SHEARMAN & STERLING LLP

Securities Enforcement
2015 Mid-Year Review

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I. Executive Summary

In the first half of 2015, the SEC's Enforcement Division announced a number of significant enforcement achievements, including settling several important cases, obtaining admissions from settling defendants and continuing to make substantial whistleblower awards. At the same time, the first half of 2015 has been marked by increasing controversy over the use of administrative proceedings (APs) to litigate enforcement actions. Also, public dissents by certain commissioners suggest significant policy differences within the Commission with respect to, among other things, the granting of so-called bad-actor waivers to large financial institutions that have admitted to conduct that would result in automatic disqualification from certain activities.

First, debate continued in the first half of 2015 over the SEC's practice of litigating enforcement actions in APs before administrative law judges (ALJs). The SEC won 90% of the matters it litigated before ALJs from October 2010 to March 2015, a success rate that some critics attribute to procedural limitations that put defendants at a significant disadvantage when obtaining discovery. On top of the discovery handicaps, some have argued that defendants are further handicapped by the fact that their matters are presided over by SEC employees. In an apparent effort to quell the criticism, the Enforcement Division published guidance listing the factors it considers when choosing a forum. The guidance emphasized the Enforcement Division's discretion in forum selection and did little to explain how those factors are actually applied. Moreover, at least one district court enjoined an AP on constitutional grounds, and litigation over the SEC's forum choices is increasing.

Second, on another controversial issue, the SEC successfully secured admissions in six settled cases in the first half of 2015. But the number of settlements involving admissions remains relatively low, and the circumstances under which admissions would be sought continue to be murky.

Third, the issue of so-called "bad-actor" waivers has continued to dog the Commission in the first half of 2015. The SEC frequently grants waivers that permit settling defendants to avoid automatic disqualifications from the use of Well-Known Seasoned Issuer (WKSI) status, the safe harbor for forward-looking statements, and exemptions from securities registration requirements. In March, the Commission issued guidance outlining the factors it uses to determine whether to grant a waiver, but neither the guidance nor public statements defending the waivers from other commissioners and SEC Chair Mary Jo White appears to have eased the tension with segments of the legislature and media.

Fourth, the SEC's Whistleblower Program continued to make headlines. The Commission issued its first award to a whistleblower that learned of wrongdoing from a fellow employee through the company's internal reporting system and its second award to an audit or compliance professional. The Commission also instituted a settled enforcement action regarding confidentiality agreements that the SEC alleged could impede employees from reporting wrongdoing to the SEC.

Fifth, the SEC settled its long-running cross-border dispute involving Chinese affiliates of U.S. accounting firms. As part of the settlement, the affiliates agreed to produce work papers to the SEC through the Chinese Securities Regulatory Commission (CSRC). Although the CSRC has significant discretion over what work papers it will pass along to the SEC, the settlement may facilitate cross-border compliance with potentially conflicting regulatory requirements.

Sixth, the SEC continued to utilize enforcement sweeps, including by sending inquiries to dozens of public companies requesting copies of documents that contained confidentiality provisions, apparently so that the Commission could investigate whether such agreements could suppress whistleblowing.

The SEC also filed settled APs against 36 municipal securities underwriting firms, which arose out of a March 2014 voluntary self-reporting program targeting inaccuracies in municipal bond underwriting documents.

Seventh, a public dissent in the first half of 2015 by Commissioner Daniel Gallagher from recent enforcement actions against compliance officers suggested that there may be a difference of opinion among commissioners over whether such enforcement actions disincentivizes officers from creating rigorous compliance programs. In his dissent, Commissioner Gallagher warned that such enforcement actions may suggest to compliance officers that they should avoid taking ownership of compliance policies and procedures, lest they be held accountable for conduct that is their employer's responsibility.

Away from the Commission, there were a number of judicial developments in the first half of 2015 that impact the enforcement of the federal securities laws.

First, the Supreme Court clarified the scope of liability under Section 11 of the Securities Act of 1933 (Securities Act) in *Omnicare, Inc. v. Laborers District Council Construction Industry Pension Fund*. The Court held that a statement of opinion is not actionable as a misstatement under Section 11 of the Securities Act unless the speaker subjectively does not believe the opinion to be true or omits material facts relating specifically to the basis for the opinion that thus renders the opinion statement misleading.

Second, the Second Circuit denied a motion for a panel rehearing or rehearing *en banc* of the *U.S. v. Newman*, which vacated the criminal convictions of two hedge fund portfolio managers and held that to be liable for insider trading, a remote tippee must have known that: (i) insiders had tipped material non-public information in breach of a fiduciary duty, (ii) in exchange for a personal benefit and (iii) the personal benefit was of some consequence. However, several courts have read *Newman* narrowly to deny motions challenging indictments, complaints, pleas and convictions. As of publication, the government has petitioned the Supreme Court to review the portion of the Second Circuit panel's decision regarding what the government must show to prove that a tipper disclosed information in exchange for a benefit. We will further review the implications of *Newman* and the government's petition for *certiorari* in our year-end review.

Third, various district courts addressed the SEC's ability to litigate enforcement actions before ALJs. In *Hill v. SEC*, for example, a district court held that the SEC's practice of appointing ALJs is unconstitutional and enjoined an AP. However, other district courts have gone the other way and held that federal courts do not have jurisdiction to enjoin the SEC's APs, such as in *Duka v. SEC* and *Spring Hill v. SEC*.

Fourth, in *Montford & Co. v. SEC*, the U.S. Court of Appeals for the District of Columbia Circuit held that Section 4E of the Securities Exchange Act of 1934 (Exchange Act) did not limit the time the SEC has to institute an enforcement action after issuing a Wells notice. Section 4E (added by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank)) requires the SEC to institute an enforcement action no later than 180 days after it issues a Wells notice, but the court held that the 180-day period was not jurisdictional and upheld a decision by an ALJ that an enforcement action that the SEC instituted 187 days after issuing a Wells notice was not time-barred.

On the trial front, there have been relatively few verdicts thus far in 2015. To date, the SEC has obtained one partial victory and one outright victory.

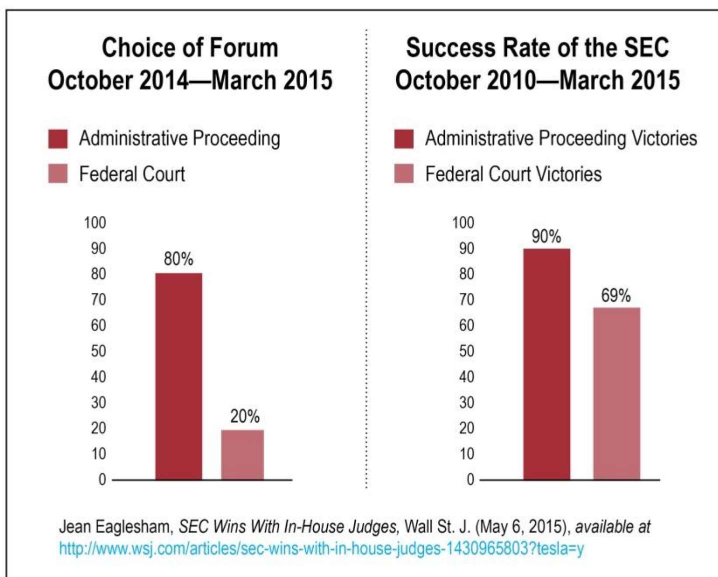
Finally, the overall activity of the Enforcement Division (which brought a record number of actions in 2014) shows no signs of slowing down in 2015. This update reviews some of the more important developments, particularly with respect to insider trading, financial reporting fraud, auditor independence, the Foreign Corrupt Practices Act (FCPA), investment advisors, broker-dealers, the financial crisis, mutual funds, and exchanges.

II. Significant Enforcement Division Developments

A. Open Questions Regarding the Use of APs

During the first half of 2015, the SEC, taking advantage of its authority under Dodd-Frank, continued to bring more enforcement actions before ALJs rather than in federal courts. Indeed, it has been reported that in the first half of the SEC's 2015 fiscal year (October 2014 to March 2015), the Commission brought 80% of its new enforcement actions before ALJs.[1] Correspondingly, the SEC continued its remarkable run of success in APs, having reportedly prevailed in 90% of the matters it litigated before ALJs from October 2010 through March 2015, a record that contrasts sharply with the Commission's 69% success rate in actions litigated in federal courts over the same period.[2] These statistics have only intensified the debate over whether this trend is evidence that APs are biased in favor of the Commission.

Enforcement Actions Brought as APs or in Federal Court



Jean Eaglesham, *SEC Wins With In-House Judges*, Wall St. J. (May 6, 2015), *available at* http://www.wsj.com/articles/sec-wins-with-in-house-judges-1430965803?tesla=y

1. Criticisms of Procedural Limitations in APs

The SEC Rules of Practice (Rules of Practice), which govern actions brought by the SEC in APs, impose severe limitations on a defendant's ability to mount a defense. Perhaps, most significantly, the SEC Rules (which were last updated in 2006) require that an ALJ issue an initial decision in a case within 120, 200, or 300 days of the issuance of an Order Instituting Proceedings (OIP), which in turn means that a factual hearing must generally be held within either one, two-and-a-half, or four months of the OIP; these time requirements hold true even in cases where the SEC has itself been investigating a matter for several years prior to the issuance of an OIP and has created an extensive investigative record, and thus can greatly limit a defendant's ability to prepare a defense.[3] These limitations are exacerbated by the fact that, unlike the Federal Rules of Civil Procedure (FRCP), the Rules of Practice do not provide for motions to dismiss and substantially limit discovery, for example, by only permitting depositions where they are necessary to preserve evidence.[4]

A recent enforcement ruling in an AP is illustrative of how defendants can be disadvantaged by the Rules of Practice. In *In the Matter of Laurie Bebo, et al.*, a defendant moved to compel production of notes taken by SEC attorneys during meetings with potential witnesses.[5] In denying the motion, ALJ Cameron Elliott noted that "Bebo correctly observes that the [FRCP] provides a mechanism for discovery of attorney work product, [but] those Rules are inapplicable here." Since third-party depositions are generally unavailable to defendants in SEC APs,[6] the Rules of Practice made it difficult for the defendant in *Bebo* to learn what witnesses had actually told the SEC in advance of the hearing.

