COVERING THE CASE LAW OF BROKERAGE HOUSE DISPUTES Vol. 2013 • No. 1

SECURITIES LITIGATION COMMENTATOR

SLAs 2013 | 01-08 • PUBLISHED 11/13 ISSN: 1557-6019

TOWARD A NEW SEC ENFORCEMENT DOCTRINE

*By: Thomas O. Gorman**

Four years ago, the SEC reorganized and refocused its Enforcement program. Specialty groups were added. Expertise was brought in to bolster the capabilities of the Enforcement Division. Record numbers of cases were brought. There can be no doubt that the program has been rejuvenated in the wake of a series of failures and scandals.

Yet, critics persist. Lawmakers on Capitol Hill, the media and the public continue to decry the fact that senior Wall Street executives were not put in prison as a result of the market crisis. The Commission's long list of cases centered on the crisis has done little to silence those critics.

New SEC Chair Mary Jo White has launched a new get tough policy. She modified the much discussed and often criticized "neither admit nor deny" settlement policy of the agency. Now she has outlined a new policy centered on a series of basic principles that will govern SEC enforcement during her tenure. While many of those principles are familiar, the key will be how they are implemented to achieve the Commission's statutory mission and goals.

The White enforcement doctrine

Ms. White specified her vision for SEC Enforcement in remarks to the Council of Institutional Investors at its fall conference on September 26, 2013.

Declaring that "a robust enforcement program is critical to fulfilling the SEC's mission…[since] In many ways, [it is] the most visible face of the SEC…," Ms. White specified five key principles to guide the Enforcement program.

First, the program will be "aggressive and creative…." This means that the agency will not shrink from bringing the "tough cases" and the "small ones." Sounding a theme that reverberated throughout her remarks, the new SEC Chair declared: "And when we resolve cases, we need to be certain our settlements have teeth, and send a strong message of deterrence." Ms. White went on to state that she thus favors legislation supported by her predecessor that would authorize the agency to impose penalties of up to three times the amount of the ill-gotten gain or the investor losses, whichever is greater.

Penalties will be considered in every corporate case, according to Ms. White. While she offered support for a prior Commission Release outlining a number of factors to be considered regarding the propriety of corporate penalties, each case will be evaluated on the basis of its particular facts and circumstances.

Second, the Commission "should consider whether to require the company to adopt measures that make the wrong less likely to occur again." Currently, the agency does this in "some cases," Ms. White noted, citing FCPA actions where, frequently, the resolution requires the adoption of extensive compliance procedures as part of an effort to prevent a recurrence of the wrongful conduct.

Third, there must be accountability. This means that in some instances the settling party will be required to make admissions. In most cases, the SEC can achieve an effective result utilizing its "neither admit nor deny" approach. In some cases, however, admissions will be required. This settlement approach will be used when there are: 1) a large number of investors who have been harmed or the conduct is egregious; 2) if the conduct presented a significant risk to the market or investors; 3) where admissions would aid investors in "deciding whether to deal with a particular party in the future;" and 4) if "recruiting unambiguous facts would send an important message to the market about a particular case."

cont'd on page 2

TABLE OF CONTENTS

Feature Article 1

Case Summaries 4

Table of Cases 44

**Thomas O. Gorman is a partner at the law firm Dorsey & Whitney, where he focuses on defending SEC, CFTC and other regulatory investigations and actions including related DOJ criminal case. His practice also regularly includes complex business litigation matters arising under the securities, commodities, antitrust laws, and the federal racketeering statutes. He can be reached by email at: gorman.tom@dorsey.com*

SEC Enforcement *cont'd from page 1*

Fourth, individuals must be held accountable. Declaring that this is "a subtle shift," Ms. White insisted it is necessary. Critical to this point is an assessment of the remedies that might be employed as to an individual. In this regard, a bar is "one of the most potent tools the SEC has..." since it not only punishes the past actions of the individual, but prevents a replication in the future.

Fifth, the program must cover the "whole market." In offering this statement, Ms. White identified three key areas: 1) investment advisers at hedge funds and mutual funds; 2) financial statement and accounting fraud; 3) insider trading; and 4) microcap fraud. At the same time it is critical that the agency continue to adapt to a diverse and rapidly changing market place.

Finally, the agency must win at trial. "For us to be a truly potent regulatory force, we need to remain constantly focused on trial redress, " according to Ms. White. Significant and consistent wins at trial give the program "credibility."

Ultimately the success of the SEC's enforcement program will be measured by its effectiveness in policing the market place. As Ms. White stated: "We should be judged by the quality of the cases we bring, by the aggressive and innovative techniques we use to pursue wrongdoers, by the tough sanctions and meaningful remedies we impose and, where appropriate, by the acknowledgements of wrongdoing that we require."

Analysis

The critical building blocks of Ms. White's enforcement approach are not new. Bringing tough cases as well as small ones, deterrence through monetary sanctions, accountability using admissions in select cases, winning a trial and remediation to protect against a replication of wrongful conduct in the future are all, with the exception of admissions, long-standing elements of the SEC enforcement program.

