

New SEC Chairman Schapiro Pledges Swift and Vigorous Enforcement

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In her opening address before the annual “SEC Speaks” conference on February 6, new Securities and Exchange Commission (SEC or the Commission) Chairman Mary L. Schapiro pledged to reinvigorate the Commission’s enforcement program and announced two significant changes to the enforcement process. First, Chairman Schapiro ended a two-year penalty pilot program, which had required that the Staff first seek the input of the Commissioners before discussing civil money penalties in enforcement cases against public companies. Second, Chairman Schapiro promised to expedite the investigative process through more rapid approval of formal orders of investigation that authorize the Staff to issue subpoenas. In addition, Chairman Schapiro set forth further policy initiatives designed to restore investor trust and confidence. Through these new measures, the new Chairman pledged swift and vigorous prosecution of securities fraud.

Following Chairman Schapiro’s address, senior Staff members of the Division of Enforcement confirmed that the industry can expect a more streamlined, yet aggressive, approach to the investigative process. They indicated that the Division of Enforcement will not endeavor to “turn over every stone” in an investigation; instead, emphasis will be placed on swiftly analyzing and addressing the primary issues in dispute. Chairman Schapiro’s new enforcement regime promises to provide new challenges to companies and their counsel involved in SEC investigations.

Ending the Penalty Pilot Program

In April 2007, then-Chairman Christopher Cox instituted a “pilot program” that would govern consideration of civil money penalties in enforcement cases against public companies. The program required the Staff to seek guidance from the Commissioners before discussing any settlement involving a civil money penalty with the company. Prior to the pilot program, the Staff and the company under investigation typically would have agreed in principle on all aspects of a proposed settlement, including the proposed civil penalty, before submitting the proposed settlement to the Commissioners for approval.

In her remarks, Chairman Schapiro explained that the pilot program had introduced significant delays into the process of bringing a corporate penalty case, discouraged the Staff from arguing for a penalty, and sometimes resulted in reductions in the size of penalties imposed. Chairman Schapiro stated that, in the current climate, the pilot program “sends the wrong message,” and that its elimination would expedite the Commission’s enforcement efforts and ensure swift justice to corporate wrongdoers. (Noticeably absent from Chairman Schapiro’s speech was any suggestion that the Commission was abrogating its January 2006 “Statement Concerning Financial Penalties,” which provides a framework

under which the Commission considers financial penalties in enforcement cases. The Penalties Statement is available on the SEC's website at <http://sec.gov/news/press/2006-4.htm>.)

Swift Formal Order Approval

Chairman Schapiro also announced a change in the investigative process to provide for more rapid approval of formal orders of investigation, which grant the Staff subpoena power to compel witness testimony and production of documents. In recent years, many requests for formal orders have been subject to plenary review by all five Commissioners before issuance, requiring weeks of advance notice so that the formal order could be placed on the Commission calendar for full review. To ensure that subpoena power is available to the Staff when needed without delay, Chairman Schapiro announced that, going forward, formal order requests would be approved by "seriatim" approval (written approval without convening a meeting) or, where appropriate, by a single Commissioner acting as a duty officer.

Regulatory Priorities and Other Initiatives

Chairman Schapiro underscored that the current financial climate requires that the SEC reinforce its role as investors' advocate through vigorous prosecution and modernization of the regulatory system. She stated that, in light of the current financial crisis, the SEC is "under the microscope" to do all it can to restore investor confidence and respond quickly to market events. In order to meet this challenge, Chairman Schapiro announced other regulatory priorities and initiatives:

- The formation of an Investor Advisory Committee to provide the Commission with first-hand information about the issues that are of the greatest concern to investors
- Improving the quality of credit ratings by addressing conflicts of interest
- Reducing systemic risk to investors by creating a centralized clearinghouse for credit default swaps
- Strengthening risk-based oversight of broker-dealers and investment advisers
- Improving the quality of audits of nonpublic broker-dealers.

In addition, Chairman Schapiro challenged Wall Street. She said that "regulation is a two-way street" and that she expected the regulated community itself to work to resolve its own problems. Chairman Schapiro also signaled her support for giving shareholders greater say on executive compensation and in deciding who serves on corporate boards. The full text of Chairman Schapiro's speech can be found at <http://sec.gov/news/speech/2009/spch020609mls.htm>.

Consistent with Chairman Schapiro's comments, senior members of the Division of Enforcement pledged a more streamlined approach that does not "turn over every stone" in an inquiry as discussed above, but emphasizes swift initiation and resolution of investigations. The Staff also discussed plans for innovative means to gather evidence, such as increased use of Section 21(a) orders requiring market participants to file statements under oath regarding trading and market activity, a technique dusted off during the Enron crisis and used recently in connection with the Commission's short-selling investigations.

In addition, the Staff promised continued aggressive enforcement efforts with respect to auction rate securities and Foreign Corrupt Practices Act cases, and made clear its intention to charge individuals, including mid-level managers, in appropriate cases. The Staff warned that it may pursue cases even where damages may be minimal, noting that “there is no ‘no-harm, no-foul’ rule” governing the types of cases the Staff will bring where evidence of fraud exists.

What to Expect

Through these enforcement changes, Chairman Schapiro has clearly signaled that the Staff will move with greater vigor and urgency with respect to the enforcement process. Public companies can expect the Staff to take a much tougher stance on the issue of monetary penalties. Moreover, companies considering settlement once again will be faced with a binary package choice—settle with the Staff, or don’t settle—and will lose the ability to make submissions to the Commissioners on penalties alone, independent of their negotiations with the Staff on other issues.

Companies also can expect more formal orders and consequently more pressure by the Staff to respond quickly to compulsory requests for documents and testimony. By quickly converting the investigative process from voluntary to compulsory under a formal order, the Staff may also limit a company’s ability to demonstrate extraordinary cooperation at the onset of an investigation through voluntary cooperation.

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