Congress now appears to have taken notice of the potential procedural deficiencies inherent in APs. On March 19, 2015, Enforcement Division Director Andrew Ceresney appeared at a hearing before the House Subcommittee on Capital Markets and Government Sponsored Enterprises. Subcommittee Chairman Scott Garrett (R-N.J.) began the hearing by questioning whether APs were fair to defendants, and ranking member Carolyn B. Maloney (D-N.Y.) asked Director Ceresney how he would respond to the criticism that APs can deprive defendants of due process. Ceresney defended the Rules of Practice, emphasizing, among other things, that the SEC's duty to disclose exculpatory evidence and the requirement that the SEC turn over its investigative file within seven days of filing a claim were rules designed to ensure that defendants' rights are protected.[7]

Courts thus far have declined to find that the Rules of Practice are inadequate with respect to due process requirements, in part because courts have generally found that any such claims must be heard only after the conclusion of an AP, appeal to the SEC, and further appeal to the D.C. Circuit Court of Appeals. However, with defendants continuing to challenge the potential limitations of the Rules of Practice and increasing attention from Congress, the debate over whether the Rules of Practice are inherently unfair to defendants and constitute a denial of due process is likely to continue. Indeed, these criticisms could at least prompt the SEC to reexamine whether its Rules of Practice should be updated given that they were last amended nearly 10 years ago (something the SEC's own General Counsel has publicly acknowledged may be appropriate).[8]

2. SEC's "Home-Field" Advantage

Critics have also suggested that the SEC enjoys an unfair home-field advantage in APs because, for example, ALJs in such proceedings are SEC employees.

These criticisms intensified in early May when former SEC ALJ Lillian McEwen reportedly told the Wall Street Journal that her loyalty to the SEC was questioned after she issued rulings favorable to defendants and that ALJs were essentially expected to approach cases with the view that the burden was on the accused to show that they did not act as the agency alleged.[9]

On the heels of that story, the SEC invited ALJ Elliott — who has reportedly never ruled against the SEC — to file a voluntary affidavit addressing whether he has ever had experiences similar to what former ALJ McEwen described. ALJ Elliott had ruled in August 2014 that Timbervest LLC violated Section 206(1) of the Investment Advisers Act of 1940 (the Advisers Act) and that the firm's principals, Joel Barth Shapiro, Walter William Anthony Boden III, Donald David Zell, Jr. and Gordon Jones II, aided and abetted the violation. ALJ Elliott ordered disgorgement of $1,899,348.49. The respondents appealed on the grounds that the SEC's APs lacked impartiality and moved to depose ALJ Elliott.[10] On June 4, 2015, the SEC denied the motion, but asked ALJ Elliott for an affidavit addressing whether he had ever been pressured to rule in favor of the Commission.[11] ALJ Elliott, in a short one-line letter, declined the SEC's invitation, which raises a question of both why he refused and why the SEC thought it necessary to ask for the affidavit in the first place.

3. Forum Selection Guidance

On February 20, 2015, Commissioner Michael Piwowar called on the SEC to formulate a set of guidelines for determining which cases are brought as APs rather than as civil injunctive actions in federal court.[12] Commissioner Piwowar noted that recent trends created the perception that the Commission is taking its tougher cases to its in-house judges and suggested that this perception could be ameliorated if the SEC publicly released guidelines, which would, in turn, ensure that everyone is treated fairly and equally. Thereafter, during his above-mentioned subcommittee testimony on March 19th, Director Ceresney was asked for written guidelines concerning the Enforcement Division's forum selection process.

On May 8, 2015, the Enforcement Division issued a policy statement titled "*Approach to Forum Selection in Contested Actions*" (Forum Selection Guidance), but the Forum Selection Guidance did little to settle the debate or clarify how the SEC actually makes its forum selection decisions. The Forum Selection Guidance described four broad factors that the Enforcement Division considers when determining whether to bring a case in federal court or as an AP, namely: (1) the availability of the desired claims, legal theories, and forms of relief in each forum, (2) whether any charged party is a registered entity or an individual associated with a registered entity, (3) the cost-, resource- and time-effectiveness of litigation in each forum and (4) the fair, consistent and effective resolution of the federal securities law issues.[13] The Forum Selection Guidance does not, however, tell practitioners how these or other factors are actually applied in deciding where to bring an enforcement action. For example, the Forum Selection Guidance states that not all factors will apply in every case and, in any particular case, some factors may deserve more weight than others, or more weight than they might in another case. In essence, the Forum Selection Guidance is a non-exhaustive list of considerations that the Enforcement Division may apply in any given case, without any clear guidance on how they will be applied.

Perhaps most significantly, the Forum Selection Guidance suggests that if a contested matter is likely to raise unsettled and complex legal issues under the federal securities laws, consideration will be given to whether, in light of the Commission's expertise concerning those matters, obtaining a Commission decision on such issues may facilitate development of the law. Given the procedural limitations discussed above, one can reasonably question whether APs are the right forum for highly complex and novel issues or whether this is a signal that, in novel areas with unclear regulatory rules, the SEC may try to regulate through enforcement.

4. Constitutional Challenges to APs

Finally, numerous defendants have continued to challenge the SEC's use of APs as due process violations warranting federal court injunctions precluding the SEC from continuing with ongoing APs. As they had in 2014, district courts uniformly rejected these injunctive actions until June, when a federal judge enjoined an AP on constitutional grounds.[14]

As discussed more fully in Section III.D below, in *Hill v. SEC*, Judge Leigh Martin May issued a preliminary injunction halting an AP against Charles Hill on the grounds that the manner in which the ALJ was appointed likely violated the appointments clause of Article II of the U.S. Constitution. The decision in *Hill* appears to have encouraged similarly placed defendants,[15] and will likely spawn a spate of new challenges. But, even though the decision in *Hill* received substantial public attention,[16] it is unclear to what extent the decision will affect the SEC's ability to institute APs. Just days after the *Hill* court enjoined the SEC, a defendant in another enforcement action filed a complaint in federal court in the Southern District of New York (SDNY) seeking to enjoin an ongoing AP, in part on the basis of *Hill*.[17] The SEC responded that the district court lacked jurisdiction and argued that *Hill* had been wrongly decided.[18] The district court agreed with the SEC and denied the injunction.[19] Another SDNY court rejected a similar injunctive action shortly thereafter.[20] Judge May's decision in *Hill* will likely not be the last word as the Commission has indicated that it plans to appeal the decision.

Even if no other court follows *Hill*, or Judge May's decision does not ultimately survive appeal, defendants will undoubtedly continue to bring various constitutional and other challenges to the SEC's use of APs.

B. Admissions of Liability in Settled Cases

The SEC has continued to pursue the admissions policy it announced in June 2013,[21] and has secured admissions in six settled cases in the first half of 2015. Since inception, the SEC has demanded and obtained admissions in at least 21 cases out of the hundreds it has settled.[22] The Commission has previously stated that it will seek admissions (1) where the misconduct harmed large numbers of investors or placed investors or the market at risk of potentially serious harm; (2) where the allegedly violative conduct was egregious and intentional; and (3) where the defendant engaged in an unlawful obstruction of the Commission's investigative processes.[23] But with the Commission seeking admissions in only a fraction of its settlements, the application of the policy remains unclear,[24] and, as evident in the matters described below, the extent of the admissions required of settling defendants varies from case to case.

On January 21, 2015, the SEC filed a settled AP against Standard & Poor's Ratings Services (S&P) alleging that S&P engaged in fraudulent conduct when rating certain commercial mortgage-backed securities (CMBS). In 2011, S&P allegedly affirmatively misrepresented in its public disclosures that it was using one approach for rating CMBS when in reality it was using a different methodology. The SEC charged that S&P's conduct violated Section 17(a)(1) of the Securities Act and Section 15E(c)(3) of the Exchange Act and Rules 17g-2(a)(2)(iii) and 17g-2(a)(6) thereunder. As part of the settlement, S&P admitted that it had published one rating methodology and used a different methodology to rate certain of the CMBS, but did not admit that it had violated the federal securities laws. S&P also agreed to pay over $58 million to settle the claims, consisting of a civil monetary penalty of $35 million, disgorgement of $6.2 million, prejudgment interest of $800,000, and additional civil monetary penalties of $16 million in connection with other related orders. S&P further agreed to take a one-year timeout from rating certain types of CMBS.[25]

On January 27, 2015, the SEC filed a settled AP against Oppenheimer & Co. Inc. (Oppenheimer), alleging that Oppenheimer participated in fraudulent activities by its customers. *First*, from July 2008 through May 2009, Oppenheimer allegedly aided and abetted the execution of transactions by an unregistered brokerage firm, Gibraltar Global Securities (Gibraltar Global), which was a registered broker-dealer in the Bahamas, but not in the United States. Oppenheimer also allegedly ignored red flags that Gibraltar Global engaged in business without an exemption from the broker-dealer registration requirement. *Second*, the SEC claimed that Oppenheimer, on behalf of an unidentified customer, engaged in unregistered sales of penny stock securities that generated approximately $12 million in profits for the customer and $588,400 in commissions for Oppenheimer. Additionally, the Commission alleged that Oppenheimer failed to file a Suspicious Activity Report (SAR) pursuant to the Bank Secrecy Act and that Oppenheimer engaged in the sale of unregistered securities on behalf of Gibraltar Global.

