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securities lawflash

February 27, 2013

The SEC Speaks: Enforcement Panel Discusses 2013 Priorities and Past Successes

Changing SEC leadership defines its priorities for a new era of SEC enforcement.

At the annual "The SEC Speaks" conference on February 22 in Washington, D.C., Acting Director George Canellos and other senior officials from the Division of Enforcement of the Securities and Exchange Commission (SEC or the Commission) reported on the progress of enforcement efforts, which continued at a near record pace in 2012.[1] This year's panel signaled a new era for SEC enforcement and a significant changing of the guard. In December 2012, then-Commissioner Elisse Walter replaced Mary Schapiro as Chairman of the Commission. Less than two months later, President Obama nominated Mary Jo White, former U.S. Attorney for the Southern District of New York, to succeed Chairman Walter. Additionally, Enforcement Director Robert Khuzami announced his departure in early January 2013, and Chairman Walter appointed Mr. Canellos as Acting Director, effective February 2013. In light of these personnel changes and a slowly recovering capital market, Acting Director Canellos described the Division as being at a point of redefining its enforcement priorities. During the conference, senior enforcement officials outlined enforcement priorities moving forward under their new leadership, while emphasizing the successes of the last enforcement regime.

2013 Enforcement Priorities

Acting Director Canellos stated that the Division will ensure that the recovering financial market and its institutions are built on strong systems of compliance and corporate governance. He underscored a heightened enforcement focus on gatekeepers, including accountants, corporate boards of directors, and supervisory personnel. Acting Director Canellos said that the Division will continue to use its broad enforcement powers to seek "conduct specific" injunctions as well as "obey the law" injunctions and will utilize its new authority to seek penalties in cease-and-desist proceedings.[2] He also stated that the Division is examining greater use of section 21(a) reports, particularly in instances where the SEC declines to bring enforcement actions.[3]

Acting Deputy Director of Enforcement David Bergers stated that the Division has put in place a new "Enforcement Advisory Committee" to improve the Division's ability to investigate and litigate cases, evaluate enforcement priorities, and help empower the enforcement staff. According to Mr. Bergers, the Division is using new forensic technology and risk modeling to help detect fraud; he described a new predictive model that the Division is using in accounting investigations that mines information obtained from periodic filings and identifies potential areas of risk, such as discretionary accruals or earnings management. With respect to priorities, Mr. Bergers said that the Division is examining the scope of its specialized units and is considering adding "additional expertise." In the area of subpoena enforcement, Mr. Bergers pledged that the Division will be aggressive against

1. The SEC's fiscal year begins on October 1. FY 2012 enforcement statistics (October 1, 2011–September 30, 2012), which are discussed herein, can be found in the SEC's "Select SEC and Market Data Fiscal 2012," available at http://www.sec.gov/about/secstats2012.pdf.

2. The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) gave the SEC the power to obtain civil penalties in administrative cease-and-desist proceedings against nonregulated entities and persons, which greatly expands the Division's choice of venue. *See* Dodd-Frank Act § 929P(a). For additional analysis of the Dodd-Frank Act's expansion of the SEC's enforcement capabilities, see our July 19, 2010, LawFlash, "Landmark Legislation Gives SEC New Enforcement Capability," available at http://www.morganlewis.com/pubs/FRR_LandmarkLegislation_LF_19jul10.pdf.

3. Section 21(a) of the Securities Exchange Act of 1934 (the 1934 Act) authorizes the SEC to issue public reports of its investigations. The SEC typically issues such reports to provide industry guidance on a particular rule or regulation, where appropriate.

individuals and companies that delay in responding to subpoenas or fail to produce documents in the proper formats.[4]

Daniel Hawke, Chief of the Division's Market Abuse Unit, also signaled new priorities for the Unit. In addition to the heavy focus on insider trading, Mr. Hawke said that the Unit is focusing on market structure investigations, including the areas of alternative trading systems, dark pools, and high-frequency trading. Mr. Hawke also noted that the Division will continue to examine the conduct of the various exchanges. He stressed the importance of self-regulatory organizations as gatekeepers and, as an example, pointed to the SEC's recent case against the New York Stock Exchange for compliance failures.[5] Insider trading will also remain a top priority for the Unit. As an example, Sanjay Wadhwa, Senior Associate Director of the SEC's New York Regional Office, pointed to the Division's recent complaint and proceedings in *SEC v. Certain Unknown Traders in the Securities of H.J. Heinz Co.* In that action, the SEC obtained an emergency order and asset freeze based on suspicious trading in an omnibus account located in Switzerland just prior to the announcement that Heinz would be acquired by outside investors.

