

SEC's 'Broken Windows' Gambit Leaves No Room For Error

By **Stephanie Russell-Kraft**

Law360, New York (September 10, 2014, 3:20 PM ET) -- Nearly a year after U.S. Securities and Exchange Commission Chair Mary Jo White said she had adopted a "broken windows" strategy of enforcement, defense attorneys and registered entities are becoming weary of the agency's "tough cop" approach, frustrated by the feeling that they're considered targets before even doing anything wrong.

The SEC's broken windows policy, which is based on the premise that no securities law violation is too small to prosecute and that minor enforcement actions lead to greater overall compliance, has been met with growing skepticism as the agency continues to push for press attention over even the most minimal infractions.

In July, the SEC issued a press release detailing charges in a \$11,776 insider trading case, and in August, the agency announced an enforcement action against a defunct company, both moves many former staff attorneys saw as a departure from the agency's past practices.

"You see press releases now touting enforcement actions that involve neither or no negligible investor harm, low dollar amounts for insider trading, and these are cases that the SEC a couple of years ago certainly would not have touted in a press release," said Joseph Dever of Cozen O'Connor, who thinks the agency's standard for issuing press releases has been lowered since his time at the SEC's Enforcement Division. Dever, who joined the SEC in 2003, left in 2012 after becoming an assistant regional director.

Under the broken windows agenda, the SEC's Enforcement Division has sent the message it may be sacrificing quality for quantity, Dever said.

The policy has also been responsible for changing attitudes across the industry, according to Stephen Ma of Early Sullivan Wright Gizer & McRae LLP. Ma, who represents individuals in enforcement actions brought by the SEC, said he recently corrected a firm's outside counsel's long-standing assumption that the agency would not pursue a small case as vigorously as a large one.

"I had to sit everybody down and say, 'If you think that just because you as an individual had alleged profits of less than \$100,000, that dollar amount is not a material issue for them not to go after fraud,'" Ma said. "The dynamic of the conversation changed immediately."

Over the past several years, smaller companies and individuals have started to pay closer attention to the SEC's enforcement policies, according to Ma, who noted that the SEC places value on every case

with the potential to increase the enforcement numbers it reports once a year.

As a result, registered entities have become frustrated by the perception that the agency doesn't appreciate the true cost of reputational harm, treating small, technical violations of securities laws the same as fraud, Dever said.

"There is concern among a lot of registered entities and the defense bar that every time the SEC finds a violation, they're subject to enforcement or a penalty and it's for conduct related to an oversight or a misinterpretation of a statutory provision," he said.

While many registrants are happy to make changes in order to comply with various rule provisions, they are discouraged by the agency's insistence on publicly disclosing even the slightest violations, according to Dever.

The broken windows policy has also undermined the SEC's other attempts to root out wrongdoing through cooperation with registered entities, according to Amy Greer, a litigation partner at Morgan Lewis & Bockius LLP.

While the agency says it encourages entities to come forward with reports of wrongdoing, it has sent "mixed signals" about what will happen when they do so, said Greer, pointing to the lack of meaningful cooperation credit cited so far on the agency's website.

"It's not like people are breaking down the door to tell them things," Greer said. "People have the sense that no matter what you do, it's not enough."

Since there is no clearly quantifiable benefit from self-reporting, many entities have simply chosen to stay quiet, according to Phil Bezanson of Bracewell & Giuliani LLP, who said cooperation is "at the very best" a "hard, complicated decision."

"At its worst, the promise of benefits is fairly faint compared with the potential costs of coming forward when you don't know what's going to happen next," Bezanson said.

Among those most worried about the agency's enforcement policies are gatekeepers like compliance officers, who fear they will face punishment no matter what, according to Greer.

"There's this feeling that they are targets even when they are doing a good job and acting in good faith," she said. "I'm not so sure that was the intention."

--Editing by Katherine Rautenberg and Philip Shea.