Oppenheimer admitted to the conduct concerning Gibraltar Global and unregistered sales of penny stock securities underlying the SEC allegations and acknowledged that its conduct violated the federal securities laws, including Sections 15(a) and 17(a) of the Exchange Act and Rules 17a-3 and 17a-8 thereunder. Oppenheimer agreed to pay $10 million as part of the settlement, comprised of $4,168,400 in disgorgement, $753,471 in prejudgment interest and $5,078,129 in civil monetary penalties. In a parallel action, Oppenheimer agreed to pay another $10 million to settle charges brought by the Treasury Department's Financial Crimes Enforcement Network, which alleged that Oppenheimer failed to establish and implement an adequate anti-money laundering program, conduct adequate due diligence on a foreign correspondent account and comply with the requirements of Section 311 of the USA PATRIOT Act and the Bank Secrecy Act. [26]

As described in more detail below in Section II.E, in a settlement that followed an administrative hearing and initial decision in the SEC's favor, on February 6, 2015, the Chinese affiliates of the big four accounting firms, Deloitte Touche Tohmatsu CPAs Limited, Ernst & Young Hua Ming LLP, KPMG Huazhen (Special General Partnership), and PricewaterhouseCoopers Zhong Tian CPAs Limited Company, admitted that they had failed to produce certain documents to the Commission in response to an SEC document demand, but did not admit or deny the SEC's other findings. The SEC appeared to seek admissions from the firms to send a message to the broader market that violating the federal securities laws is not excused by adherence to inconsistent or conflicting foreign laws, though the firms did not actually agree that their conduct constituted such a violation. Another reason the SEC may have sought these admissions is that they would help the SEC establish the relevant facts should APs later be reinstated against the firms. In addition to the admissions, each firm agreed to pay a $500,000 civil penalty as part of a settlement, and the SEC agreed not to implement the ALJ's initial recommendation that each firm be suspended from auditing U.S.-listed companies for six months.[27] Additionally, the firms were censured and a procedure was established by which the firms would produce documents to the SEC in the future. The order further provides that if a settling firm does not comply, the SEC retains the right to impose an automatic six-month bar on a single firm's performance of certain audit work, commence a new proceeding against a firm, or resume the settled proceeding against all four firms.[28]

On February 10, 2015, the SEC filed a settled civil injunctive action against Craig S. Lax, the chief executive officer (CEO) of CovergEx Group, LLC, for violating Section 20(a) of the Exchange Act and Rule 10(b)-5 thereunder.[29] Lax admitted to causing certain employees under his control to charge brokerage customers hidden fees.[30] Lax agreed to cooperate with the SEC's ongoing investigation, be barred from the industry for five years and pay $783,297 in disgorgement with prejudgment interest to be determined at a later date. In this case, it appears that, regardless of the egregiousness of the conduct, the Commission sought the admissions, at least in large part, to further its case against another defendant pending in federal court and to further Lax's cooperation.

On April 9, 2015, the SEC instituted a settled AP for financial reporting and internal controls violations against Molex Inc. (Molex), a publicly-traded company in Illinois that designs, manufactures and sells electronics components. On the same day, the SEC also filed a settled civil action against Katsuichi Fusamae, a former senior accounting officer at Molex Japan Co. Ltd. (Molex-Japan), Molex's Japanese subsidiary. According to the SEC's allegations, Fusamae made unauthorized trades that resulted in $110 million of losses using Molex-Japan's

brokerage accounts. Also, Fusamae allegedly tried to conceal the losses by taking out unauthorized and undisclosed loans on behalf of Molex-Japan, which he used to replenish account balances and make additional trades, which ultimately resulted in Molex recognizing a $201.9 million loss. The SEC charged Molex with failing to file accurate annual and quarterly reports, as described in Section V below. The SEC charged Fusamae with violations of Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rules 12-20, 13a-1 and 13a-13 thereunder. Molex consented to a cease-and-desist order that did not require it to admit to the SEC's findings or pay any fines or penalties. Fusamae, on the other hand, agreed to settle the charges by admitting wrongdoing and accepting a permanent bar from serving as an officer or director of a publicly traded company, with possible monetary sanctions to be determined by the court. It appears the SEC sought an admission of wrongdoing from Fusamae because of the magnitude of the losses and, potentially, its view of the egregiousness of his conduct.[31]

On June 1, 2015, the SEC instituted a settled AP against an investment bank for allegedly using inaccurate data in the execution of short sale orders. The SEC alleged that the investment bank prepared easy-to-borrow (ETB) lists comprised of stocks the bank deemed readily accessible for the purpose of identifying a stock for short selling. During the trading day, however, certain securities on the ETB list became no longer easily available to borrow, and the SEC alleged that while the bank's personnel stopped using the ETB list when availability of certain shares became restricted, the firm's execution platforms nevertheless continued processing short-sale orders based on the ETB list. The investment bank admitted to violations of Rule 203(b) of Regulation SHO, began implementing systems enhancements to correct the problem, and agreed to pay $1,566,245.67 in disgorgement, $334,564.65 in prejudgment interest and $9 million in civil monetary penalty, totaling $10.9 million.[32] While essentially a strict liability claim, it appears the SEC may have sought an admission in this matter to underscore the significance it places on market participants avoiding systemic issues that can lead to repeated errors.

Throughout each of these cases it is notable that the SEC appears to be satisfied with partial admissions, as settling defendants infrequently admit to all of the Commission's allegations and to violations of law. Indeed, negotiating the nuances of an admission has become a central issue when considering entering into a settlement of an enforcement action with the SEC.

C. Tension Over SEC Waivers

One of the issues that have divided the Commission in recent years is the use of so-called "bad actor" waivers. This division appears to have sharpened in the first half of 2015. Individuals or entities found to have engaged in a wide variety of serious federal securities law violations can be automatically disqualified from relying on exemptions provided under the federal securities laws. For example, an issuer that is subject to a criminal conviction, fraud-based administrative order or injunction may not issue securities using the exemptions from registration under Regulation A and Rules 505 and 506 of Regulation D.[33] Similarly, under Rule 405 of the Securities Act, issuers that have violated the anti-fraud provisions of the federal securities laws are barred from qualifying as WKSIs.[34] The SEC has historically exercised its discretion and granted waivers from these bad-actor disqualifications upon a showing of good cause and a determination that the disqualification is not necessary under the circumstances.[35]

In the first half of 2015, however, a public rift emerged between Democratic Commissioners, who argued in public dissents that it was inappropriate to keep granting waivers to institutions that had repeatedly committed serious violations of the federal securities laws, and Republican Commissioners (as well as Chair White), who contended that disqualification provisions were not designed for remedial or punitive purposes, but rather to protect markets from recidivists. The disagreement has seemingly begun to interfere with the Commission's ability to negotiate settlements of enforcement actions.[36]

For example, as discussed above, on January 27, 2015, Oppenheimer's settlement for allegedly helping to execute sales of penny stocks on behalf of an unregistered brokerage firm based in the Bahamas triggered the automatic disqualification provisions of Rule 506 of Regulation D, but the Commission granted Oppenheimer a waiver in part because it agreed to retain outside counsel to review its compliance policies.[37] Commissioners Luis A. Aguilar and Kara M. Stein dissented, arguing that the waiver was inappropriate.[38]

Shortly after the Oppenheimer case, Commissioner Gallagher warned of a movement to inappropriately treat disqualifications as sanctions enhancements and argued that disqualification provisions were tools to reduce recidivism that were never intended to be remedial or punitive.[39] Commissioner Gallagher added that the SEC does not rubber-stamp waiver requests, but rather carefully considers the relevant facts and circumstances. A week later, Commissioner Stein appeared to respond to Commissioner Gallagher's remarks by stating that while she agreed automatic disqualification was not intended to be a punishment mechanism, she believed that automatic disqualification was a powerful compliance tool that was routinely ignored.[40] Commissioner Stein called on the SEC to establish a transparent, consistent process for how the staff decides waiver requests in the future.

Almost three weeks later, on March 12, Chair White emphasized that disqualifications were not enforcement remedies and reiterated that waivers should only be denied to protect markets from those whose misconduct suggests that they cannot be "relied upon to conduct those activities in compliance with the law and in a manner that will protect investors and our markets," *i.e.*, those that present a serious threat of future misconduct.[41] Chair White also defended the Commission's grant of waivers as the product of rigorous analysis.

The next day, on March 13, the SEC issued guidance clarifying that, in determining whether a disqualification is necessary, the staff will consider the nature of the violation, the duration of the wrongdoing, the seniority of employees involved, the participant's state of mind and remedial efforts, and whether the misconduct touched on all activities that the disqualification would affect.[42] The guidance also indicated that the staff may tailor a waiver by using conditions or limitations.

