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**TRENDS IN PENALTIES IN SEC ENFORCEMENT CASES  
BROUGHT AGAINST PUBLIC COMPANIES**

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A staple of recent commentary on the SEC’s Enforcement program has been the observation that the Commissioners have been reining in the SEC’s Enforcement Staff on the amounts of civil money penalties that public company defendants must pay to settle enforcement cases.<sup>2</sup> Can such a tendency be discerned among the accounting cases that the Commission brings? The answer is certainly “yes” if one focuses on “mega” accounting-case penalties of \$100 million or more, of which there have been none for almost two years. At a more workaday level, the SEC’s accounting enforcement program as to public companies has shown considerable consistency over the past three years, but with a pronounced drop in case output in the past two quarters.

**The Commissioners Try to Get Control of Penalties**

Since January 4, 2006, the discussion of penalties in SEC enforcement cases has been given greater structure by the Commission’s Statement Concerning Financial Penalties (the “Penalties Statement”).<sup>3</sup> The Penalties Statement represented the Commission’s first attempt to

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<sup>1</sup>Partner, Morgan, Lewis & Bockius LLP, Washington, D.C.

<sup>2</sup> See, e.g., “Fears That the Market Watchdog Is Losing Its Bite,” *New York Times*, April 8, 2008; “Watchdog to investigate SEC’s enforcement arm,” *FT.com*, April 2, 2008.

<sup>3</sup> Available on the SEC’s Website at [www.sec.gov/news/press/2006-4.htm](http://www.sec.gov/news/press/2006-4.htm). Interestingly for present purposes, the Penalties Statement used two accounting cases – *SEC v. McAfee, Inc.*, AAER No. 2360

state publicly, and unanimously, how the Commission would go about determining what financial penalties to seek against public companies. It identified two principal considerations – the presence or absence of a direct benefit to the corporation as a result of the violation, and the degree to which the penalty will recompense or further harm injured, innocent shareholders -- along with the following “additional considerations”:

- The need to deter the particular type of offense;
- The extent of the injury to innocent parties;
- Whether complicity in the violation is widespread throughout the corporation;
- The level of intent on the part of the perpetrators;
- The degree of difficulty in detecting the particular type of offense;
- Presence or lack of remedial steps by the corporation;
- Extent of cooperation with Commission and other law enforcement.

When it issued the Penalties Statement, the Commission expressed the hope “that the elucidation of these principles will provide a high degree of transparency to our decisions,” “and will be of assistance to the Commission’s professional staff, to corporate issuers and their counsel, and to the public.” However, the considerations laid out in the Penalties Statement – like every policy statement of its type, including the 2001 “Seaboard” Release on cooperation – are not a simple checklist. Instead, the presence or absence of any given consideration in any given case, and the respective weights to be given to each consideration, are legitimately the subject of debate and advocacy.

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(Jan. 4, 2006) (\$50 million penalty) and *In the Matter of Applix, Inc.*, AAER No. 2359 (Jan. 4, 2006) (no penalty) -- as illustrative bookends for when a penalty would be assessed under the Penalties Statement, and when it would not.

Apparently dissatisfied that the Penalties Statement had done the trick, a year ago SEC Chairman Christopher Cox announced a procedural change in the way civil money penalties are negotiated in enforcement cases that involve public companies.<sup>4</sup> Noting that the SEC's rules have long contemplated some involvement by the Commission at the front end of the settlement process,<sup>5</sup> Chairman Cox described a new approach under which the Enforcement Staff will not even begin to discuss a civil money penalty with a public company until the Staff has first sought the input of the Commissioners on the size of the penalty, which apparently is expected to take the form of a range of penalty amounts that the Commissioners believe should apply. If the penalty actually negotiated comes in within the range specified by the Commissioners, the settlement containing it will receive faster, or "seriatim," approval by the Commissioners. If the specified range is violated, then the case goes onto a slower track.

#### **Civil Money Penalties in SEC Accounting Enforcement Cases Against Public Companies**

The above announcements by the Commissioners suggest two dates by which to measure penalties in SEC cases: January 4, 2006, when the SEC issued its Penalties Statement, and April 13, 2007, when Chairman Cox announced the new SEC settlement program for penalties against public companies. To isolate the effect of those two events on SEC accounting cases in particular, the attached chart lists every Accounting and Auditing Enforcement Release between January 1, 2005 (one year prior to the Penalties Statement) and March 31, 2008 that announced a

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<sup>4</sup> Speech by Chairman Christopher Cox to the Seventh Annual Policy Conference of the Mutual Fund Directors Forum (April 13, 2007), available on the SEC's Website at [www.sec.gov/news/speech/2007/spch041207cc.htm](http://www.sec.gov/news/speech/2007/spch041207cc.htm). The comparatively short section of the Chairman's speech that deals with penalties in enforcement cases appears on pages 7-8.