The critical point of her remarks is not identifying these elements but, as Ms. White acknowledged, their application and how the elements are mixed and blended in specific cases over time. Deterrence, for example, is a standard law enforcement goal. Whether this can be achieved through monetary penalties, even if coupled with admissions in select cases is, however, at best a highly debatable point. Critics of monetary sanctions have long argued that the only real impact of corporate fines is the aggravation of the injury already suffered by shareholders from the wrongful conduct, since they are ultimately the ones who pay. Others, such as Judge Rakoff, have noted that, given the size of many corporations, the fines imposed by regulators amount to little more than a cost of doing business.

Increasing the authority to impose penalties as Ms. White suggests is not likely to change this analysis. Indeed, it is difficult to see how coupling even large fines with admissions in select cases will create the sought after deterrence. The two cases in which the SEC has applied

cont'd on page 3

Securities Litigation Commentator is a semi-quarterly publication of Securities Litigation Commentator, Inc., P.O. Box 112, Maplewood, NJ 07040. Business Office: 93 Riggs Place, South Orange, NJ 07079. Tel: 973-761-5880. FAX: 973-761-1504. E-Mail: help@sacarbitration.com. WebSite: www.sacarbitration.com.
Subscription Information: Regular Subscription (semi-quarterly newsletter only): $350/year, regular rate. Preferred Subscription (semi-quarterly newsletter and weekly email Alert): $695/year, regular rate.

its newly minted admissions policy are illustrative. Shortly after hedge fund mogul Philip Falcone settled with the SEC based in part on admissions, he moved forward with a large IPO for one of his companies. While JP Morgan made a series of admissions in settling with the SEC over the London Whale episode, the deterrence effect of those statements is difficult, at best, to assess, since much of the conduct admitted had been previously disclosed in filings made with the Commission or was well known in the market place.

To be sure, there is a certain element of accountability in having to pay a large fine. Likewise, it cannot be denied that making admissions demonstrates accountability. But for the Commission's enforcement program, the real impact of the fines and admissions may not be the specific payments or statements, but the impact of the requirement on the market place. Stated differently, the headlines and buzz generated in the market place that help the SEC create presence is the critical point. While market place presence is a key goal of law enforcement, as Ms. White noted, care must be taken that any penalties and demand for admissions are based only on what is needed for an effective settlement. If more is demanded in the name of building market place presence, it may well undercut the program.

In contrast, there is little doubt that Chair Mary Jo White is correct when she states that the SEC must win a trial, cover the market place and focus on remediation. Winning at trial is vital to the goals of market place presence and deterrence. A successful record at trial tells would-be violators that they will be held accountable. It also garners buzz in the market place that can bolster the agency's presence. Creating this, however, takes more than claiming to win a high percentage of its cases. Rather, the SEC must win in high profile cases. With the exception of the recent victory against former Goldman Sachs employee Fabrice Tourre, that has not been the track record of the agency as well illustrated by the losses in the *Cuban* case, the Primary Reserve Fund action and the case involving former JP Morgan employee Brian Stoker.

Finally, it is clear that remediation should be a critical part of SEC enforcement settlements. This permits the agency to evaluate the wrongful conduct and its causes and take steps to protect shareholders, investors and the market place from future wrongful conduct. It is telling that Ms. White acknowledged that, in "some cases," the agency utilizes this approach, pointing to FCPA settlements. This should be a key consideration in any of the agency's cases.

Yet, effective remediation can be difficult. In the financial fraud cases Ms. White identified as a key focus of future enforcement efforts, for example, the wrongful conduct may be driven by an inherent conflict. As former SEC Chairman Levitt noted in his now famous "Numbers Games" speech in 1998, financial fraud actions frequently stem from the pressure to make the numbers and meet street expectations. Nobody would argue with wanting to make the numbers. Yet that goal, as history demonstrates, can conflict with faithfully reporting the financial results of the company. In such cases, effective remediation may require reordering the culture of the company and installing the necessary procedures.

The principles detailed by Ms. White clearly represent the building blocks of enforcement policy. What will be critical moving forward is how the Commission applies and blends those principles to craft effective results in its enforcement actions. And, it is those enforcement actions that will inform the market place about the meaning of the new "get tough" policy and ultimately determine the success of the SEC enforcement program.

THE SEC PULLS RANK IN REJECTING A DEAL

New SEC Chair Mary Jo White had a chance to demonstrate her seriousness in adopting a more stringent standard for settling enforcement actions when, stung by criticisms of "no admit" settlements, she announced that the SEC would force more admissions of wrongdoing in return for not going to trial in cases of "egregious" conduct. The SEC recently put that policy into effect when it rejected a tentative deal with Philip Falcone, accused of failing to disclose a loan from an investment he managed and conducting a "short squeeze" against Goldman Sachs by buying up bonds the investment bank had shorted and forcing it to pay through the nose to settle the trade. The original deal banned Falcone for two years but did not require an admission from him; a revised deal banned him for five years and extracted an admission. However, some experts warned that, despite the apparent vindication of the SEC's action, its rejection of the original deal may have harmed the enforcement division's credibility and made it harder to strike future deals.

(Source: "SEC Chief Wins Falcone Admission, But At Staff's Expense," by Max Stendahl, www.law360.com (8/19/13).)