Far from ending the debate, however, further criticism followed. On March 24, Representative Maxine Waters (D-CA), the top-ranking minority member on the House Financial Services Committee, stated that she was "disappointed with the seemingly reflexive granting of waivers to bad actors, which can enshrine a policy of 'too-big-to-bar'" and introduced the "Bad Actor Disqualification Act," which would, among other things, require the Commission to maintain public records of all waiver requests and denials.[43] The New York Times described the bill as unlikely to gain traction.[44]

Next, in May, several large financial institutions received waivers in settlements with the SEC, and Commissioner Stein dissented. First, on May 1, the SEC permitted a bank to maintain its WKSI status after a subsidiary was convicted of manipulating the London Interbank Offered Rate (LIBOR).[45] In dissent, Commissioner Stein argued that the waiver was inappropriate because the alleged misconduct had purportedly occurred over a decade and involved many employees at offices around the world.[46]

Three weeks later, on May 20, four more banks pled guilty to conspiring to manipulate foreign exchange rates, and a fifth pled guilty to wire fraud in connection with the manipulation of LIBOR.[47] All five banks received waivers preserving their WKSI status, three received waivers allowing continued access to safe harbors for forward-looking statements, and two received waivers avoiding disqualification under Rule 506 of Regulation D. It was also reported, however, that one large financial institution had withdrawn a request for a WKSI waiver after learning that its request would not be approved.[48]

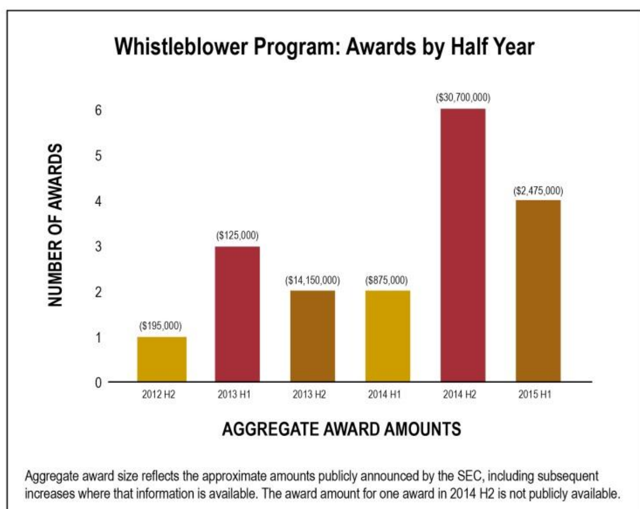
On June 2, Senator Elizabeth Warren sent a letter to Chair White that, among other things, noted that Chair White had previously pledged to "curb the use of waivers for companies found to be in violation of securities law."[49] The letter highlighted that, based on information revealed in March 2015, 20 of the 38 institutions that had requested WKSI waivers in the previous year had received them. Senator Warren asked the SEC to provide her with a list of all of its waiver decisions from January 2015 to the present, including information on who requested the waiver, what kind of waiver was requested, the reason for the waiver, the outcome of the waiver request and the reason why the waiver was or was not granted. On July 10, Chair White defended the Commission's use of waivers in a letter responding to Senator Warren.[50] Chair White reiterated that disqualifications were not enforcement remedies and that the SEC staff carefully and rigorously considered whether to grant waivers. Chair White refused to describe the Commission's deliberations or turn over documents concerning waiver requests, but said she was aware of seven WKSI disqualifications since January 2014 and 19 Rule 506 disqualifications since September 2013 when waivers were either not requested or not granted.

Notwithstanding Chair White's strong stance, the debate over waivers is likely to continue through the remainder of 2015 and has the potential to complicate settlement discussions in pending enforcement matters.

D. Update on the Whistleblower Program

The SEC's whistleblower program rewards individuals who report violations of the federal securities laws with between 10% and 30% of funds collected in connection with the resolution of the alleged violations, if certain criteria are met. Since it began in 2011, the program has paid more than $50 million to 18 whistleblowers, including a more than $30 million award in 2014[51] and a more than $14 million [52] award in 2013. The first six months of 2015 have seen significant developments.[53]

As shown in the chart below, the number of whistleblower awards granted in the first half of 2015 is down from the second half of 2014, but is consistent with grants in the prior three six-month periods.



1. Significant New Awards

On March 2, 2015, the SEC issued a whistleblower award that it estimated would be between $475,000 and $575,000 to an unidentified former company officer.[54] According to the SEC, the former company officer learned of an alleged fraud from a fellow employee through the company's internal reporting processes. This award marked the first time the SEC had ever issued an award in such circumstances.[55] Corporate officers who receive relevant information second-hand are usually ineligible for awards under the SEC's whistleblower program, but there is an exception for officers who report such information to the SEC more than 120 days after other responsible compliance personnel obtained the information and failed to adequately address the issue.[56] The award suggests that corporate officers may be rewarded for second-guessing internal compliance officers' decisions as to what is and is not reportable conduct.

On April 22, 2015, the SEC awarded between $1.4 million and $1.6 million to a compliance professional.[57] This, too, was notable because employees with compliance or internal audit responsibilities are typically not eligible for awards unless an exception applies.[58] Here, according to the SEC, the whistleblower was eligible for an award because there was "a reasonable basis to believe that disclosure to the SEC was necessary to prevent imminent misconduct from causing substantial financial harm to the company or investors."[59] The SEC noted that this was the second award to an employee with internal audit or compliance responsibilities.

On April 28, 2015, the SEC announced a whistleblower award of over $600,000 in connection with the SEC's first anti-retaliation enforcement action, which itself was described in our *Securities Enforcement 2014 Year-End Review*. When announcing the award, Director Ceresney emphasized that the Enforcement Division was committed to taking action when appropriate against companies and individuals that retaliate against whistleblowers.[60]

2. KBR Settles Novel Enforcement Action

On April 1, 2015, the SEC announced its first enforcement action pursuant to Rule 21F-17 under the Exchange Act, against KBR Inc. Purportedly, certain of KBR's confidentiality agreements could be read to impede employees from reporting wrongdoing to the SEC. The SEC alleged that KBR employees were required to agree to the following contractual provision in connection with internal investigations: "I understand that … I am prohibited from discussing any particulars regarding this interview and the subject matter discussed during the interview, without the prior authorization of the Law Department. I understand that the unauthorized disclosure … may be grounds for disciplinary action up to and including termination of employment." The SEC acknowledged that it did not know of any efforts by KBR to enforce these confidentiality provisions, nor was it

aware of any employees who had been dissuaded from becoming whistleblowers.[61] Even so, the SEC claimed that requiring employees to agree to the broad confidentiality language violated Rule 21F-17 under the Exchange Act by potentially disincentivizing employees from reporting possible federal securities law violations to the SEC. Without admitting or denying the findings, KBR agreed to pay a $130,000 civil monetary penalty and to amend its confidentiality agreement to include a carve-out stating that nothing in the agreement prohibits employees from reporting possible violations of federal law or regulations to any governmental agency or entity, including the SEC.

Given the lack of prior guidance, a report under Section 21(a) of the Exchange Act would have been a more appropriate resolution. The decision to bring an enforcement action in this case appears to reflect the Commission's intention to sharpen the message to issuers that it will not tolerate corporate policies that chill potential whistleblowing.

E. Audit Firms Resolve Document Production Case

On February 6, 2015, the SEC issued a final order in the long-running enforcement action involving Chinese affiliates of the big four accounting firms, Deloitte Touche Tohmatsu CPAs Limited, Ernst & Young Hua Ming LLP, KPMG Huazhen (Special General Partnership) and PricewaterhouseCoopers Zhong Tian CPAs Limited Company, which we have covered in previous publications. This order comes nearly three years after the SEC instituted APs against these firms for their alleged violations of Section 106 of the Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley).[62] As described above in Section II.B, each firm admitted to withholding documents called for by the SEC and agreed to pay a $500,000 civil penalty as part of a settlement in which the SEC agreed to defer further enforcement and stay the AP for a period of four years.[63] Additionally, the order censures the firms and articulates procedures that the firms must follow in response to any future requests for documents pursuant to Section 106 of Sarbanes-Oxley. The order implementing the settlement also provides that if a settling firm does not comply with the order, the SEC retains the right to impose an automatic six-month bar on the performance of certain audit work, commence a new proceeding against a firm, or resume the settled proceeding against all four firms.[64]

The procedures established by the order for the production of audit work papers by the settling firms are apparently designed to resolve longstanding conflicts between U.S. and Chinese regulations governing such productions. Going forward, the SEC will request assistance from the CSRC pursuant to international sharing mechanisms and simultaneously serve a corresponding request on the accounting firm.[65] Each firm, within specified time limits, must provide responsive documents to the CSRC along with a privilege log. After the CSRC transfers the production to the SEC, the accounting firm will certify to the SEC that all responsive documents, except those listed in the log, have been produced.[66]

The procedures may provide comfort to the settling firms and the issuers they audit, as they signal heightened cooperation between the U.S. and Chinese law. However, the extent to which the SEC will have access to the work papers provided to the CSRC remains unclear. Indeed, this procedure is essentially what the audit firms had been requesting from the outset, but the SEC previously argued that a non-direct channel for production from audit firms was insufficient. In any event, the order suggests that, in the future, the SEC will not hesitate to sanction a foreign audit firm if cooperation with the CSRC (or similarly situated foreign regulators) breaks down. Even if foreign audit firms claim an inability to provide work papers directly to the SEC because of conflicting local laws, the SEC may take the position that such a conflict provides no defense.

F. Enforcement Sweeps

The first half of 2015 saw the SEC bring three enforcement sweeps.

