, and that KPMG engaged in improper professional conduct as defined by Section 4C of the Exchange Act and Rule 102(e) of the Commission's Rules of Practice.[158] In essence, the SEC charged KPMG with having conflicts with audit clients. KPMG allegedly violated Exchange Act Rule 2-01 by providing "prohibited non-audit services" such as restructuring, corporate finance, and expert services to its audit clients. Further, certain KPMG employees allegedly were shareholders of their clients.[159] Without admitting or denying liability, KPMG agreed to disgorge $5,266,347, prejudgment interest of $1,185,002, and $1,775,000 in civil penalty, for a total of $8,226,349. Moreover, KPMG agreed to engage an independent consultant to assist KPMG with implementing internal changes to educate its personnel and monitor KPMG's compliance with auditor independence.[160] The SEC issued an Exchange Act Section 21(a) Report of Investigation in connection with the settlement, in which the SEC addressed in detail the independence issues presented when auditors loan personnel to their audit clients.[161]

On May 20, 2014, the SEC filed settled administrative proceedings against a former Deloitte LLP chief risk officer, James Adams.[162] The SEC's order requires Adams (who neither admitted nor denied liability) to cease-and-desist from causing violations of Rule 2-02(b)(1) of Regulation S-X, Section 13(a) of the Exchange Act, and Exchange Act Rule 13a-1.[163] The order also denies Adams the right to appear as an accountant, yet permits him to reapply for reinstatement in two years. According to the SEC, Adams purportedly accepted tens of thousands of dollars in casino markers while advising the audit of a casino gaming corporation (a marker is an instrument used by a casino customer to receive gaming chips drawn against the customer's line of credit at the casino).[164] In a related press release, Scott Friestad of the Enforcement Division stated, "The transactions by which Adams accepted the casino markers were loans from an audit client that are prohibited by the auditor independence rules."

In 2014, the SEC continued to pursue the Chinese affiliates of major accounting firms for failing to produce their audit work papers. On January 22, 2014, an SEC Administrative Law Judge (the "ALJ") issued an initial decision censuring the Chinese accounting firms affiliated with Ernst & Young LLP, KPMG LLP, PricewaterhouseCoopers LLP, and Deloitte LLP, as well as a fifth firm, BDO China Dahua CPA Co., Ltd. According to the ALJ, the accounting firms willfully violated Section 106 of the Sarbanes-Oxley Act of 2002 by failing to comply with the SEC's requests for audit work papers, notwithstanding their good-faith reason for non-compliance (*i.e.*, compliance with the SEC's requests for the audit work papers would constitute a violation of Chinese law). The ALJ suspended the firms affiliated with Ernst & Young LLP, KPMG LLP, PricewaterhouseCoopers LLP, and Deloitte LLP from practicing before the SEC for six months. The fifth firm was censured, but not banned, because it had exited the US market. As of publication, the accounting firms' appeal of the ALJ's decision remains pending. If the ban is upheld on appeal, US-listed Chinese companies that have retained these four firms to handle their audits could have difficulty in the near term with finding alternate auditors. The SEC and the accounting firms have publicly stated that they are in continued settlement efforts.[165]

B. FCPA

So far in 2014, the Enforcement Division has announced significant FCPA actions (or developments in FCPA actions) against Alcoa Inc. and Hewlett-Packard.

On January 9, 2014, the SEC instituted settled administrative proceedings against Alcoa Inc. ("Alcoa"), a global aluminum provider, for bribes paid by its subsidiaries to government officials in Bahrain.[166] According to the complaint, more than US $110 million in bribes (which were improperly recorded in Alcoa's books as legitimate commissions or sales to a distributor) were paid to Bahraini officials with influence over contract negotiations between Alcoa and a major government-operated aluminum plant.[167] Alcoa agreed to pay $175 million in disgorgement of ill-gotten gains.[168] On the same day, the US Department of Justice announced that Alcoa World Alumna LLC would plead guilty to one count of violating the anti-bribery provisions of the FCPA and pay $223 million in criminal fines and forfeiture ($14 million of which would be used by Alcoa to satisfy its judgment in the SEC action). The total amount to be paid by the Alcoa entities, $384 million, places this case in the top five FCPA cases in terms of criminal fines and civil penalties.

On April 9, 2014, the SEC filed settled administrative proceedings against Hewlett-Packard Company ("HP Co.") stemming from allegations that HP Co.'s subsidiaries made improper payments to government officials in various countries to obtain or retain lucrative public contracts.[169] The United States Department of Justice ("Justice Department") also filed a parallel criminal case against ZAO Hewlett-Packard A.O., a Russian subsidiary.[170] The Hewlett-Packard entities resolved both cases, agreeing to pay $76,760,224 in criminal penalties and forfeiture to the Justice Department and $31,472,250 in disgorgement and prejudgment interest to the SEC (for a total of more than $108 million). The Hewlett-Packard entities allegedly failed to maintain internal controls sufficient to prevent a pattern of illegal payments (which were reflected as legitimate commissions and expenses) to win business in Mexico, Poland, and Russia from the early 2000s to 2010.[171] In a related press release, Kara Brockmeyer, chief of the Enforcement Division's FCPA Unit, said that "companies have a fundamental obligation to ensure that their internal controls are both reasonably designed and appropriately implemented across their entire business operations, and they should take a hard look at the agents conducting business on their behalf."

For a fuller discussion of the civil and criminal FCPA enforcement actions brought in the first half of 2014, please see our publication titled ***FCPA Digest: Recent Trends and Patterns in the Enforcement of the Foreign Corrupt Practices Act.***[172]

C. Insider Trading

In addition to the numerous insider trading trials discussed above, during the first part of 2014, the Enforcement Division announced many significant new insider trading cases. Indeed, the charges reveal that, notwithstanding its struggles at trial, the SEC remains focused on aggressively pursuing insider trading cases, particularly those involving expert networks and personal relationships.

1. Traditional Insider Trading Cases

There are two general theories of insider trading: the classical theory and the misappropriation theory. Traditional insider trading cases involve a corporate insider who, after being entrusted with material nonpublic information, either trades on the information or discloses the information to a tippee who trades. On the other hand, misappropriation theory cases involve 'outsiders' who, after being entrusted with material nonpublic information even though they are not corporate insiders, either trade on the information or disclose the information to a tippee in violation of the trust pursuant to which the information was disclosed.

During the first half of 2014, the SEC filed a number of cases against corporate insiders and their tippees.[173] For example, on January 29, 2014, the SEC filed charges in the United States District Court for the Northern District of Illinois against Steven Dombrowski, the former director of internal audit at a Chicago-based healthcare company.[174] Allegedly, Dombrowski—knowing that his employer, Allscripts Healthcare Solutions, had performed far worse than expected in the first quarter of 2012—sold Allscripts stock before the company's earnings announcement. The SEC charged Dombrowski with violating Section 17(a)(1)-(3) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. On April 8, 2014, the Northern District of Illinois stayed the SEC proceeding until the earlier of either August 8, 2014 or the conclusion of the parallel criminal action filed by the US Attorney's Office for the Northern District of Illinois against Dombrowski. The criminal action remains pending.