Enforcement Program Successes

The SEC's Cooperation Program

Eric Bustillo, Director of the SEC's Miami Regional Office, highlighted the successes of the SEC's Cooperation Program, which was initiated in 2010 to encourage greater cooperation from individuals and companies and which introduced new cooperation tools similar to those used by the U.S. Department of Justice (DOJ).[6] According to Mr. Bustillo, to date, the SEC has entered into 51 formal cooperation agreements, which have resulted in more than 40 enforcement actions. Mr. Bustillo said that the cooperation achieved through these agreements has enhanced dramatically the SEC's ability to investigate and prosecute cases, which ranged from insider trading to Foreign Corrupt Practices Act (FCPA) violations. Each SEC regional office has used a formal cooperation agreement.

In addition, Mr. Bustillo said that the Commission will be transparent in crediting individuals for cooperation. As an example, he noted the case involving AXA Rosenberg Group LLC, in which the SEC credited a senior executive for his cooperation by declining to take enforcement action against him based on certain factors identified in the SEC's Policy Statement Concerning Cooperation by Individuals in its Investigations and Related Enforcement Actions.[7]

The Office of the Whistleblower

Jane Norberg, Deputy Director of the SEC's Office of the Whistleblower, highlighted protecting whistleblowers as a top priority for the SEC. Here, she addressed corporate compliance with section 922(h)(1)(A) of the Dodd-Frank Act, which prohibits retaliation, and Rule 21F-17(a), which prohibits actions designed to impede a whistleblower from communicating directly with the SEC about a possible securities law violation, including enforcing or threatening to enforce a confidentiality agreement. Ms. Norberg said that the Office has significant concerns about employer conduct in these areas.

Ms. Norberg also highlighted the successes of the Office, including its first award to a whistleblower who provided

4. However, in FY 2012, the SEC filed nine actions to enforce subpoenas—the same number as in FY 2011.

5. In September 2012, the SEC brought its first-ever charges against the New York Stock Exchange for compliance failures that gave certain customers improper head starts on valuable trading information. *See* Press Release, Sec. & Exch. Comm'n, SEC Charges New York Stock Exchange for Improper Distribution of Market Data (Sept. 14, 2012), *available at* http://www.sec.gov/news/press/2012/2012-189.htm.

6. A full description of the Cooperation Program is available at http://www.sec.gov/spotlight/enfcoopinitiative.shtml. For additional details on the program, see our January 2010 White Paper, "The Securities and Exchange Commission Announces New Cooperation Initiative," available at http://www.morganlewis.com/pubs/WP_SECAnnouncesNewCooperationInitiative_Jan2010.pdf.

7. SEC Credits Former Axa Rosenberg Executive for Substantial Cooperation during Investigation, Litigation Release No. 22,298 (Mar. 19, 2012), *available at* https://www.sec.gov/litigation/litreleases/2012/lr22298.htm.

documents and other significant information to help the Division stop a multimillion-dollar fraud. She further noted that the Office is receiving many high-quality tips, which help save substantial time and investigative resources. In the first full fiscal year since its creation, the Office received more than 3,000 tips, complaints, and referrals from whistleblowers in all 50 states, the District of Columbia, the U.S. territory of Puerto Rico, and 49 foreign countries.[8]

Litigation Issues

Division Chief Counsel Joseph Brenner said that the U.S. Supreme Court's decision in *Janus Capital Group, Inc. v. First Derivative Traders*[9] has had a modest impact on the Division's enforcement program.[10] Mr. Brenner stated that the principal impact of *Janus* has been in deciding what charges to bring in enforcement actions. He explained that, in close calls where primary liability may not be available in light of *Janus*, the SEC is charging defendants under theories of secondary liability, including aiding-and-abetting and controlling-person liability. He noted that the Division views the U.S. Court of Appeals for the Second Circuit's recent decision in *SEC v. Apuzzo*[11] as favorable to the SEC in charging individuals with aiding-and-abetting primary violations. In *Apuzzo*, the Second Circuit held that, to satisfy the substantial assistance component of aiding and abetting, the SEC must show only that the defendant in some sort "associated himself with the [violative conduct], participated in it as in something he wished to bring about, and sought by his actions to make it succeed."[12] The SEC is not required to prove that the aider and abettor had proximately caused the violation. In the context of making Wells submissions, Mr. Brenner cautioned practitioners not to spend as much time arguing that no enforcement action is appropriate based on *Janus* when secondary theories of liability may exist.