On February 25, 2015, the *Wall Street Journal* reported that the Enforcement Division had sent inquiries to dozens of public companies requesting nondisclosure agreements, employment contracts, severance agreements and other employment-related documents that contained confidentiality provisions, apparently so that the Division could investigate whether companies like KBR were requiring employees to abide by policies or provisions that the Commission viewed as potentially suppressing whistleblowing.[67]

On March 26, 2015, the SEC instituted a settled AP against Global Fixed Income LLC (GFI), a Chicago-based trading firm, its owner, Charles Perlitz Kempf, and 22 corporate and individual participants that bought securities on behalf of GFI. The SEC claimed that, from 2009 to 2012, GFI, as part of its practice of purchasing investment grade corporate bonds, entered into agreements with the 22 participants whereby the participants, who were not registered as broker-dealers, purchased $2.5 billion of newly issued bonds so that GFI's bond offering allocations would increase. The SEC further claimed that because the offerings were frequently oversubscribed, GFI was able to quickly sell the bonds and reap small profits that it would share with the participants. As part of the settlement, the SEC ordered GFI to pay a civil monetary penalty of $500,000, the corporate participants to each pay civil monetary penalties of $50,000, the individual participants to each pay $5,000 in civil monetary penalties, and barred Kempf from associating with a registered entity or participating in a penny stock offering for one year. The SEC also ordered GFI, Kempf and the 22 participants to disgorge a total of $4,871,989, for a total of $5,376,979.[68]

On June 18, 2015, the SEC announced the filing of settled APs against 36 municipal securities underwriting firms pursuant to its Municipalities Continuing Disclosure Cooperation (MCDC) Initiative, which we have discussed in previous publications.[69] The defendants allegedly sold municipal bonds without the issuer (or otherwise obligated person) complying with the undertakings in the continuing disclosure statement, thereby making the offering documents materially false and misleading. The SEC asserted further that the respondents failed to conduct the due diligence necessary to identify the inaccurate statements or omissions. The settlement agreements arose out of the voluntary self-reporting program targeting inaccuracies in municipal bond offering documents announced in March 2014. Without admitting or denying the alleged violations, the firms settled for a combined total of approximately $9 million in civil penalties.

G. Compliance Officers Face SEC Scrutiny

On June 18, 2015, Commissioner Gallagher publicly explained why he dissented from two recent SEC enforcement actions involving alleged violations of Rule 206(4)-7 of the Advisers Act by two chief compliance officers (CCOs).[70] Commissioner Gallagher warned that bringing such actions against CCOs — particularly actions that focus on the implementation of compliance policies — potentially gave CCOs an incentive to avoid working to create rigorous compliance programs, and reflected a troubling trend toward strict liability for CCOs.

In *BlackRock*, an investment firm's portfolio manager, who was responsible for investments in energy companies, allegedly founded an oil and natural gas partnership. The oil and natural gas partnership later formed a joint venture with another energy company.[71] The portfolio manager allegedly committed $50 million to the partnership over three years, became the managing partner of the partnership, and made substantial investments in the partnership's joint venture's counterparty. The SEC filed a settled AP against the firm and its CCO, Bartholomew Battista, and found that Battista and other executives knew and approved of the portfolio manager's substantial involvement with the partnership, but that the firm failed to disclose the purported conflict of interest to either the boards of the funds that the portfolio manager managed or the investment firm's advisory clients. As part of the settlement, without admitting or denying liability, Battista consented to the entry of an order finding that, among other things, he had caused the firm's "failure to adopt and implement [compliance] policies and procedures" because he did not recommend written policies and procedures to assess and monitor outside activities or disclose conflicts of interest to the funds' boards and clients. Battista agreed to pay a $60,000 penalty.

In *SFX*, the SEC instituted a settled AP against SFX Financial Advisory Management Enterprises, Inc. (SFX) and its CCO, Eugene Mason.[72] The Commission alleged, among other things, that Mason failed to implement compliance policies and procedures that would have detected an SFX executive's embezzlement of $670,000. Under the terms of the settlement, Mason was required to pay a civil monetary penalty of $25,000.

Historically, the Commission has brought enforcement actions against CCOs either when the CCOs were actively involved in wrongdoing, tried to conceal wrongdoing, or ignored red flags. *BlackRock* and *SFX*, however, suggest that the Commission may be pursuing a new policy whereby compliance officers can be held liable for the

poor implementation of compliance programs and controls, even in the absence of specific red flags, a standard troublingly close to strict liability.

In the face of the two enforcement actions against CCOs, Commissioner Gallagher warned that these enforcement actions send a message that CCOs "should not take ownership of their firm's compliance policies and procedures."[73] Commissioner Gallagher urged the SEC "to avoid the perverse incentives that will naturally flow from targeting compliance personnel who are willing to run into the fires that so often occur at regulated entities."

On June 29, in response to Commissioner Gallagher's dissent, Commissioner Aguilar issued a public statement to reassure CCOs that they were not being targeted by the SEC.[74] Commissioner Aguilar highlighted that the SEC had brought actions against CCOs relating solely to their compliance responsibilities only eight times over the past 11 years.

On July 14, 2015, Chair White similarly stated that it was not the SEC's intention to use its enforcement program to target compliance professionals.[75] Although Chair White noted that serving as a CCO did not provide immunity from liability, she also emphasized that the Commission did not bring enforcement actions to second-guess good-faith judgments, but rather to sanction actions or inactions that cross a clear line. Nevertheless, in light of the two recent enforcement actions, it remains to be seen whether CCOs will continue to find themselves in the crosshairs of the SEC.

III. Selected Judicial Developments

A. The *Newman* Influence

As we have previously discussed, on December 10, 2014, in *United States v. Newman*, a Second Circuit panel unanimously vacated the criminal convictions of two hedge fund portfolio managers, holding that to be held criminally liable for insider trading, a remote tippee must have known that the insiders tipped inside information in breach of a fiduciary duty in exchange for a personal benefit and that the personal benefit must be of some consequence.[76] On April 3, 2015, the Second Circuit unanimously denied the government's request for panel rehearing or rehearing *en banc* of *Newman*.[77] This is not the end of the matter, however, as the government can still seek Supreme Court review. On July 30, 2015, the Solicitor General petitioned the Supreme Court for a writ of *certiorari* to review the Second Circuit panel's decision regarding what the government must show to prove that a tipper disclosed information in exchange for a benefit. We will further review the implications of *Newman* and the government's petition for *certiorari* in our 2015 year-end review.

In the time it took the Solicitor General to seek *certiorari*, lower courts continued to grapple with *Newman*'s implications in both criminal and civil cases.

In response to *Newman*, federal prosecutors first sought to limit the impact of the holding to the "classical" theory of insider trading, where a corporate insider trades on the basis of material non-public information in breach of a duty to shareholders, as opposed to the "misappropriation" theory, where a person trades on material non-public information allegedly stolen or misappropriated from its source.[78]

In *United States v. Conradt*, five defendants were criminally charged with trading on the basis of material non-public information concerning IBM Corporation's $1.2 billion purchase of SPSS Inc. in 2009. The government alleged that an associate at a law firm that represented a party to the transaction revealed the planned acquisition to RBS Group PLC analyst Trent Martin. According to the indictment, the associate privately discussed the anticipated acquisition in order to receive moral support, reassurance and advice.[79] Rather than maintaining the information in confidence, the indictment alleged that Martin purchased SPSS shares and shared the information with his roommate, Thomas Conradt, who, in turn, shared the information with Daryl Payton, Benjamin Durant III and David Weishaus. Four of the defendants had already pled guilty, but in the immediate aftermath of the *Newman* decision, District Judge Andrew Carter stated that he was inclined to vacate the guilty pleas. Indeed, on January 22, 2015, the guilty pleas were vacated after Judge Carter found them to be insufficient in light of *Newman*'s clarification of the insider trading laws.[80] Rejecting the government's arguments to the contrary, the court emphasized that the elements of tipping liability were the same, regardless of whether a tipper's duty arose under the classical or the misappropriation theory. After Judge Carter vacated the guilty pleas, the government

asked for the insider trading charges against each of the five defendants to be dismissed, effectively conceding that, in light of *Newman*, they did not have sufficient evidence to establish knowledge of a personal benefit to the tippers.[81]

It was not long after *Conradt*, however, that courts began interpreting *Newman* narrowly. On April 6, 2015, Judge Rakoff denied a motion to dismiss in *SEC v. Payton*, a parallel civil action against Payton and Durant for insider trading that arose out of the same facts in *Conradt*.[82] First, Judge Rakoff agreed with Judge Carter that *Newman* applied to allegations of insider trading under either classical or misappropriation theories of liability, but noted that while defendants must act willfully to be criminally liable, they need only act *recklessly* to be civilly liable. Under a reckless standard, Judge Rakoff held, the SEC only needed to show that a tippee disregarded warning signs about the source of the information, not that a tippee actually knew or consciously avoided knowing that information had been disclosed in exchange for a benefit. Judge Rakoff then held that the SEC sufficiently alleged that Martin, the misappropriator and tipper, had received a benefit for giving Conradt inside information because Martin and Conradt were roommates with intertwined personal expenses and Conradt had negotiated a lower rent for their apartment and helped Martin resolve a criminal assault charge so that Martin could remain in the country.