On March 13, 2014, the SEC filed a settled civil injunctive action in the Southern District of New York against a former analyst, Ronald Dennis, at a SAC Capital affiliate, charging Dennis with violations of Section 10(b) of the Exchange Act, Rule 10b-5, and Section 17(a) of the Securities Act. The SEC alleged that Dennis received illegal tips from two friends who were fellow hedge fund analysts concerning impending announcements at Dell Inc. and Foundry Networks and then traded in Dell and Foundry stock, thus enabling hedge funds managed by SAC Capital to generate illegal profits and avoid significant losses.[175] On April 22, 2014, the court entered a judgment requiring Dennis to pay disgorgement of $95,351, prejudgment interest of $12,632, and a $95,351 civil penalty. The judgment also permanently enjoined Dennis from committing future securities violations.[176]

On April 17, 2014, the SEC filed a complaint in the United States District Court for the Eastern District of Louisiana against Keith Seilan, a former employee of BP and senior responder for BP during the 2010 oil spill in the Gulf of Mexico.[177] The SEC alleged that Seilhan received material, nonpublic information indicating that the magnitude of the oil spill (and, in turn, BP's potential liability and financial exposure), and then caused to be sold his and his family's entire $1 million portfolio of BP securities. The SEC charged him with allegedly violating Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, as well as Section 17(a) of the Securities Act. Without admitting or

denying the allegations, Seilhan consented to the entry of a final judgment (which the Court entered on April 24, 2014) permanently enjoining him from future violations of federal antifraud laws and SEC antifraud rules, and requiring him to return $105,409 of allegedly ill-gotten gains (plus $13,300 of prejudgment interest) and pay a $105,409 civil penalty.

On April 21, 2014, the SEC brought a settled civil injunctive action in the District of New Jersey against an executive of Genta, Inc., a biopharmaceutical company in New Jersey, as well as two individuals who purportedly traded on the inside information the executive provided.[178] According to the SEC's allegations, Dr. Loretta Itri, chief medical officer and president of pharmaceutical development, purportedly tipped off her friend Dr. Neil Moskowitz the day before Genta was due to announce the results of an important clinical trial.[179] Moskowitz then purportedly sold his shares in Genta and advised his friend, Matthew Cashin, to do the same.[180] Without admitting or denying liability, each defendant agreed to be enjoined from further violations of the federal securities laws and agreed to pay a penalty as high as $64,300 (according to the SEC, Cashin's amount was reduced due to his cooperation with the SEC). On April 25, the court entered orders requiring (i) Itri to pay a $64,300 civil penalty; (ii) Moskowitz to pay $64,300 in disgorgement (with $9,556 in prejudgment interest) and a $64,300 civil penalty; and (iii) Cashin to pay $75,140 in disgorgement (with $10,955 in prejudgment interest) and a $37,570 civil penalty. This was one of several insider trading cases that the SEC filed during the first half of 2014 relating to clinical trial results.[181]

On April 25, 2014, the SEC filed a settled civil injunctive action in the United States District Court for the Eastern District of Pennsylvania against Christopher Saridakis, a former GSIC Commerce executive, and his longtime friend, Jules Gardner, based on allegations that Saridakis prematurely shared information about eBay's intention to acquire his company. According to SEC allegations, Saridakis provided nonpublic information to family members and friends who then traded on that information. Saridakis agreed to an officer-and-director bar and to pay $644,822, an amount which includes a penalty equal to twice the amount of his tippee's profits.[182] Saridakis also pled guilty to related criminal charges brought against him by the US Attorney's Office for the Eastern District of Pennsylvania and is scheduled to be sentenced on September 19, 2014. Gardner has agreed to disgorge his ill-gotten gains of $259,054 as part of a cooperation agreement in which the SEC is not seeking a penalty. In addition, on April 25, 2014, the SEC filed settled administrative proceedings against four other individuals who traded on the information received directly or indirectly from Saridakis or another unidentified tipper, in which each defendant agreed to pay disgorgement, prejudgment interest, and penalties of approximately $50,000.

On April 23, 2014, the SEC filed a settled civil injunctive action in the Southern District of New York charging Chris Choi, one of the insiders who allegedly supplied information that eventually made its way to Anthony Chiasson and Todd Newman, with insider trading. Chiasson and Newman were convicted of trading on inside information regarding Dell Inc. and NVIDIA Corporation after a five-week trial in 2013. However, their convictions remain on appeal before the Second Circuit, which must decide (among other things) whether the jury instructions were inconsistent with the Supreme Court's ruling in ***Dirks v. SEC***, 463 US 646 (1983), in that the instructions in ***United States v. Newman*** did not require jurors to conclude that the defendants had known that insiders were improperly leaking confidential information in exchange for some "personal benefit."[183] On June 2, 2014, the court entered a final judgment requiring Choi to pay a $30,000 civil penalty without admitting or denying liability. The judgment also permanently enjoined Choi from committing future securities violations.[184] In a related release, the SEC

indicated that Choi was the 45th defendant charged by the SEC in its ongoing investigation into the activities of expert networks stemming from the SEC's inquiry into Galleon Management and Raj Rajaratnam.[185]

Of note, the SEC's administrative proceeding initiated against Steven Cohen of SAC Capital on July 19, 2013 remains ongoing. The SEC has charged Cohen under Section 203(f) of the Advisors Act for purportedly failing to supervise (among others) Michael Steinberg and Mathew Martoma, both of whom were recently convicted of insider trading in connection with their trading activities at SAC and its subsidiaries. According to the SEC, Cohen should have been prompted to investigate the sources of the "highly suspicious information" that Cohen purportedly received from Steinberg and Martoma.[186] Having failed to do so, and opting instead to allow Steinberg and Martoma to trade on the information and in doing so enabling SAC to avoid losses of over $275 million, Cohen himself, the SEC argues, must now face liability. The administrative proceeding has been stayed since August 2013, and in May of this year, federal prosecutors again sought and obtained an extension of the stay pending the outcome of the Newman appeal discussed above, which could have a direct impact on the prior conviction of Michael Steinberg and the SEC's theory as to Cohen.

2. *Misappropriation Cases*

In addition, during the first half of 2014, the SEC brought several cases seemingly based on the misappropriation theory of insider trading liability.

On March 19, 2014, the SEC filed a complaint in the District of New Jersey against a stockbroker (Vladimir Eydelman) and a managing law clerk (Steven Metro).[187] According to the SEC, the insider trading scheme involved three participants: (1) Metro (the corporate insider) who worked in the New York office of a large international law firm and who accessed material, nonpublic information on the law firm's computer systems regarding corporate transactions; (2) an unidentified middleman who passed along information to Eydelman; and (3) Eydelman, a stockbroker who received the tip and traded. The SEC alleged that the scheme netted more than $5.6 million in illegal profits on at least 12 transactions. The middleman, a friend of Metro's from law school, is cooperating with authorities, and is alleged to have consumed the post-its and napkins on which the tips were written (hence, why the media is referring to the case as the "post-it" or "napkin" case). The US Attorney's Office for the District of New Jersey announced criminal charges against Metro and Eydelman. As of publication, both the SEC and DOJ proceedings remain pending.

In addition, the SEC also brought apparent misappropriation cases involving family members. On March 31, 2014, the SEC announced two unrelated settled civil injunctive actions filed in the Northern District of California against individuals who purportedly received information from their spouses and subsequently traded on the information.[188] The same day, the Northern District of California entered a judgment against Tyrone Hawk, who the SEC alleged traded on information provided by his wife concerning Oracle's upcoming acquisition of Acme Packet Inc. Hawk must pay $151,480 in disgorgement (plus prejudgment interest of $2,654) plus a civil penalty of $151,480. On April 7, 2014, the court entered a judgment against Ching Hwa Chen, who allegedly traded shares in Informatica Corporation based on information he overheard during a conversation in which his wife participated. Chen must pay $138,068 in disgorgement, prejudgment interest of $4,297, and $138,068 in civil penalties.[189]

D. Investment Advisors

The SEC brought a range of cases against investment advisors during the first half of 2014, highlighting its examination priorities such as valuation issues and expense allocation.[190]

On January 27, 2014, the SEC filed two settled administrative proceedings against Western Asset Management Company ("Western Asset"), a Legg Mason subsidiary.[191] Allegedly, Western Asset failed to disclose, and promptly correct, a coding error that improperly allocated a restricted private investment to nearly 100 ERISA accounts. Also, Western Asset purportedly engaged in illegal cross trading, which is the practice of moving a security from one client's account to another without exposing the trade to the market. The SEC's orders found that Western Asset violated Sections 206(2) and 206(4) of the Investment Advisers Act of 1940 and Rule 206(4)-7, and aided and abetted and caused violations of Sections 17(a)(1) and 17(a)(2) of the Investment Company Act of 1940. Western Asset (without admitting or denying the allegations) agreed to be censured and cease and desist from further such violations. To address the alleged coding error, Western Asset must distribute more than $10 million to clients, pay a $1 million civil penalty to the SEC, and pay a $1 million penalty to the US Department of Labor ("Labor Department"). For the cross trading allegations, Western Asset must distribute more than $7.4 million to clients, pay a $1 million civil penalty to the SEC, and pay a $607,717 penalty to the Labor Department. Western Asset also must hire an independent compliance consultant.