Additionally, according to Mr. Brenner, cases instituted under section 304 of the Sarbanes-Oxley Act of 2002 remain a priority for the Division. He stated that the SEC will continue to seek to claw back compensation from chief executive and chief financial officers under this provision, even where the executives have not been charged with the underlying fraud. Mr. Brenner explained that the federal courts support the SEC's position and, as an example, cited *SEC v. Baker*,[13] a recent decision by the U.S. District Court for the Western District of Texas. In *Baker*, the court held that the SEC had the right under section 304 to claw back bonus compensation paid to the CEO and CFO of a public company, even though those executives had no involvement in or awareness of the alleged misconduct that caused the company to misreport its financial results.

For his part, Chief Litigation Counsel Matthew Martens noted that the Division's trial unit achieved a record of 23–1 against defendants nationwide in FY 2012. Mr. Martens also stated that recent judicial scrutiny of SEC settlements will not alter the trial unit's approach to settlements or result in more administrative proceedings versus civil actions. In addition, he noted that, although federal courts continue to grapple with the scope of the U.S. Supreme Court's holding in *Morrison v. National Australia Bank Ltd.*,[14] the decision is becoming less important to the SEC's enforcement program because of the "Dodd-Frank fix" with respect to post-2010 conduct[15] and judicial interpretations of *Morrison*.[16]

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8. *See* U.S. Sec. & Exch. Comm'n, Annual Report on the Dodd-Frank Whistleblower Program: Fiscal Year 2012 (Nov. 2012), *available at* http://www.sec.gov/about/offices/owb/annual-report-2012.pdf.

9. *Janus Capital Grp., Inc., v. First Derivative Traders*, 131 S. Ct. 2296 (2011).

10. In June 2011, the U.S. Supreme Court held that mutual fund adviser Janus Capital Management LLC and its parent, Janus Capital Group, Inc. could not be held liable in a private suit under Rule 10b-5 under the 1934 Act for allegedly false statements contained in a mutual fund prospectus because the Janus Investment Fund itself, rather than the adviser, "made" the statements in the prospectus. *Id.*

11. *Sec. & Exch. Comm'n v. Apuzzo*, 689 F.3d 204 (2d Cir. 2012).

12. *Id.* at 214.

13. *Sec. & Exch. Comm'n v. Baker*, No. A-12-CA-285-SS, 2012 WL 5499497 (W.D. Tex. Nov. 13, 2012).

14. *Morrison v. Nat'l Austl. Bank Ltd.*, 130 S. Ct. 2869 (2010).

15. Dodd-Frank Act § 929P(b).

16. In *Morrison*, the Supreme Court addressed the extraterritorial application of section 10(b) of the 1934 Act and adopted a "transactional test," which provided that section 10(b) only applied to "transactions in securities listed on domestic exchanges" or "domestic transactions in

FCPA Issues

Kara Brockmeyer, Chief of the FCPA Unit, reported on FCPA issues in the enforcement workshops following the main panel discussion. She began by discussing the SEC's and DOJ's "Resource Guide to the U.S. Foreign Corrupt Practices Act," which the agencies jointly released in November 2012. Ms. Brockmeyer explained that companies should not subscribe to a "one size fits all" compliance model and that they would be wise to design and implement programs that address the risks specific to their industries. She cautioned that such programs should not be static; rather, they must adapt and adjust to new risks. Ms. Brockmeyer further emphasized that the most effective compliance programs are intertwined with the financial controls of a company.

Ms. Brockmeyer also discussed two recent decisions from the U.S. District Court for the Southern District of New York regarding the extraterritorial reach of the FCPA—*SEC v. Straub*[17] and *SEC v. Sharef*.[18] On February 8, in *Straub*, Judge Richard Sullivan denied a motion by three former Magyar Telekom PLC executives challenging the court's exercise of personal jurisdiction. Judge Sullivan found that the defendants, who had allegedly signed misleading representation letters to Magyar's auditors as well as false SEC filings, engaged in unlawful conduct abroad that was "directed toward the United States, even if not principally directed there," and thus had sufficient minimum contacts with this country to justify the exercise of personal jurisdiction.[19]

On February 19, in *Sharef*, Judge Shira Scheindlin granted a motion by a former Siemens AG executive challenging the FCPA's extraterritorial reach. Herbert Steffen—a German citizen who served as chief executive officer of Siemens's Argentine subsidiary, Siemens S.A. Argentina—moved to dismiss the case in October 2011, arguing that the court lacked personal jurisdiction over him because "he had virtually no contact with the United States." Judge Scheindlin agreed and concluded that Steffen lacked minimum contacts with the United States necessary to subject him to personal jurisdiction where he (i) allegedly advocated for—but did not authorize or cover up—the illegal activity and (ii) was not alleged to have played any role in falsifying or manipulating financial statements relied upon by U.S. investors.