Turning to Payton and Durant, Judge Rakoff held that the complaint sufficiently alleged that Payton and Durant knew or were reckless in not knowing that Martin had tipped Conradt in exchange for a benefit because they knew that Martin had tipped Conradt, and Payton knew about Martin's arrest for assault. Judge Rakoff further noted that Payton and Durant allegedly tried to conceal their trading by paying for a lunch with cash to avoid a paper trail, agreeing with other tippees to keep the trades secret, and lying to their employer about the origins of their interest in SPSS, which Judge Rakoff found to be further evidence of defendants' knowledge that the inside information had been disclosed in breach of a fiduciary duty. By allowing the SEC to proceed in *Payton*, Judge Rakoff interpreted *Newman* in an important respect by holding that the government does not need to show actual knowledge of a benefit in a civil action.

On June 8, Judge Oetken also interpreted *Newman* narrowly by holding that *Newman* does not alter the pleading standard for an insider trading claim.[83] The SEC had alleged that Dhia Jafar and Omar Nabulsi traded on material non-public information concerning proposed transactions involving biotech companies Onyx Pharmaceuticals, Inc. and Life Technologies Corp. Both traders allegedly reaped profits on trades in the companies' shares just before the publication of articles announcing proposed transactions that would result in an increase in the companies' values. Neither Nabulsi nor Jafar had previously purchased securities in either company before the purchases at issue. Judge Oetken denied the defendants' initial motion to dismiss in September 2014 on the grounds that it was impractical to require the government to plead with particularity the details of an insider trading scheme because tips are passed in secret and, based on the SEC's allegations, it was fair to characterize the defendants' trades as suspicious and risky and to infer that someone was feeding the defendants inside information.

Jafar and Nabulsi moved for reconsideration in light of *Newman*, arguing that the SEC's complaint should be dismissed because it failed to allege a quid pro quo exchange or adequately plead that Jafar and Nabulsi knew or should have known that the tipper divulged material non-public information in exchange for a personal benefit.[84] Judge Oetken denied the defendants' motion and held that while *Newman* may make it more difficult for the government to ultimately prove its case, *Newman* did not change the standard for pleading a claim of insider trading. Judge Oetken then held that the SEC's complaint stated sufficient facts for the Court to infer that defendants had acted unlawfully, including specific instances of highly profitable, risky trades by defendants.[85]

Another recent decision to interpret *Newman* narrowly is *SEC v. Sabrdaran*. The SEC had filed a suit against Sasan Sabrdaran, a former director of a pharmaceutical company, alleging that he and his friends made almost $1 million trading on the basis of material non-public information.[86] The case centered on the approval process in the European Union for Esbriet, a product designed to treat a fatal lung disease. The SEC alleged that Sabrdaran disclosed confidential information about the approval process to his friend, Farhang Afsarpour, who made substantial profits by opening a spread-betting account and betting that the

price of the underlying security would increase before the public knew that the drug had been approved. Afsarpour also purportedly shared the material non-public information with certain of his friends and acquaintances.[87]

Sabrdaran sought dismissal of the claims, arguing, among other things, that the complaint did not allege that the downstream tippees, Afsarpour's friends and acquaintances, were aware that the information they received was confidential and obtained in breach of a fiduciary duty, or that the disclosures were made for a personal benefit. More specifically, Sabrdaran argued, the remote tippees (Afsarpour's friends) would not be liable under the *Newman* standard and, therefore, Sabrdaran could not be held liable for the profits they made. Magistrate Judge Jacqueline Scott Corley disagreed with Sabrdaran's arguments and held that it is well settled in the Ninth Circuit that a tipper can be required to disgorge his tippees' profits, whether or not the tippees themselves have been found liable. Judge Corley also held that nothing in *Newman* suggests that the Second Circuit intended to undercut the long line of authority holding tippers liable for the profits gained by tippees, even where the tippees lacked knowledge about the impropriety of the information they received.

On July 6, the U.S. Court of Appeals addressed *Newman* in *United States v. Salman*.[88] The government claimed that Bassam Yacoub Salman had traded on the basis of material non-public information concerning mergers and acquisitions involving healthcare companies. The government alleged that former investment banker Maher Kara provided material non-public information to his brother Michael, who traded on the information and passed it on to Salman, Maher's fiancée's brother, who traded on the information as well. At Salman's trial, the government did not claim that Michael paid Maher for the material non-public information. Instead, the government claimed that the brothers shared a close and mutually beneficial relationship, namely that Michael had previously helped pay for Maher's college education, stood in for their deceased father at Maher's wedding and coached Maher in basic science to help him succeed professionally. Maher also testified at trial that he loved his brother and had passed material non-public information to benefit Michael. The government further claimed at trial that the Kara and Salman families were close, which showed that Salman knew or had the opportunity to know of the brothers' close relationship, *i.e.*, that Salman knew or had the opportunity to know that Maher had tipped Michael in exchange for a personal benefit. Salman was convicted of insider trading.

On appeal, Salman argued, that his conviction should be overturned in light of *Newman* because the government had not introduced evidence that Maher passed material non-public information to Michael in exchange for a tangible personal benefit. The panel affirmed Salman's conviction in an opinion written by Judge Rakoff, who was sitting with the panel by designation, and held that where material non-public information was passed among close family members, the government was not required to show proof of a tangible benefit to the tipper because it could have been intended as a gift of information.

B. Supreme Court Update

Omnicare, Inc. v. Laborers District Council Construction Industry Pension Fund

On March 24, 2015, in *Omnicare, Inc. v. Laborers District Council Construction Industry Pension Fund*, the Supreme Court resolved a circuit split over whether a signer of an offering document can be held liable under Section 11 of the Securities Act for a statement of opinion in the offering document. The Court held that a speaker cannot be held liable for a statement of opinion under Section 11 of the Securities Act unless the statement is materially false and the speaker subjectively believes it is false or, in the case of an omission, the speaker did not have a reasonable basis for the opinion.[89]

The case arose out of Omnicare Inc.'s (Omnicare) registration statement in connection with a December 2005 public stock offering, which stated that the company believed that its contracts with certain healthcare providers and pharmaceutical manufacturers complied with applicable state and federal laws. The plaintiffs alleged these statements were materially false and misleading under the strict liability standards of Section 11 of the Securities Act because Omnicare at the time was allegedly engaged in illegal activities, including kickback arrangements with pharmaceutical manufacturers. The district court granted Omnicare's motion to dismiss because the plaintiffs had failed to allege that Omnicare's officers knew that Omnicare was violating the law, but the Sixth Circuit reversed and held that Section 11 of the Securities Act does not require a plaintiff to allege that a

speaker did not subjectively believe a statement of opinion to be true. The Sixth Circuit's holding created a circuit split, and the Supreme Court granted *certiorari* and reversed.

In reversing the Sixth Circuit, the Court began by distinguishing between opinions that are factual misstatements and opinions that are misleading because the speaker has omitted certain facts. With respect to factual misstatements, the Court noted that a difference between fact and opinion is ingrained in how people speak and think and held that Congress incorporated that distinction in Section 11 of the Securities Act by explicitly providing liability only for untrue statements of fact. To the Court, the only fact explicitly affirmed in a statement of opinion is that the speaker actually believes what she says, and thus an opinion is only an untrue statement of material fact for the purposes of Section 11 of the Securities Act if the speaker does not actually believe what she is saying.

The Court then considered whether an omission could make a speaker liable under Section 11 of the Securities Act for a statement of opinion that the speaker honestly holds. The Court explained that an investor may understand an opinion to convey facts about how the speaker formed the opinion, *e.g.*, that the speaker has reasonably investigated the underlying facts. If an opinion suggests facts about the basis for the opinion that are not true, the Court reasoned, and the speaker does not disclose those facts, the speaker has misled the investor and violated Section 11 of the Securities Act. The Court thus held that a plaintiff states a claim for a violation of Section 11 of the Securities Act if the plaintiff identifies particular material facts suggested by the speaker's opinion and the omission of which makes the opinion misleading to a reasonable person reading the statement fairly and in context. The Court noted that it is not enough for a plaintiff to allege that an opinion is wrong; the plaintiff must call into question the speaker's basis for offering
the opinion, a burden the Court characterized as "no small task for an investor."

Omnicare is significant for issuers and others who sign offering documents because it clarifies that a statement of opinion will not result in liability simply because it was wrong or even objectively unreasonable. It also serves as a warning, though, that the process by which an issuer arrives at an opinion may be subject to heightened scrutiny from plaintiffs, regulators and courts than had previously been the case in many jurisdictions.

C. D.C. Circuit on Wells Notice Deadlines

On July 10, 2015, in *Montford & Co. v. SEC*, a D.C. Circuit panel held that Section 4E of the Exchange Act does not set a limitation period for the SEC to bring an enforcement action after issuing a Wells notice.[90] The SEC instituted an AP against Ernest Montford and his firm, Montford Associates (together, Montford), claiming that Montford violated fiduciary duties to clients by allegedly failing to disclose that it referred clients to investment managers in exchange for kickbacks. Section 4E of the Exchange Act provides that the SEC shall institute an enforcement action not later than 180 days after issuing a Wells notice, and Montford moved to dismiss on the grounds that the SEC's enforcement action was time-barred because the SEC instituted it 187 days after issuing Wells notices.

The ALJ presiding over the enforcement action denied the motion and concluded that Ernest Montford and his firm had violated Sections 204, 206 and 207 of the Advisers Act and Rule 204-1(a)(2) thereunder. The ALJ then barred Ernest Montford from the securities industry and imposed $860,000 in penalties and disgorgement on *Montford*, consisting of a civil monetary penalty of $150,000 against Ernest Montford individually and a civil monetary penalty of $500,000 and disgorgement of $210,000 against Montford Associates.