On January 30, 2014, the SEC filed a settled administrative proceeding against Navigator Money Management ("NMM") and NMM's money manager, President, and Chief Compliance Officer, Mark Grimaldi.[192] According to the SEC, the defendants made multiple false claims to investors about the success of their investment advice. The SEC's order found that NMM violated Sections 17(a) of the Securities Act, Sections 206(1), 206(2), and 206(4) of the Investment Advisers Act of 1940 and Rules 206(4)-1(a)(2), 206(4)-1(a)(5), 206(4)-7, and 206(4)-8, as well as Section 34(b) of the Investment Company Act of 1940; Grimaldi allegedly violated several of the same provisions and aided and abetted and caused NMM's violations. NMM and Grimaldi (without admitting or denying the allegations) agreed to be censured, cease and desist from further such violations, and retain an independent compliance consultant for three years. Grimaldi also agreed to pay a $100,000 civil penalty.

In an administrative proceeding brought on February 25, 2014, the SEC charged Scott Brittenham and Clean Energy Capital, LLC with violating Sections 17(a) of the Securities Act and Section 10(b) of the Exchange Act, Rule 10b-5 thereunder, Sections 206(1), 206(2), 206(3), 206(4), and 207 of the Investment Advisers Act of 1940, and Rules 206(4)-2, 206(4)-7 and 206(4)-8(a) thereunder, for misallocating expenses for their managed funds. According to the SEC, the defendants improperly paid more than $3 million in expenses from their managed funds without having disclosed such payment arrangements in any offering documents. Moreover, the SEC claims that when funds ran out of money to pay the expenses, the defendants loaned money to the funds at unfavorable rates.[193] The litigation is ongoing before an SEC Administrative Law Judge.[194]

On April 3, 2014, the SEC instituted settled administrative proceedings against Transamerica Financial Advisors ("Transamerica"), a Florida-based investment advisor and broker-dealer, alleging that Transamerica improperly calculated advisory fees and overcharged its clients in violation of Sections 206(2), 206(4)-7, and 207 of the Investment Advisers Act and Rule 206(4)-7 promulgated thereunder. According to the SEC, Transamerica offered breakpoint discounts designed to reduce advisory fees when the clients increased their assets in certain investment

programs. Clients could aggregate the values of related accounts to get the discounts. However, Transamerica failed to process every aggregation request and had conflicting policies concerning the breakpoint discounts, all of which led to clients being overcharged. Transamerica settled the charges, without admitting or denying liability, by agreeing to take remedial efforts, including providing refunds to 2,304 client accounts totaling $553,624.32.[195]

On April 15, 2014, the SEC instituted litigated administrative proceedings against Total Wealth Management, a San Diego-based investment advisory firm, and several of its executives alleging that they had misled investors and breached their fiduciary duty to clients in violation of the antifraud provisions of the federal securities laws.[196] According to the SEC, top executives at Total Wealth Management, including its owner and CEO Jacob Cooper, paid themselves kickbacks or "revenue sharing fees" and failed to disclose the conflicts of interest associated with these arrangements. In a related press release, the Enforcement Division noted that "investment advisers owe a fiduciary duty of utmost good faith and full and fair disclosure to their clients. Total Wealth violated that duty with its pervasive practice of placing clients in funds holding risky investments while concealing the revenue sharing fees they paid themselves."[197] The defendants have denied the allegations, and the litigation is ongoing before an SEC Administrative Law Judge.[198]

On May 29, 2014, the SEC announced a settled civil injunctive action, filed in the United States District Court for the Northern District of Illinois, against Neal Goyal and two investment advisers that Goyal owned and controlled, namely Blue Horizon Asset Management and Caldera Advisors.[199] The US Attorney's Office for the Northern District of Illinois also filed criminal charges against Goyal. According to the SEC, Goyal allegedly raised more than $11.4 million for investments in four private funds that he managed. When the investments lost money, Goyal allegedly hid those losses from the fund investors through Ponzi payments and false account statements. The SEC's complaint charged the defendants with violating Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Sections 206(1), 206(2), and 206(4) of the Investment Advisers Act of 1940. The District Court has entered a judgment stating that, without admitting or denying the allegations, the defendants will pay ill-gotten gains (plus prejudgment interest) and civil penalties in amounts determined by the District Court. The criminal case against Goyal remains pending.

In a settled administrative proceeding filed on June 20, 2014, the SEC charged TL Ventures Inc., a private equity firm, with violating "pay-to-play" rules, which prohibit advisers from providing compensated services either directly or indirectly to a government client for two years after the adviser's firm or associates have made campaign contributions to officials with certain types of influence.[200] TL Ventures allegedly continued to receive advisory fees from various pension funds in violation of these rules. The SEC's order found that TL Ventures violated Sections 203(a), 206(4), and 208(d) of the Investment Advisers Act of 1940, as well as Rule 206(4)-5. TL Ventures (without admitting or denying the allegations) agreed to pay disgorgement of $256,697 (with prejudgment interest of $3,197) and a $35,000 civil penalty. It also agreed to be censured and to cease and desist from further such violations. This is the first case under the "pay-to-play" rules, which were enacted in 2010.

E. Broker-Dealers

The SEC also brought several cases against broker-dealers during the first half of 2014.[201] This is consistent with Director's Ceresney's remarks in May 2014 that the SEC "must continue to focus on broker-dealers."[202]

On January 31, 2014, the SEC filed settled administrative proceedings against two college professors who allegedly operated a complex, naked short selling scheme that earned more than $400,000 in illicit profits. In basic terms, naked short selling occurs when one sells shares (without actually having the shares to deliver) and then purposefully fails to deliver the securities within the settlement period. Professors Gonul Colak and Milen Kostov, according to the SEC, repeatedly entered into such sham transactions in a way that created an illusion that they had delivered the underlying securities when in fact they had not. The SEC's order found that Colak and Kostov violated Section 17(a) of the Securities Act, as well as Section 10(b) of the Exchange Act and Rules 10b-5 and 10b-21 thereunder. Colak and Kostov (without admitting or denying the allegations) agreed to cease and desist from future violations of the federal securities laws. Colak also agreed to pay $285,600 in disgorgement (with $21,957 in prejudgment interest) and a $150,000 civil penalty. Kostov agreed to pay $134,400 in disgorgement (with $10,340 in prejudgment interest) and a $70,000 civil penalty. This is one of several short selling cases that the SEC filed or settled during the first half of 2014.[203]