<sup>5</sup> See Rule 202.5(f) of the SEC's Informal and Other Procedures, 17 C.F.R. § 202.5(f) ("In the course of the Commission's investigations, civil lawsuits, and administrative proceedings, the staff, *with appropriate authorization*, may discuss with persons involved the disposition of such matters by consent, by settlement, or in some other manner.") (Emphasis added.)

final judgment or SEC order against a public company.<sup>6</sup> For each such judgment or order, the chart lists the company involved, the prospective relief (injunction or cease-and-desist order) that was part of the decree, the amount of disgorgement and prejudgment interest, if any, that was assessed against the public company, and the civil money penalty, if any. The results are discussed below.

In 2005, the year before the Penalties Statement, the SEC settled 29 accounting cases against public companies. Of those 29, 21 involved no civil money penalty; eight, or 28%, included civil money penalties, in a total amount of \$443,000,000 – an average of more than \$55,000,000 per case in which any penalty was assessed.

In 2006, the first year after the Penalties Statement, the number of accounting cases settled with public companies was slightly greater – 33 – of which only six (18%) involved civil money penalties, but in which the total amount of penalties was \$612,125,000, for an average of \$102,020,083 per case in which any penalty was assessed.

In 2007, the number of accounting cases settled with public companies again increased slightly, to 36. Interestingly, thirteen of those cases, or 36%, involved a civil money penalty; however, the total amount of penalties assessed in 2007 was \$290,625,000, for an average of \$22,355,769 per case in which any penalty was assessed.

Finally, in the first quarter of 2008, the SEC brought only four accounting cases against public companies, of which one involved a penalty, of \$10,000,000. Although quarter-by-quarter comparisons are chancy because the sample size is so small, it is striking that those four

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<sup>6</sup> Unsurprisingly, all but a handful represent settlements, although two default judgments also appear on the list. In the case of either a settlement or a default, the SEC is in a position to demand the type of judgment or order that it believes is required by its enforcement program, so that the defaults are included for purposes of this paper.

cases compare to nine each brought in the first quarters of 2005 and 2006, and eight brought in the first quarter of 2007. The hypothesis that we may be looking at a real slowdown in accounting cases brought against public companies is reinforced by the fact that the last quarter of 2007 saw only three such cases, compared to five in 2005 and six in 2006.

What conclusions can we draw from these facts? One is that both before and after the Commission’s 2006 and 2007 announcements regarding corporate penalties, a solid majority of the Commission’s settled cases with public companies involved no civil money penalty at all (72% in 2005, 82% in 2006, 64% in 2007, and 75% in the first quarter of 2008), suggesting that concern about penalizing innocent shareholders is not a new phenomenon. Another conclusion that emerges from reading down the chart is that there are cases, and then there are what might be called “mega-cases.” “Mega-cases” can be defined those that involve penalties of \$100 million or more – *Time Warner* (March 21, 2005; \$300 million), *Healthsouth* (June 23, 2005; \$100 million), *AIG* (February 9, 2006; \$100 million), and *Fannie Mae* (May 23, 2006; \$400 million). Those four settlements alone accounted for \$900 million, or 66%, of the total \$1.36 billion in public-company penalties in accounting cases between January 1, 2005 and the first quarter of 2008. Mega-cases have disappeared altogether from the SEC’s AAERs since May 2006. If they are removed from the calculations on the previous page, the drop in average penalties during 2007 becomes much less striking:

<b><u>Year</u></b>	<b><u>Avg. Penalty in Penalty Cases</u></b>	<b><u>Avg. Penalty in Penalty Cases w/o Mega-Cases</u></b>
2005	\$ 55,375,000	\$ 7,166,000
2006	\$102,020,083	\$28,031,250
2007	\$ 22,355,769	\$22,355,769

The above data, together with the larger headcount of corporate penalty cases (thirteen in 2007, compared to six and eight in 2006 and 2005 respectively), suggest a world in which the SEC will

continue to assess corporate penalties in as many or more accounting cases, but at a more modest level. It remains to be seen if that trend continues, or is overtaken by the more recent tendency by the SEC to bring fewer corporate accounting cases of any sort, with or without penalties, than it has done in recent years.