In reconciling the two cases, Ms. Brockmeyer noted that Judge Scheindlin distinguished her ruling in *Sharef* from that of Judge Sullivan in *Straub* by explaining that, in the latter case, the foreign defendants clearly engaged in conduct directed at the United States by allegedly signing misleading management representations to the company's auditors and signing false SEC filings, whereas Steffen's activities in *Sharef* were not similarly forum directed.

By the Numbers: Enforcement Actions and Awards

In FY 2012, the SEC initiated 734 enforcement actions, one shy of its record of 735 enforcement actions in FY 2011.[20] Of these, 462 were filed as administrative proceedings. The SEC obtained orders requiring $3.1 billion in

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other securities." *Morrison*, 130 S. Ct. at 2874. As an example of a recent instructive decision helping to define the scope of *Morrison*, Mr. Martens cited *Absolute Activist Value Master Fund Ltd. v. Ficeto*, 677 F.3d 60 (2d Cir. 2012), in which the Second Circuit considered the second prong of the *Morrison* test—under what circumstances the purchase or sale of a security not listed on a domestic exchange should be considered "domestic." The Second Circuit held that transactions involving securities that are not traded on a domestic exchange may still be subject to section 10(b) if title to a security is transferred within the United States or one party incurs "irrevocable liability" within the United States. *Id.* at 68.

17. *Sec. & Exch. Comm'n v. Straub* (*Magyar Telekom*), No. 11 Civ. 9645, 2013 WL 466600 (S.D.N.Y. Feb. 8, 2013) (order denying defendants' motion to dismiss), *available at* http://www.nysd.uscourts.gov/cases/show.php?db=special&id=263.

18. *U.S. Sec. & Exch. Comm'n v. Sharef*, No. 11 Civ. 9073 (SAS), 2013 WL 603135 (S.D.N.Y. Feb. 19, 2013) (order granting motion to dismiss), *available at* http://www.morganlewis.com/documents/Sharef_DistrictCourtDecision.pdf.

19. *Straub*, slip op. at 8.

20. Press Release, Sec. & Exch. Comm'n, SEC's Enforcement Program Continues to Show Strong Results in Safeguarding Investors and Markets (Nov. 14, 2012), *available at* http://www.sec.gov/news/press/2012/2012-227.htm. For more details on enforcement statistics from FY 2012, see our February 7, 2013, LawFlash, "Select SEC and FINRA Cases and Developments: 2012 Year in Review," available at http://www.morganlewis.com/pubs/Securities_LF_EnforcementCasesAndDevelopments-2012Review_07feb13.

penalties and disgorgement, representing an 11% increase from the amounts collected in FY 2011.[21]

Additional enforcement statistics from FY 2012 include the following:

- 150 "National Priority" cases, representing an increase of approximately 30% from the prior year
- 58 insider trading cases, one more than in FY 2011
- 29 cases related to the financial crisis, an increase of 26% from the prior year
- 134 cases related to broker-dealers, compared to 113 in FY 2011
- 147 cases related to investment advisers and investment companies, one more than the prior year's record number

What to Expect

The nomination of Ms. White and selection of Mr. Canellos as Acting Enforcement Director suggest that Division will remain proactive and aggressive and will continue to capitalize on the programs and enforcement tools put in place under its predecessors and in the Dodd-Frank legislation. The panelists at this year's conference signaled that they plan to build upon the successes of the prior leadership by using enhanced technological tools and risk modeling and that they will make full use of all available enforcement powers and remedies. In addition, the Division will continue to emphasize the policing of gatekeepers, which include accountants, board directors, supervisory personnel, and self-regulatory organizations. Moving forward, as our nation's market structures evolve, the Division also will expand and adapt its enforcement efforts to police activity in areas such as alternative trading systems, dark pools, and high-frequency trading.

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21. *Id.*

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