In an administrative proceeding filed on March 12, 2014 against a major global investment bank and brokerage firm, the SEC alleged that the investment bank failed to supervise employees, including a man who was convicted on March 7, 2014 of having lied to customers regarding the pricing of mortgage-backed securities, and thus violated Section 15(b)(4)(E) of the Exchange Act.[204] In a settlement, the investment bank agreed to pay $4.2 million in disgorgement, $292,515 in prejudgment interest, and a $4.2 million civil penalty.[205] The investment bank also entered into a non-prosecution agreement with the United States Attorney's Office for the District of Connecticut in which the bank agreed to pay a $25 million penalty (including restitution paid to victims (up to $11 million), a civil penalty paid to the SEC (up to $4.2 million), and a $9.8 million criminal penalty) and to retain an independent compliance consultant to review its internal procedures.[206] While the number of cases relating to the financial crisis of the late 2000s appear to be slowing (in part because the statutes of limitations relating to such cases either have expired or are expiring soon), the SEC's claims against the investment bank illustrate that the SEC continues to extract penalties in this area.[207]

On April 4, 2014, the SEC instituted settled administrative proceedings against Visionary Trading LLC ("Visionary"), Lightspeed Trading LLC ("Lightspeed"), Andrew Actman (Lightspeed's Chief Financial Officer), and Joseph Dondero, Eugene Giaquinto, Lee Heiss, and Jason Medvin (all owners of Visionary).[208] Allegedly, from May 2008 through November 2011, Visionary operated an office in New Jersey where the firm's owners and others engaged in day-trading through various accounts held at Lightspeed, a registered broker-dealer. In connection with the tradings, Visionary's clients paid commissions to Lightspeed, and two Lightspeed registered representatives improperly shared a portion of this transaction-based compensation with Visionary, an unregistered entity. The SEC charged each defendant with various violations of the federal securities laws. Actman agreed to pay a $10,000 civil penalty and a one-year bar from the securities industry. Dondero agreed to pay disgorgement of approximately $1.1 million (plus prejudgment interest of $46,792) and a $785,000 civil penalty, as well as a permanent bar from the securities industry. In addition to a two-year bar from the securities industry, Giaquinto, Heiss, and Medvin agreed to each pay disgorgement of $118,601.96 (plus prejudgment interest of $14,391.32) and a $35,000 civil

penalty. Lightspeed agreed to pay disgorgement of $330,000 (plus prejudgment interest of $43,316.54 and post-order interest of $4,900.38) and a $100,000 civil penalty. Each defendant agreed to cease and desist from future violations of Section 15(a)(1) of the Exchange Act.

F. Market Structure

High-frequency trading and concerns over equity market structure have received a considerable amount of media attention following the March 31, 2014 release of Michael Lewis' ***Flash Boys***. But while this appears to be a new topic for much of the public, the SEC has been focused on these issues for years, within both the Enforcement Division and its other divisions. As Chair White told the House Financial Services Committee on April 29, 2014, the SEC has "a number of ongoing investigations as to practices by high-frequency trading firms and dark pools."[209] These are areas in which the SEC has brought enforcement actions in the past and where it will continue to do so. But while calls for regulatory change have been made to bring broad-based enforcement actions in the area, the SEC has so far focused on traditional theories of manipulation or other violations of the securities laws.

On May 1, 2014, the SEC filed settled administrative proceedings against the New York Stock Exchange and two affiliated exchanges (collectively the "NYSE") and Archipelago Securities LLC ("Archipelago"), an affiliated routing broker. According to the SEC, the NYSE, in violation of Section 19(b) and 19(g) of the Exchange Act, failed to comply with the responsibilities of a self-regulatory organization by both engaging in business practices without having effective exchange rules in place and operating in a manner that did not comply with the exchange rules or the federal securities laws. As for Archipelago, the SEC alleged that Archipelago failed to establish and enforce policies and procedures in connection with error account trading that were reasonably designed to prevent the misuse of material, nonpublic information by brokers or affiliates thereof, in violation of Sections 15(g) of the Exchange Act. The SEC further alleged that Archipelago effected transactions without sufficient net capital, which violated Section 15(c)(3) of the Exchange Act and Rule 15c3-1 thereunder. Under the settlement terms, the NYSE and Archipelago (neither of which admitted or denied liability) agreed to pay a $4.5 million civil penalty, and the NYSE agreed to complete significant undertakings, including conducting a comprehensive compliance review by an independent consultant.[210]

On June 6, 2014, the SEC filed settled administrative proceedings against Liquidnet, Inc. ("Liquidnet"), a New York-based brokerage firm that operates a dark pool alternative trading system ("ATS").[211] The SEC charged Liquidnet with violating Section 17(a)(2) of the Securities Act, Rule 301(b)(2) of Regulation ATS (which requires that an ATS file certain amendments on Form ATS with the SEC), and Rule 301(b)(10) of Regulation ATS (which requires an ATS to establish adequate safeguards and procedures for protecting confidential trading information of its subscribers). According to the SEC, Liquidnet—notwithstanding its assurance to customers that it would keep their information confidential—allegedly used that confidential information to market its services (for instance, by providing issuers with descriptions of ATS subscribers who were interested in trading the issuer's stock). Without admitting or denying liability, Liquidnet agreed to the filing of an order under which it will pay a $2 million civil penalty and cease and desist from committing such violations again.[212]

Also on June 6, 2014, the SEC instituted litigated administrative proceedings against Wedbush Securities Inc., which has consistently ranked as one of the five largest firms by trading volume on NASDAQ, its former executive vice president in charge of Wedbush's market access business and a senior vice president in the market access

division.[213] According to the SEC, Wedbush purportedly violated multiple regulatory requirements as a result of trading by its market access customers, namely Exchange Act Rule 15c3-5 (which is the market access rule), Rule 203(b)(1) of Regulation SHO relating to short sales, Rule 611(c) of Regulation NMS related to intermarket sweep orders, Rule 17a-8 concerning anti-money laundering requirements, and Rule 17a-4(b)(4) concerning the preservation of records. As for the illegal trading, the SEC alleged that Wedbush allowed the majority of its market access customers to send orders directly to US trading venues by using trading platforms over which Wedbush did not have direct and exclusive control, and that the two charged officials knew that the firm's risk management controls and supervisory procedures did not comply with the market access rule.

G. Cases Involving Chinese Companies

While the SEC's filings related to Chinese issuers have appeared to be waning over the last year, on June 11, 2014, Ceresney stated that it remains one of the SEC's "focus areas."[214] Consistent with that, the SEC filed several new lawsuits and resolved others during the first half of 2014.

On February 11, 2014, the SEC announced its settlements with two Hong Kong-based asset management firms, whose accounts had been frozen in connection with a previously-filed insider trading case brought by the SEC in the Southern District of New York.[215] The case (filed in 2012) relates to alleged insider trading in advance of the public announcement that China National Offshore Oil Corporation had agreed to acquire Canadian energy company, Nexen Inc.[216] Without admitting or denying liability, the first firm agreed to pay $3.3 million in disgorgement and a $3.3 million civil penalty for purchasing shares of Nexen stock in the US on behalf of others. The second firm (which was sued as a relief defendant) agreed to pay, along with other relief defendants, $4.3 million in disgorgement for making pre-announcement Nexen stock trades.[217] The SEC acknowledged in its announcement that the first firm had cooperated in the investigation.[218]

On March 11, 2014, the SEC filed a litigated civil injunctive action in the United States District Court for the Middle District of Tennessee against China-based AgFeed Industries Inc. ("AgFeed") and four executives, in connection with a "massive accounting fraud" in which AgFeed allegedly reported fictitious revenues for years (which the SEC claims were inflated by hundreds of millions of dollars).[219] The SEC alleged in its complaint that the executives violated or aided and abetted violations of the antifraud, reporting, books and records, and internal controls provisions of the federal securities laws.[220] Of note, the SEC alleged that AgFeed's audit committee chair sought out, yet ignored, advice from a former director and company advisor, who advised that independent investigators guided by outside legal counsel should be used to identify the extent of the fraud.[221] Two former executives of AgFeed—one of whom had signed a cooperation agreement with the SEC—previously settled with the SEC without admitting or denying liability.[222] As of publication, the litigation remains pending.[223]