SEC Accounting and Auditing Enforcement Releases Involving Public Companies

1/1/2005 – 3/31/2008

AAER	Date	Company	Prospective Relief	Disgorgement/PJI	Penalty
2161	1/6/2005	Broad Vision, Inc.	C&D	-	-
2160, 2159	1/6/2005	Monsanto Co.	C&D (FCPA)	-	\$500,000
2172	1/24/2005	Daisytek Int'l Corp.	C&D	-	-
2181	2/8/2005	Elan Corporation, plc	Injunction	\$1	\$15,000,000
2186	2/14/2005	GE InVision, Inc.	C&D	\$617,703.57	-
2185	2/14/2005	FFP Marketing Co.	C&D	-	-
2199	3/4/2005	TALX Corp.	C&D	\$1	\$2,500,000
2213	3/16/2005	Soulfood Concepts, Inc.	Injunction	-	-
2215	3/21/2005	Time Warner Inc.	Injunction	-	\$300,000,000
2227	4/7/2005	Easylink Services Corp.	C&D	-	-
2226	4/7/2005	Dollar General Corp.	Injunction	\$1	\$10,000,000
2231	4/11/2005	Global Crossing Ltd.	C&D	-	-
2232	4/18/2005	The Coca-Cola Company	C&D	-	-
2249	5/20/2005	Diagnostic Products Corp.	C&D	\$2,788,622	-
2252 2151	6/2/2005	Huntington Bancshares, Inc.	C&D	\$1	\$7,500,000
2254	6/7/2005	Mount Sinai Medical Center of Florida, Inc.	C&D	-	-
2259	6/9/2005	Take-Two Interactive Software, Inc.	Injunction	-	\$7,500,000
2265	6/22/2005	Schick Technologies, Inc.	Injunction	-	-
2263	6/23/2005	Healthsouth Corp.	Injunction	\$100	\$100,000,000
2273	7/8/2005	Duke Energy Corp.	C&D	-	-
2274	7/11/2005	Foamex Int'l, Inc.	C&D	-	-
2278	7/15/2005	Comerica, Inc.	C&D	-	-
2285	7/28/2005	Microtune, Inc.	C&D	-	-
2306	8/31/2005	Premier Financial Bancorp, Inc.	C&D	-	-
2309	9/13/2005	NCO Group, Inc.	C&D	-	-
2317	9/22/2005	Bio One Corp.	C&D, Revocation	-	-
2340	10/25/2005	Ocumed Group, Inc.	Injunction	-	-

AAER	Date	Company	Prospective Relief	Disgorgement/PJI	Penalty
2351	11/30/2005	Friedman's Inc.	Injunction	\$2,000,000 (paid to Postal Inspection Service)	-
2352	12/5/2005	Cedric Kushner Promotions, Inc.	Injunction	-	-
2360	1/4/2006	McAfee, Inc.	Injunction	-	\$50,000,000
2359	1/4/2006	Applix, Inc.	C&D	-	-
2362	1/11/2006	Pegasus Satellite Comms. Inc.	C&D	-	-
2364	1/19/2006	Sport-Haley, Inc.	Injunction	-	-
2370	2/7/2006	Cummins, Inc.	C&D	-	-
2371	2/9/2006	American Int'l Group, Inc.	Injunction	\$700,000,000	\$100,000,000
2386	2/27/2006	Sun Communities, Inc.	C&D	-	-
2382	2/27/2006	Net Ease.com, Inc.	Injunction	-	-
2403	3/29/2006	Netopia, Inc.	C&D	-	-
2408	4/7/2006	Exotics.com, Inc.	Injunction (default)	-	-
2414	4/17/2006	Tyco Int'l Ltd.	Injunction	\$1	\$50,000,000
2424	4/27/2006	Oil States Int'l, Inc.	C&D (FCPA)	-	-
2423	4/27/2006	Lumenis, Ltd.	Injunction	-	-
2422	4/27/2006	Ingles Markets Inc.	Injunction	-	-
2426	5/5/2006	Unified Fund Services, Inc.	C&D	-	\$125,000
2433	5/23/2006	Federal National Mortgage Ass'n	Injunction	-	\$400,000,000
2434	5/30/2006	Tribune Co.	C&D	-	-
2443	6/22/2006	Scientific-Atlanta, Inc.	Injunction	\$20,000,000	-
2446	6/27/2006	Power Linx, Inc.	Injunction	-	-
2453	6/28/2006	Walco Int'l, Inc.	C&D	-	-
2451	6/28/2006	Vedco, Inc.	C&D	-	-
2449	6/28/2006	Raytheon Co.	C&D	\$1.00	\$12,000,000
2452	6/28/2006	Virbac Corp.	Injunction	-	-
2455	6/30/2006	Greentech USA, Inc.	C&D	-	-
2454	6/30/2006	Information Architects Corp.	C&D	-	-
2471	8/1/2006	Blast Energy Services, Inc.	Injunction	-	-
2485	9/27/2006	Lantronix, Inc.	C&D	-	-
2504	10/30/2006	Delphi Corp.	Injunction	-	-
2511	11/7/2006	Stansbury Holdings Corp.	Injunction (default)	-	-
2518	11/29/2006	Ashland Inc.	C&D	-	-