On appeal, the SEC affirmed the ALJ's ruling and stated that Section 4E of the Exchange Act is a non-jurisdictional internal deadline because (i) the statute does not state what the consequences are for noncompliance and (ii) there is no jurisdictional consequence for failure to comply with an internal deadline for federal agency action. Denying Montford's appeal, the D.C. Circuit, which applied *Chevron* deference to the SEC's interpretation of Section 4E of the Exchange Act, held that the Commission's interpretation of the provision was reasonable.[91]

D. District Court Rulings of Note: – Debate Over APs

Hill v. SEC

On June 8, 2015, District Judge Leigh Martin May issued an opinion preliminarily enjoining the SEC's AP against Charles Hill Jr. on constitutional grounds.[92] This marked the first time a federal judge found that the SEC's in-house APs were potentially unconstitutional. The SEC had instituted an AP against Hill on February 17, 2015, alleging that Hill had violated Section 14(e) of the Exchange Act and Rule 14e-3 thereunder by selling shares of Radiant Systems, Inc. (Radiant) on the basis of material non-public information he received from a Radiant insider about an impending takeover of the company.

After the presiding ALJ denied Hill's motion for summary disposition, Hill filed a complaint in federal court on May 19, 2015 requesting an injunction against the AP and a declaratory judgment that the proceedings were unconstitutional. Hill argued that (1) the manner in which SEC ALJs are appointed violated the Appointments Clause in Article II of the Constitution, (2) Dodd-Frank violates the non-delegation doctrine in Article I of the Constitution in allowing the SEC unfettered discretion to choose its forum and (3) the use of an AP violated Hill's Seventh Amendment right to a jury trial.

The SEC moved to dismiss for lack of subject matter jurisdiction on the grounds that the Commission had exclusive jurisdiction over Hill's claims, subject to judicial review of the Commission's affirmation of a final order in a circuit court of appeals. Judge May disagreed, and held that she had jurisdiction to hear Hill's claims because the statutes governing administrative and federal court proceedings did not restrict the statutory grant of federal question jurisdiction to federal courts. Judge May also noted several additional factors which helped persuade her to find subject matter jurisdiction, including (1) preclusion of the claim would foreclose all meaningful judicial review; (2) the suit was wholly collateral to the governing statute's review provisions; and (3) constitutional claims are outside the agency's expertise.

Judge May rejected Hill's constitutional arguments concerning Article I and the Seventh Amendment, but found that his claim that the appointment of ALJs violated Article II of the Constitution was likely to succeed on the merits. Judge May found that since ALJs exercise significant authority under the laws of the United States and have their duties, salary and means of appointment specified by statute, ALJs are subject to the Appointments Clause of Article II, which requires that government officials with significant authority and roles that are defined by statute to be appointed by the President, the federal courts, or the heads of federal departments. On June 24, 2015, the SEC appealed.[93]

Although it remains unclear whether *Hill* will substantially impede the SEC's ability to litigate enforcement actions before ALJs, it seems unlikely that it will have a significant effect. Not only can the SEC potentially solve the constitutional problem identified by Judge May by having its Commissioners appoint ALJs (although, as discussed below, the SEC appears unwilling to do so), but some courts have declined to follow *Hill*.

Duka v. SEC

District Judge Richard Berman was one of the first judges to react to *Hill*. Judge Berman had denied a similar request for an injunction in *Duka v. SEC*, which was filed after the SEC had brought an enforcement proceeding against Barbara Duka, a former S&P executive who allegedly made false and misleading statements in 2011 about the methodology used to rate commercial mortgage-backed securities. After he was notified of the holding in *Hill*, Judge Berman asked the Justice Department to brief on behalf of the SEC whether the SEC could easily cure the constitutional defect identified by Judge May. The Justice Department responded that the government was likely to appeal *Hill* and maintained its position that ALJs were employees who were not subject to the Appointments Clause of Article II of the Constitution. Judge Berman pressed the government at a subsequent status conference to answer whether it could fix the appointment problem easily, but the Justice Department replied that changing the way the SEC appoints its ALJs was not a meaningful way to address the issues raised by Judge May.[94]

Although Judge Berman denied a request from Duka to renew her motion for a preliminary injunction, the SEC's motion to dismiss the underlying complaint is still pending. Moreover, Judge Berman ordered expedited briefing on the motion to dismiss and ordered the SEC to anticipate and address the arguments it expects the plaintiff

would have made in connection with a motion for a preliminary injunction.

Spring Hill Capital Partners LLC v. SEC

Just days after the decision in *Hill*, Spring Hill Capital Partners LLC (Spring Hill), which had filed a complaint in federal court contesting an enforcement action brought by the SEC, moved for a temporary restraining order and preliminary injunction.[95] Spring Hill raised the same arguments in favor of subject matter jurisdiction cited by Judge May in *Hill*, namely that a federal court had subject matter jurisdiction over the action because the constitutional challenges were collateral to the alleged securities law violations, the constitutional claims were beyond the expertise of SEC ALJs, and Spring Hill would not otherwise be able to obtain a meaningful review. Spring Hill further claimed the administrative actions were unconstitutional because the appointment of ALJs violated Article II of the Constitution. On June 29, 2015, Judge Edgardo Ramos dismissed Spring Hill's complaint for lack of subject matter jurisdiction without reaching the constitutional issues, finding that federal court jurisdiction was limited to an appeal of a final order in the AP to a circuit court of appeals.[96] The next day, another federal court denied a similar motion for an injunction in a separate action in the wake of *Hill*.[97]

IV. SEC Trial Update

Continuing a trend from 2014, the first half of 2015 saw a significant decrease in the number of district court SEC trials. As we noted in our *Securities Enforcement 2014 Year-End Review*, the SEC ended 2014 with a total of five outright victories, four losses and five mixed verdicts. For the first half of 2015, the SEC has so far obtained one outright win and one partial victory.

On March 18, 2015, the SEC obtained a partial victory in *SEC v. Heart Tronics*, *Inc*., when a jury found former NFL player Willie Gault liable for his role in an alleged pump-and-dump scheme involving the stock of Heart Tronics, Inc.[98] In its 2011 complaint against Gault and others, the SEC alleged that Heart Tronics (formerly known as Signalife, Inc.) fraudulently announced millions of dollars in sales orders for its heart monitoring device between 2006 and 2008. The SEC claimed that Heart Tronics never had viable sales orders from actual customers, but that the company (led by Mitchell J. Stein and his assistant Martin B. Carter, each of whom have since been convicted for their roles in the fraud) fabricated documents to support false public disclosures. Further, the SEC charged that Heart Tronics installed Gault as a figurehead CEO in 2008 to raise Heart Tronics' profile and foster investor confidence.

According to the SEC's complaint, after being named CEO, Gault abdicated his fiduciary responsibilities to shareholders by signing or authorizing the addition of his signature to false SEC filings and false certifications. The SEC further alleged that Gault made false representations to a Heart Tronics investor by stating that the investor's capital would be invested in company operations, when in fact the money was diverted for Gault's personal use, including the purchase of Heart Tronics stock by Gault's own personal brokerage account to create the appearance of demand for the stock.[99] Gault was charged with violating Section 17(a) of the Securities Act, Sections 10(b) and 13(b)(5) of the Exchange Act and Rules 10b-5 and 13a-14 thereunder, and aiding and abetting violations of Section 10(b) of the Exchange Act and Rules 10b-5(a) and 10b-5(c) thereunder.

The jury found Gault liable for three of the seven claims against him, concluding that he was negligent in connection with the fraud, which was orchestrated by others, knowingly circumvented internal company controls, and filed false certifications, in violation of Section 17(a)(3) of the Securities Act, Section 13(b)(5) of the Exchange Act and Rule 13a-14 thereunder, respectively. The jury did not find Gault liable, however, for fraud or intentional misconduct.

Both sides claimed victory following the verdict. Director Ceresney said the SEC was content with the verdict because the jury properly held the CEO of a public company accountable for circumventing the company's internal controls and filing false certifications. But Gault's camp also declared victory, explaining that Gault "entered the courtroom today with the shroud of serious securities fraud violations hanging over his head, and he exited the courtroom cleared of any serious [intentional] misconduct and essentially with the equivalent of a securities parking ticket."[100] Gault's subsequent motion for judgment as a matter of law was denied.

On April 1, 2015, in *SEC v. Levin*, the SEC scored an outright victory against investment manager George Levin when a jury found Levin liable for his involvement in a $1.2 billion Ponzi scheme orchestrated by former Florida attorney Scott Rothstein.[101] Levin and fellow investment manager Frank Preve allegedly used investor funds to purchase sham legal settlement awards from Rothstein's firm, which they, without registration, resold as promissory notes from Levin's company as interests in a private investment fund. Levin and Preve purportedly raised $157 million from 173 investors between 2007 and 2009. The offering materials for the promissory notes and private fund also allegedly contained material misrepresentations and omissions regarding verification of the Rothstein settlements, as well as the nature of the business strategy, payments by Rothstein and investment recovery.

At trial, Levin conceded the existence of material misrepresentations, but argued that the SEC had not presented evidence showing his state of mind.[102] Levin also emphasized that he was a victim of the Rothstein scheme, as he had personally invested personally guaranteed the investments of others, and is now bankrupt. In closing arguments, however, the SEC stressed that Levin made between $42 million and $49 million through his fraudulent conduct, and the jury found that Levin violated Sections 5(a), 5(c) and 17(a)(1)-(3) of the Securities Act, and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and aided and abetted violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.[103] The SEC is now seeking more than $170 million in disgorgement and fines.[104]

V. Significant Investigations and Cases

As we discussed in our *2014 Year-End Review*, the SEC filed a record number of cases in fiscal year 2014. That trend appeared to continue in the first half of 2015. In the following section, we highlight some of the more important and novel SEC enforcement actions of 2015.