Finally, on May 5, 2014, the SEC filed a partially litigated civil injunctive action in the United States District Court for the District of New Jersey against five individuals who, together, allegedly brought two China-based companies to the US market to "manipulate" trading and gain profit.[224] The named defendants are S. Paul Kelley, George Tazbaz, Roger Lockhart, Robert Agriogianis, and Shawn Becker. The SEC alleges that certain defendants bought controlling interests in two US public shell companies to perform reverse mergers with two China-based companies, China Auto Logistics Inc. and Guanwei Recycling Corp. Defendants then allegedly hired a stock promoter (Becker) to promote the stock of the Chinese companies to investors, and engaged in various forms of manipulative trading

to drive up the price and volume of the stock. The SEC charged all five defendants with violating the antifraud, securities registration, and securities ownership reporting provisions of the federal securities laws; one defendant with violating the antifraud and securities registration provisions; and two defendants with violating the broker-dealer registration provisions. As of publication, Kelley, Lockhart, and Agriogianis (all without admitting or denying liability) have agreed to settle the SEC's charges.[225] Kelly agreed to pay disgorgement of $2.8 million, prejudgment interest of $560,812, and a $2.8 million civil penalty. Lockhart agreed to pay disgorgement of $1.8 million, prejudgment interest of $332,268, and a $1 million civil penalty. Agriogianis entered into a cooperation agreement. As of publication, the litigation remains pending against Tazbaz and Becker.

VI. Conclusion

The SEC's Enforcement Division has continued its aggressive focus on policing the securities markets and professionals. While the SEC has seen mixed results at trial, it has secured enough big wins at trial, on appeal, and at the investigative stage that there is no reason to expect it to shift its aggressive approach to enforcement anytime soon. Indeed, we expect that the next six months will largely continue the same trends.

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1 *SEC v. Citigroup Global Mkts., Inc.*, Nos. 11–5227–cv (L), 11–5375–cv(con), 11–5242–cv(xap.), 2014 WL 2486793 (2d Cir. June 4, 2014).

2 *Id.* at *1.

3 *SEC v. Citigroup Global Mkts., Inc.*, 827 F. Supp. 2d 328, 332 (S.D.N.Y. 2011).

4 *SEC v. Citigroup Global Mkts., Inc.*, 2014 WL 2486793, at *6.

5 Andrew Ceresney, Director of the Div. of Enforcement, SEC, Address at The SEC Speaks to the D.C. Bar, Part I (June 11, 2014).

6 Andrew Ceresney, Director of the Div. of Enforcement, SEC, Keynote Address at Compliance Week 2014 (May 20, 2014). SEC Press Release, SEC Charges Lions Gate With Disclosure Failures While Preventing Hostile Takeover, Rel. No. 2014-51 (March 13, 2014); SEC Press Release, Credit Suisse Agrees to Pay $196 Million and Admits Wrongdoing in Providing Unregistered Services to US Clients, Rel. No. 2014-39 (Feb. 21, 2014); SEC Press Release, Scottrade Agrees to Pay $2.5 Million and Admits Providing Flawed "Blue Sheet" Trading Data, Rel. No. 2014-17 (Jan. 29, 2014); *In the Matter of G-Trade Services LLC*, Admin. Proc. File No. 3-15654 (Dec. 18, 2013); *In the Matter of JPMorgan Chase & Co.*, Admin Proc. File No. 3-15507 (Sept. 19, 2013) (order instituting cease-and-desist proceedings); *SEC v. Philip A. Falcone*, No. 12-cv-5027 (S.D.N.Y. Sept. 16, 2013) (final consent judgment); *SEC v. Harbinger Capital Partners LLC*, No. 12-cv-5028 (S.D.N.Y. Sept. 16, 2013) (final consent judgment); *In the Matter of North East Capital, LLC*, Admin. Proc. File No. 3-15429 (Aug. 16, 2013) (order instituting administrative cease-and-desist proceedings).

7 SEC Press Release, Scottrade Agrees to Pay $2.5 Million and Admits Providing Flawed "Blue Sheet" Trading Data, Rel. No. 2014-17 (Jan. 29, 2014).

8 *Id.*

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[10] SEC Press Release, Credit Suisse Agrees to Pay $196 Million and Admits Wrongdoing in Providing Unregistered Services to US Clients, Rel. No. 2014-39 (Feb. 21, 2014).

[11] *Id.*

[12] SEC Press Release, Credit Suisse Agrees to Pay $196 Million and Admits Wrongdoing in Providing Unregistered Services to US Clients, Rel. No. 2014-39 (Feb. 21, 2014). *See also* SEC Press Release, SEC Charges Rafferty Capital Markets With Illegally Facilitating Trades for Unregistered Firm, Rel. No. 2014-97 (May 15, 2014) (charging New York-based Rafferty Capital Markets with, allegedly, facilitating trades for another firm that was not registered as a broker-dealer as required under the federal securities laws).

[13] SEC Press Release, SEC Charges Lions Gate With Disclosure Failures While Preventing Hostile Takeover, Rel. No. 2014-51 (Mar. 13, 2014).

[14] *Id.*

[15] *Settlement Agreement, SEC v. Wyly*, No. 1:10-cv-5760 (S.D.N.Y. Mar. 20, 2014).

[16] Andrew Scurria, Wyly brothers' ex-lawyer settles SEC fraud case, admits errors, Reuters, Mar. 20, 2014, available at http://www.law360.com/articles/517171/wyly-atty-close-to-exiting-550m-sec-fraud-case.

[17] *Settlement Agreement, SEC v. Wyly*, No. 1:10-cv-5760 (S.D.N.Y. Mar. 20, 2014).

[18] *SEC v. Citigroup Global Mkts., Inc.*, 827 F. Supp. 2d 328, 335 (S.D.N.Y. 2011).

[19] *SEC v. Michel Terpins and Rodrigo Terpins*, 1:13-cv-01080-JSR, Dkt. No. 37, at 4-5.

[20] *SEC v. Michel Terpins and Rodrigo Terpins*, 1:13-cv-01080-JSR, Dkt. No. 40.

[21] Andrew Ceresney, Director of the Div. of Enforcement, SEC, Keynote Address at Compliance Week 2014 (May 20, 2014).

[22] *See, e.g.*, *In the Matter of JP Morgan Chase & Co.*, Admin. Proc. File No. 3-15507 (Sept. 19, 2013) (order instituting cease-and-desist proceedings).

[23] Andrew Ceresney, Director of the Div. of Enforcement, SEC, Address at The SEC Speaks to the D.C. Bar, Part I (June 11, 2014).

[24] SEC Press Release No. 2010-6, "SEC Announces Initiative to Encourage Individuals and Companies to Cooperate and Assist in Investigations," Jan. 13. 2010.

[25] *Id.*

[26] *See generally* Mary Jo White, Chair, SEC, Speech at Stanford University Rock Center for Corporate Governance (June 23, 2014) (describing how companies can cooperate with SEC investigations).

[27] SEC Press Release, SEC Charges Six Individuals With Insider Trading in Stock of E-Commerce Company Prior to Acquisition by eBay, Rel. No. 2014-85 (Apr. 25, 2014).

[28] SEC Press Release, SEC Announces Fraud Charges Against Three Former Regions Bank Executives in Accounting Scheme, Rel. No. 2014-125 (June 25, 2014).

[29] Joseph K. Brenner, Chief Counsel, Div. of Enforcement, SEC, Address at The SEC Speaks in 2014 (Feb. 21, 2014).