AAER	Date	Company	Prospective Relief	Disgorgement/PJI	Penalty
[see 2563]	12/12/2006	Bennett Environmental, Inc.	Injunction	-	-
2528	12/21/2006	Interstate Bakeries Corp.	C&D	-	-
2529	12/29/2006	Whitemark Homes, Inc.	C&D	-	-
2540	1/12/2007	Lattice Semiconductor Corp.	C&D	-	-
2548 2547	1/29/2007	MBIA, Inc.	C&D	\$1	\$50,000,000
2550	2/6/2007	RenaissanceRe Holdings Ltd.	Injunction	-	\$15,000,000
2554 2555	2/13/2007	Dow Chemical Co.	C&D (FCPA)	-	\$325,000
2562	2/21/2007	Veritas Software Corp.	Injunction	-	\$30,000,000
2573	3/7/2007	Northwestern Corp.	C&D	-	-
2581	3/26/2007	Collins & Aikman Corp.	Injunction	-	-
2588	3/29/2007	Atlas Air Worldwide Hollings, Inc.	C&D	-	-
2591	4/2/2007	Tenet Healthcare Corp.	Injunction	-	\$10,000,000
2602	4/26/2007	Baker Hughes Inc.	Injunction (FCPA)	\$23,000,000	\$10,000,000
2604	5/2/2007	Capitol Distributing Ltd.	Injunction	-	-
2607	5/8/2007	Motorola	C&D	\$25,000,000	-
2608	5/10/2007	Penthouse Int'l Inc.	Injunction	-	-
2611	5/23/2007	BISYS Group, Inc.	Injunction	\$25,000,000	-
2616	6/5/2007	IBM	C&D	-	-
2618	6/20/2007	Allied Capital Corp.	C&D	-	-
2620	6/20/2007	Cambrex Corp.	C&D	-	-
2623	6/25/2007	IBM	C&D	\$7,000,000 "undertaking"	-
2626	6/29/2007	CVS Caremark	C&D	-	-
2644	7/17/2007	Quovadx	C&D	-	-
2643	7/18/2007	OM Group, Inc.	C&D	-	-
2652	7/25/2007	ConAgra Foods	Injunction	-	\$45,000,000
2658	7/26/2007	Delta & Pine Land Co.	C&D (FCPA)	-	\$300,000
2654	7/26/2007	Cardinal Health, Inc.	Injunction	\$1	\$35,000,000
2661	8/1/2007	Integrated Silicon Solutions, Inc.	Injunction	-	-
2664	8/7/2007	First BanCorp	Injunction	-	\$8,500,000
2673	8/30/2007	Integrated Electrical Services, Inc.	Injunction	-	-
2674	9/5/2007	Saks Incorporated	Injunction	-	-

<b>AAER</b>	<b>Date</b>	<b>Company</b>	<b>Prospective Relief</b>	<b>Disgorgement/PJI</b>	<b>Penalty</b>
2717	9/13/2007	Ferro Corporation	C&D	-	-
2725	9/25/2007	Electronic Data Systems	C&D	\$490,902	-
2727	9/26/2007	Bristow Group, Inc.	C&D (FCPA)	-	-
2730	9/27/2007	Tidewater Inc.	C&D	-	-
2728	9/27/2007	FHLMC	Injunction	-	\$50,000,000
2740	10/15/2007	Nortel	Injunction	-	\$35,000,000
2744	10/18/2007	MQ Associates, Inc.	C&D	-	-
2760	12/21/2007	Lucent Tech., Inc.	Injunction (FCPA)	-	\$1,500,000
2784	2/14/2008	AXM Pharma, Inc.	C&D	-	-
2785	2/14/2008	Westinghouse Air Brake Tech. Corp.	C&D (FCPA)	\$288,351	-
2801	3/24/2008	Biovail	Injunction	\$1	\$10,000,000
2803	3/25/2008	Hollinger Inc.	Injunction	\$0 (offset existing payment)	