[30] Mary Jo White, Chair, SEC, Three Key Pressure Points in the Current Enforcement Environment, Address at N.Y.C. Bar Ass'n Third Annual White Collar Crime Institute (May 19, 2014) (transcript available at http://www.sec.gov/News/Speech/Detail/Speech/1370541858285).

[31] *See, e.g., SEC v. J.W. Barclay & Co.*, 442 F.3d 834, 845 (3d Cir. 2006) (control persons may not be liable under Section 20(b) because they did not participate in the underlying primary violation); *Union Cent. Life Ins. Co. v. Credit Suisse Sec.* (*USA*), LLC, No. 11 CIV. 2327 GBD, 2013 WL 1342529, at *9 (S.D.N.Y. Mar. 29, 2013) (section 20(a) requires an underlying primary violation whereas Section 20(b) requires just an unlawful act).

[32] Mary Jo White, Chair, SEC, The SEC in 2014, Address at the 41st Annual Securities Regulation Institute (Jan. 27, 2014) (transcript available at http://www.sec.gov/News/Speech/Detail/Speech/1370540677500).

[33] *Id.*

[34] *Id.*

[35] *Id.*

[36] SEC Press Release, SEC to Hold Cybersecurity Roundtable, Rel. No. 2014-32 (Feb. 14, 2014).

[37] *See* SEC Press Release, SEC Announces Agenda, Panelists for Cybersecurity Roundtable, Rel. No. 2014-57 (Mar. 24, 2014).

[38] SEC Office of Compliance Inspections & Examinations, OCIE Cybersecurity Initiative (Apr. 15, 2014), available at http://www.sec.gov/ocie/announcement/Cybersecurity+Risk+Alert++%2526+Appendix+-+4.15.14.pdf.

[39] *Id.*

[40] SEC Press Release, SEC Announces Enforcement Initiatives to Combat Financial Reporting and Microcap Fraud and Enhance Risk Analysis, Rel. No. 2013-121 (July 2, 2013).

[41] David R. Woodcock, Reg'l Dir., SEC, Address at The SEC Speaks in 2014 (Feb. 21, 2014).

[42] Since the FRATF was launched, no SEC press releases have expressly linked an investigation or case to the efforts of the FRATF. Moreover, in February 2014, Chair Woodcock did not identify any such investigations or cases.

[43] *Id.*

[44] *Id.*

[45] SEC Fiscal Year 2013 Agency Financial Report, p. 30 (Dec. 2013).

[46] Andrew Ceresney, Director of the Div. of Enforcement, SEC, Keynote Address at Compliance Week 2014 (May 20, 2014).

[47] Daniel Gallagher, Commissioner, SEC, Remarks at the 46th Annual Rocky Mountain Securities Conference (May 9, 2014) (transcript available at http://www.sec.gov/News/Speech/Detail/Speech/1370541779229).

[48] SEC Press Release, SEC Announces Enforcement Initiatives to Combat Financial Reporting and Microcap Fraud and Enhance Risk Analysis, Rel. No. 2013-121 (July 2, 2013).

[49] Elisa L. Frank & Michael D. Paley, Assistant Dirs., SEC, Workshop C: Enforcement at The SEC Speaks in 2014 (Mar. 8, 2014).

[50] SEC Press Release, SEC Continues Microcap Fraud Crackdown, Proactively Suspends Trading in 255 Dormant Shell Companies, Rel. No. 2014-21 (Feb. 3, 2014).

[51] SEC Press Release, SEC Obtains Asset Freeze Against Promoter Behind Microcap Stock Scalping Scheme, Rel. No. 2014-52 (Mar. 13, 2014).

[52] For more information about the SEC's Office of the Whistleblower, visit http://www.sec.gov/whistleblower.

[53] *In the Matter of the Claim for Award*, SEC Whistleblower Award Proc. File No. 2014-5 (June 3, 2014).

[54] *See id.*

[55] SEC Press Release, SEC Announces Additional $150,000 Payment to Recipient of First Whistleblower Award, Rel. No. 2014-68 (Apr. 4, 2014).

[56] *Id.*

[57] SEC Press Release, "SEC Charges Hedge Fund Adviser With Conducting Conflicted Transactions and Retaliating Against Whistleblower," (June 16, 2014).

[58] SEC Press Release, SEC Launches Enforcement Cooperation Initiative for Municipal Issuers and Underwriters, Rel. No. 2014-46 (May 16, 2014).

[59] *Id.* On March 10, 2014, the SEC released detailed guidance to the Municipalities Continuing Disclosure Cooperation Initiative. SEC.gov, "Municipalities Continuing Disclosure Cooperation Initiative," last modified Mar. 10, 2014, available at http://www.sec.gov/divisions/enforce/municipalities-continuing-disclosure-cooperation-initiative.shtml.

[60] *Id.*

[61] The SEC's unit focused on fraud in municipal securities offerings filed only a few cases during the first half of 2014. *See* SEC Press Release, SEC Charges Charter School Operator in Chicago with Defrauding Bond Investors, Rel. No. 2014-110 (June 2, 2014) (charging UNO Charter School Network, Inc. and United Neighborhood Organization of Chicago with defrauding investors in a $37.5 million bond offering for school construction) and SEC Press Release, SEC Obtains Court Order to Halt Fraudulent Bond Offering by City of Harvey, Ill., Rel. No. 2014-122 (June 25, 2014) (obtaining an emergency court order against the City of Harvey, Illinois and its comptroller to stop a fraudulent bond offering that the City was marketing to potential investors).

[62] Ed Beeson, *Halliburton Deflates Hopes for 'Basic' Reform*, Law360, June 23, 2014, http://www.law360.com/articles/550782/halliburton-deflates-hopes-for-basic-reform.

[63] 134 S. Ct. 1058 (2014). This case was joined with two other cases for decision: *Willis of Colorado Inc. v. Troice* (Dkt. No. 12-86) *and Proskauer Rose LLP v. Troice* (Dkt. No. 12-88).

[64] *Id.* at 1066.

[65] *Id.* at 1069-70.

[66] *Id.* at 1074 (Kennedy, J. dissenting).

[67] 485 US 224 (1988).

[68] Brief for Former SEC Commissioners and Officials and Law Professors as Amici Curiae in Support of Petitioners, *Halliburton v. Erica P. John Fund, Inc.*, No. 13-317 (US Oct. 11, 2013).

[69] To analyze market efficiency, courts use the *Cammer* factors, which are as follows: (1) the average weekly trading volume of the securities at issue; (2) the number of securities analysts reporting on or following the securities; (3) the extent to which market makers traded in the securities; (4) the extent to which the issuer was/is eligible to file an SEC Registration Form S-3; and (5) the demonstration of a cause and effect relationship between the unexpected, material disclosures and changes in the securities' price. *Cammer v. Bloom*, 711 F. Supp. 1264, 1286-87 (D.N.J. 1989).

[70] Courts sometimes also use the *Krogman* factors, which are as follows: (1) the company's market capitalization; (2) the size of the bid-ask spread; and (3) the percentage of shares available to the public. *Krogman v. Sterritt*, 202 F.R.D. 467, 478 (N.D. Tex. 2001).

[71] *Halliburton II*, 2014 WL 2807181, at *17 ("As explained, we see no reason to artificially limit the inquiry at the certification stage to indirect evidence of price impact. Defendants may seek to defeat the Basic presumption at that stage through direct as well as indirect price impact evidence.").

[72] *See, e.g., id.* at *15 (After all, plaintiffs themselves can and do introduce evidence of the existence of price impact in connection with "event studies"—regression analyses that seek to show that the market price of the defendant's stock tends to respond to pertinent publicly reported events.").

[73] *Halliburton II*, 2014 WL 2807181, at *14.

[74] *Id.*

[75] *Id.* at 10.

[76] http://www.shearman.com/en/newsinsights/publications.

[77] *SEC v. Contorinis*, 743 F.3d 296 (2d Cir. 2014).

[78] *Id.* at 300.

[79] *SEC v. Contorinis*, No. 09-cv-1043 (RJS), 2012 WL 512626, at * 6 (S.D.N.Y. Feb. 3, 2012).

[80] *SEC v. Contorinis*, 743 F.3d 296, 301 (2d Cir. 2014).

[81] *Id.* at 302.

[82] *Id.* at 306-08.

[83] *Id.* at 309-10 (Chin, C. J., dissenting).

[84] *Id.*

[85] *See* Stephen M. Juris, *Contorting the Law of Disgorgement in Contorinis: Disgorging Ill-Gotten Gains that Were Never Gotten,* Forbes, Mar. 6, 2014, available at http://www.forbes.com/sites/insider/2014/03/06/contorting-the-law-of-disgorgement-in-contorinis-disgorging-ill-gotten-gains-that-were-never-gotten/.

[86] *SEC v. Shields*, 744 F.3d 633 (10th Cir. 2014).

[87] *Id.* at 643 (quoting *United Hous. Found., Inc. v. Forman*, 421 US 837, 849 (1975)).

[88] *Id.* at 644.

[89] *Id.* at 647.

[90] *US v. Esquenazi*, No. 11-15331, 2014 WL 1978613 (11th Cir. May 16, 2014).

[91] *Id.* at *3.

[92] *Id.* at *8-9.

[93] *Id.* at *8-9.

[94] *Id.* at *9-11.

[95] *Chau v. SEC*, No. 14-cv-01903 (S.D.N.Y. Mar. 18, 2014).

[96] Complaint at ¶ 4, *Chau v. SEC*, No. 14-cv-01903(S.D.N.Y. Mar. 18, 2014).

[97] *Id.* at ¶ 55.

[98] *Gupta v. SEC*, No. 11-cv-01900 (S.D.N.Y. July 11, 2011) (opinion and order denying motion to dismiss).

[99] Order Dismissing Proceedings, *In the Matter of Rajat K. Gupta*, Admin. Proc. File No. 3-14279 (Aug. 4, 2011), available at http://www.sec.gov/litigation/admin/2011/33-9249.pdf.

[100] Memorandum of Law in Opposition to Plaintiff's Motion for Preliminary Injunction and Motion to Dismiss, *Chau v. SEC*, No. 14-cv-01903 (S.D.N.Y. May 12, 2014)).

[101] *Jarkesy v. SEC*, No. 14-cv-00144 (D.D.C. June 10, 2014) (memorandum opinion dismissing action).

[102] *SEC v. Graham*, 2014 WL 1891418 (S.D. Fla. May 12, 2014).

[103] 2014 WL 1891418, at 8.

[104] Bruce Carlton, *SEC Trial Scorecard Update: SEC Loses Second Trial in Seven Days,* Compliance Week, June 10, 2014, http://www.complianceweek.com/sec-trial-scorecard-update-sec-loses-second-trial-in-seven-days/article/355052/.

[105] *SEC v. Wyly*, No. 10-cv-05760 (S.D.N.Y. May 12, 2014).

[106] Max Stendahl, *SEC Says Wylys Ran 'Scheme of Secrecy' As Trial Nears End,* Law360, May 6, 2014, http://www.law360.com/articles/534991/sec-says-wylys-ran-scheme-of-secrecy-as-trial-nears-end.

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[108] Max Stendahl, *SEC Wins Big As Wyly Brothers Found Liable in $550M Trial,* Law360, May 12, 2014, http://www.law360.com/articles/536500/sec-wins-big-as-wyly-brothers-found-liable-in-550m-trial.

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[112] *SEC v. Radius Capital Grp.*, No. 11-cv-00116 (M.D. Fla. Feb. 6, 2014).

[113] Complaint, *SEC v. Radius Capital Grp.*, No. 11-cv-00116 (M.D. Fla. Mar. 7, 2011).

[114] *Id.*

[115] SEC Litigation Release, Jury Returns Verdict Against President/CEO of Issuer of Mortgage-Backed Securities, Lit. Rel. No. 22947 (Mar. 19, 2014).

[116] Jeff Sistrunk, *Fla. Jury Finds Radius CEO Liable for MBS Fraud,* Law360, Feb. 6, 2014, http://www.law360.com/articles/507926/fla-jury-finds-radius-ceo-liable-for-mbs-fraud.

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[123] Sarah N. Lynch, *SEC Scores Partial Victory in Case Against Hedge Fund Manager,* Reuters, Feb. 11, 2014, http://www.reuters.com/article/2014/02/11/court-sec-quan-idUSL2N0LG24Q20140211.

[124] Plaintiff Securities & Exchange Commission's Motion for Remedies and Final Judgment, *SEC v. Quan*, No. 11 cv 00723 (D. Minn. Apr. 25, 2014).

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[126] *Id.*

[127] *Id.*

[128] Plaintiff's Request for Full Remedies, *SEC v. Jacobs*, No. 13-cv-1289 (N.D. Ohio Mar. 19, 2014).

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[131] *SEC v. Schvacho*, No. 12-cv-02557, 2014 WL 54801, at *13, *16 (N.D. Ga. Jan. 7, 2014) (alterations omitted).

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[145] Brandon Lowrey, *SEC Loses 2nd Insider Trading Trial in 7 Days*, Law360, June 6, 2014, http://www.law360.com/articles/545632.

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[153] SEC Press Release, SEC Charges Five Executives and Finance Professionals Behind Fraudulent Bond Offering by International Law Firm, Rel. No. 2014-45 (Mar. 6, 2014).

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[170] *United States v. ZAO Hewlett-Packard A/O.*, No. 14-cr-201 (DLJ) (N.D. Cal. Apr. 9, 2014).

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[178] SEC Press Release, SEC Charges a Former Biopharmaceutical Company Executive and Two Others with Insider Trading, Rel. No. 2014-80 (Apr. 21, 2014).

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[180] *Id.*

[181] *See* SEC Press Release, SEC Charges Two Clinical Drug Trial Doctors With Insider Trading, Rel. No. 2014-100 (May 19, 2014) (announcing charges against two doctors who allegedly traded on inside knowledge that the Food and Drug Administration had halted the clinical trials of a new prostate cancer drug developed by biopharmaceutical company GTx Inc.).

[182] SEC Press Release, SEC Charges Six Individuals With Insider Trading in Stock of E-Commerce Company Prior to Acquisition by eBay, Rel. No. 2014-85 (Apr. 25, 2014).

[183] *Id.*

[184] *SEC v. Choi*, No. 14-cv-2879 (S.D.N.Y. June 2, 2014).

[185] SEC Press Release, SEC Charges Technology Company Insider in California With Tipping Confidential Information Exploited by Hedge Funds, Rel. No. 2014-82 (Apr. 23, 2014).

[186] *In the Matter of Cohen*, Admin. Proc. File No. 3-15382 (July 19, 2013) (corrected order instituting administrative proceedings).

[187] SEC Press Release, SEC Charges Stockbroker and Law Firm Managing Clerk in $5.6 Million Insider Trading Scheme, Rel. No. 2014-55 (Mar. 19, 2014).

[188] SEC Press Release, SEC Charges Two Men With Insider Trading on Confidential Information From Their Wives, Rel. No. 2014-61 (Mar. 31, 2014).

[189] *Id.*

[190] *See also* SEC Press Release, SEC Announces Charges and Asset Freeze Against Hedge Fund Advisory Firm Distributing Falsified Performance Results, Rel. No. 2014-92 (May 7, 2014) (announced fraud charges and an asset freeze against a New York-based investment advisory firm called Alphelion Fund Management and two executives for purportedly distributing falsified performance results to prospective investors in two hedge funds they managed); SEC Press Release, SEC Charges Ohio-Based Investment Adviser and President for Fraudulently Hiding Account Shortfall, Rel. No. 2014-90 (May 5, 2014) (announcing fraud charges and an asset freeze against Columbus, Ohio-based investment advisory firm Professional Investment Management and its president for, allegedly, repeatedly hiding a shortfall of more than $700,000 in client assets).

[191] SEC Press Release, SEC Charges Legg Mason Affiliate With Defrauding Clients, Rel. No. 2014-13 (Jan. 27, 2014).

[192] SEC Press Release, SEC Charges N.Y.-Based Money Manager and Firm for Misleading Advertisements, Rel. No. 2014-18 (Jan. 30, 2014).

[193] SEC Press Release, SEC Announces Charges Against Arizona-Based Private Equity Fund Manager in Expense Misallocation Scheme, Rel. No. 2014-41 (Feb. 25, 2014).

[194] *In the Matter of Clean Energy Capital, LLC*, Admin. Proc. File No. 3-15766 (filed Feb. 25, 2014).

[195] SEC Press Release, SEC Charges Transamerica Financial Advisors With Improperly Calculating Advisory Fees and Overcharging Clients, Rel. No. 2014-64 (Apr. 3, 2014).

[196] SEC Press Release, SEC Charges San Diego-Based Investment Adviser, Rel. No. 2014-76 (Apr. 15, 2014).

[197] *Id.*

[198] *In the Matter of Total Wealth Mgmt., Inc.*, Admin. Proc. File No. 3-15842 (filed Apr. 15, 2014).

[199] SEC Press Release, SEC Charges Chicago-Based Investment Fund Manager With Stealing Investor Money and Conducting Ponzi Scheme, Rel. No. 2014-108 (May 29, 2014).

[200] SEC Press Release, SEC Charges Private Equity Firm With Pay-to-Play Violations Involving Political Campaign Contributions in Pennsylvania, Rel. No. 2014-120 (June 20, 2014).

[201] *See, e.g.*, SEC Press Release, SEC Announces Fraud Charges Against Two Wall Street Traders Involved in Parking Scheme, Rel. No. 2014-24 (Feb. 4, 2014) (charging two traders involved in a fraudulent "parking" scheme in which one temporarily placed securities in the other's trading book to avoid penalties that would affect his year-end bonus); SEC Press Release, SEC Charges Brokerage Firm Executives in Kickback Scheme to Secure Business of Venezuelan Bank, Rel. No. 2014-74 (Apr. 14, 2014) (charging several people involved in a massive kickback scheme to secure the bond trading business of a state-owned Venezuelan bank).

[202] *See* Andrew Ceresney, Director of the Div. of Enforcement, SEC, Keynote Address at Compliance Week 2014 (May 20, 2014) (stating: "In addition to trading venues like exchanges and dark pools, we also must continue to focus on broker-dealers that route much of the order flow in today's markets.").

[203] *See, e.g.*, *In the Matter of Axius Holdings, LLC and Henry Robertelli* (Jan 6., 2014) (alleging that Axius participated in 13 offerings by companies whose stock Axius shorted at the direction of Robertelli, and realized profits and related benefits totaling approximately $31,100); *In the Matter of John Durrett* (Jan. 6, 2014) (alleging that Durrett participated in 15 offerings and earned profits and related benefits totaling approximately $44,700 by shorting the issuing companies' shares); SEC Litigation Release, SEC Charges Investment Adviser and Principal for Illegal Short Selling, Litigation Rel. No. 22915 (Feb. 3, 2014) (announcing a civil injunctive action alleging illegal short selling against Revelation Capital Management Ltd. and its principal, Christopher Kuchanny); SEC Press Release, SEC Announces Largest Monetary Sanction for Rule 105 Short Selling Violations, Rel. No. 2014-43 (Mar. 5, 2014) (announcing the largest-ever monetary sanction for Rule 105 short selling

violations against a Long Island-based proprietary trading firm and its owner who agreed to pay $7.2 million to settle the charges); SEC Press Release, SEC Announces Charges Against Four Former Officials at Clearing Firm Penson Financial Services for Regulation SHO Violations, Rel. No. 2014-101 (May 19, 2014) (announcing charges against four former officials at clearing firm Penson Financial Services for their roles in alleged violations of Rule 204 under Regulation SHO); *In the Matter of Ironbird Capital LLC* (May 21, 2014) (alleging that Ironbird and other entities engaged in trading that violated Rule 105 in connection with 25 separate secondary and follow-on offerings, and earned approximately $279,900 in attributable profits and losses avoided).

[204] SEC Press Release, SEC Charges Jefferies LLC With Failing to Supervise Its Mortgage-Backed Securities Desk During Financial Crisis, Rel. No. 2014-48 (Mar. 12, 2014).

[205] *Id.*

[206] Jefferies LLC, DOJ Non-Prosecution Agreement (Jan. 29, 2014), available at http://www.justice.gov/usao/ct/Documents/Jefferies%20NPA.pdf.

[207] *See* Andrew Ceresney, Director of the Div. of Enforcement, SEC, Keynote Address at Compliance Week 2014 (May 20, 2014).

[208] SEC Press Release, SEC Charges Owner of N.J.-Based Brokerage Firm With Manipulative Trading, Rel. No. 2014-67 (April 4, 2014).

[209] *Oversight of the SEC's Agenda, Operations, and FY 2015 Budget Request: Hearing Before the House Committee on Financial Services*, 113th Cong. (statement of Mary Jo White, Chair of SEC).

[210] SEC Press Release, SEC Charges NYSE, NYSE ARCA, and NYSE MKT for Repeated Failures to Operate in Accordance With Exchange Rules, Rel. No. 2014-87 (May 1, 2014).

[211] SEC Press Release, SEC Charges New York-Based Dark Pool Operator With Failing to Safeguard Confidential Trading Information, Rel. No. 2014-114 (June 6, 2014).

[212] *Id.*

[213] SEC Press Release, SEC Announces Charges Against Wedbush Securities and Two Officials for Market Access Violations, Rel. No. 2014-115 (June 6, 2014).

[214] Andrew Ceresney, Director of the Div. of Enforcement, SEC, Address at The SEC Speaks to the D.C. Bar, Part I (June 11, 2014).

[215] SEC Press Release, Two Hong Kong-Based Firms to Pay $11 Million for Insider Trading Ahead of Nexen Acquisition by Company in China, Rel. No. 2014-26 (Feb. 11, 2014).

[216] *Id.*

[217] *Id.*

[218] *Id.*

[219] *SEC v. AgFeed Indus., Inc.*, No. 14-cv-00663 (M.D. Tenn. filed Mar. 11, 2014).

[220] SEC Press Release, SEC Charges Animal Feed Company and Top Executives in China and US With Accounting Fraud, Rel. No. 2014-47 (Mar. 11, 2014).

[221] Complaint, *SEC v. AgFeed Indus., Inc.*, No. 14-cv-00663 (M.D. Tenn. Mar. 11, 2014).

[222] SEC Press Release, SEC Charges Animal Feed Company and Top Executives in China and US With Accounting Fraud, Rel. No. 2014-47 (Mar. 11, 2014).

223 *SEC v. AgFeed Indus., Inc.*, No. 14-cv-00663 (M.D. Tenn. filed Mar. 11, 2014).

224 *SEC v. Kelley*, No. 14-cv-2827 (D.N.J. filed May 5, 2013).

225 *Id.*

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This memorandum is intended only as a general discussion of these issues. It should not be regarded as legal advice. We would be pleased to provide additional details or advice about specific situations if desired.

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