A. Insider Trading

Although the SEC's approach to insider trading enforcement actions continues to evolve in light of the Second Circuit's decision in *Newman* and subsequent rulings, *Newman* does not appear to have slowed the SEC's pursuit of alleged insider trading violations.

On February 5, 2015, the SEC filed a settled civil injunctive action charging four people with operating an insider trading ring that purportedly generated almost $750,000 in profits. According to the SEC, John Gray, an analyst at a bank, and his friend, Christian Keller, traded on the basis of material non-public information concerning a merger that Keller had learned about while working at two public companies in Silicon Valley. Purportedly, Gray and Keller used a brokerage account in the name of a friend, Kyle Martin, to conceal their trades. Gray supposedly tipped his friend, Aaron Shepard.

All four men were charged with violating Section 10(b) of the Exchange Act and Gray, Keller and Martin with violating Section 14(e) of the Exchange Act. Without admitting or denying the allegations, all four men agreed to settle with the SEC. Gray agreed to pay $758,200.46 consisting of $287,487.55 in disgorgement, $21,836.88 in prejudgment interest, and a penalty of $448,876.03. Gray also agreed to be barred from the securities industry and from participating in penny stock offerings. Keller agreed to pay disgorgement of $52,000, prejudgment interest of $4,002.03 and a penalty of $417,468.73 for a total of $473,470.76, and to be barred from serving as an officer or director of a public company for 10 years. Martin agreed to pay disgorgement of $243,276.10 plus prejudgment interest of $21,404.28 for a total of $264,680.38. Shepard agreed to pay disgorgement of $161,388.36, plus prejudgment interest of $9,633.07 for a total of $171,021.43.[105]

On February 19, 2015, the SEC filed a civil injunctive action against Scott Zeringue, a former officer of The Shaw Group, Inc. (Shaw), and his brother-in-law, Jesse Roberts III, for insider trading. The SEC alleged that Zeringue tipped Roberts ahead of a merger between Shaw and Chicago Bridge & Iron Company N.V. and that both Roberts and Zeringue allegedly purchased Shaw common stock based on material non-public information. Zeringue had pled guilty to criminal charges in June 2014 and settled with the SEC for $96,018 consisting of $32,006 in disgorgement and $64,012 in penalties, as well as a 10-year bar from serving as an officer or director of a publicly-traded company.[106] The civil claims and criminal charges against Roberts are pending.

On February 19, 2015, the SEC filed a settled AP against Proteonomix, Inc. (Proteonomix) and its CEO, Michael M.

Cohen. The SEC claimed that Cohen caused Proteonomix to issue shares to corporate entities that he secretly controlled, which were sold on the open market at a $600,000 profit to Cohen. The SEC found that Proteonomix violated Sections 5(a), 5(c) and 17(a) of the Securities Act and Sections 10(b), 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rules 10b-5, 12b-20, 13a-1 and 13a-13 thereunder. Cohen was found to have violated Sections 5(a), 5(c) and 17(a) of the Securities Act and Sections 10(b) and 13(b)(5) of the Exchange Act and Rules 10b-5, 13a-14 and 13b2-1 thereunder. Proteonomix and Cohen agreed to pay civil monetary penalties to be determined at a later date, and Cohen agreed to an officer or director bar. Cohen has also pled guilty to criminal charges in a parallel case. [107]

On April 2, 2015 the SEC filed a civil injunctive action against Amit Kanodia and Iftikar Ahmed and relief defendants Rakitfi Holdings, LLC and Lincoln Charitable Foundation for insider trading. The SEC alleged that Kanodia received confidential information from his wife regarding an upcoming merger between Apollo Tyres Ltd. and Cooper Tire and Rubber Company (Cooper Tire). Kanodia then allegedly tipped Ahmed, who in turn purchased a significant amount of Cooper Tire securities. The Commission is seeking permanent injunctions to enjoin the defendants from engaging in the violations described in the complaint, disgorgement, prejudgment interest and civil penalties. Parallel criminal actions against Kanodia and Ahmed were also announced.[108]

On June 3, 2015, a civil injunctive action was initiated against a California day trader, two of his friends and his brother-in-law for insider trading. Purportedly, Steven Fishoff, Steven Costantin, Ronald Chernin and Paul Petrello stole confidential information from investment banks by posing as legitimate portfolio managers and by setting up meetings where they received material non-public information regarding upcoming secondary offerings. Moreover, the defendants then supposedly executed short sales on the basis of the material non-public information and eventually expanded into taking long positions. As such, the defendants violated Sections 17(a) and 10(b) of the Exchange Act and Rule 10b-5 thereunder. In addition, the defendants were charged with violations of Rule 105 of Regulation M in connection with short sales made in anticipation of offerings in which the defendants purchased shares. The SEC is seeking an injunction, disgorgement, prejudgment interest and civil monetary penalties. Criminal charges were also brought against the defendants. [109]

On June 9, 2015, the SEC filed a settled civil injunctive action against Michael Fefferman, Chad Wiegand, and Akis Eracleous for alleged insider trading. According to the SEC, between April 2009 and April 2012, Fefferman, who was the senior director of information technology at Ardea Biosciences, Inc. (Ardea), learned material non-public information about, among other things, a proposed acquisition. He then tipped his brother-in-law, Wiegand, before major public announcements, including regarding pharmaceutical trials and the acquisition of Ardea by AstraZeneca PLC. Wiegand allegedly bought Ardea stock through various accounts and tipped Eracleous, a stockbroker and friend, so that Eracleous could purchase shares on behalf of his customers. One of these customers, Eracleous's cousin, was also named as a relief defendant. Fefferman, Wiegand and Eracleous entered into deferred prosecution agreements and consented to an injunction, disgorgement, prejudgment interest and penalties to be determined at a later date. Eracleous's cousin also agreed to disgorge the illicit profit in his account, which totaled $219,175. Wiegand and Eracleous agreed to be barred from the securities industry. Criminal charges against Wiegand and Eracleous are pending.[110]

On June 15, 2015, the SEC brought a settled AP against a Swiss trader, Helmut Anscheringer, for insider trading. The SEC alleged that Anscheringer learned from a longtime friend that a company, AuthenTec Inc., was to be acquired by Apple Inc. Based on this information, Anscheringer allegedly purchased call options and shares in AuthenTec prior to the public announcement, in violation of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. Without admitting or denying the allegations, Anscheringer agreed to cease and desist from violating Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and to pay $1,820,024 in disgorgement, $121,732 in prejudgment interest and $910,012 in civil penalties, for a total of $2,851,768.[111]

B. Financial Reporting Fraud

The SEC filed several actions involving financial reporting fraud in the first half of 2015, including a long-rumored

settlement with Computer Sciences Corporation (Computer Sciences).

On June 5, 2015, the SEC filed a settled AP against Computer Sciences, a Virginia-based technology company, and five of its executives for allegedly manipulating Computer Sciences' financial results and concealing problems with the company's largest contract.

The SEC charged Computer Sciences and five executives with violations of various combinations of Sections 17(a)(1), 17(a)(2) and 17(a)(3) of the Securities Act and Sections 10(b), 13(a), 13(b)(5), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rules 10b-5(a), 10b-5(c), 13a-1, 13b2-1 and 13a-13 thereunder. Without admitting or denying liability, Computer Sciences agreed to settle by paying $190 million in civil monetary penalties. The five charged executives, also without admitting or denying liability, agreed to pay civil money penalties and return certain compensation under the clawback provisions of Sarbanes-Oxley.[112]

The circumstances of the Computer Sciences settlement suggest that tensions within the SEC may be complicating the resolution of certain enforcement actions. Computer Sciences had disclosed that it had reached a tentative settlement for $190 million at the end of 2014, but the SEC did not formally announce the settlement for six months, reportedly because of those within the agency who were pushing for a lower fine.[113]

On January 28, 2015, the SEC instituted a settled AP against First National Community Bancorp Inc. (First National) and its former principal financial officer, William Lance. Allegedly, First National's Form 10-K for 2009 and 10-Qs for the first and second quarters of 2010 materially understated the other-than-temporary impairment (losses) provision for its investment securities portfolio by 230%. Additionally, First National supposedly sold 100,000 shares of stock to a private investor pursuant to an agreement that incorporated the misstated financials. The SEC found that First National violated Section 17(a)(2) of the Securities Act and Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1 and 13a-13 thereunder and that Lance caused First National's Exchange Act violations. To settle the claim, Lance agreed to pay a civil monetary penalty of $20,000 and First National agreed to pay a civil monetary penalty of $175,000, for a total payment of $195,000.[114]

On February 5, 2015, the SEC brought a settled civil injunctive action against Broadwind Energy (Broadwind), a Chicago alternative energy company, J. Cameron Drecoll, its former CEO, and Stephanie K. Kushner, its former CFO, for alleged accounting and disclosure violations. The SEC asserted that Broadwind privately shared with its auditors, investment bankers and lenders that it anticipated having to record a $58 million impairment charge as a result of the deterioration of certain customer relationships, but delayed recording and disclosing the impairment for several months. Drecoll purportedly approved and certified the SEC filings that he knew contained misrepresentations and that Kushner — although newly hired — failed to ensure that the financial statements and disclosures were accurate.

The SEC charged Broadwind with violations of Section 17(a)(2) of the Securities Act and Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1 and 13a-13 thereunder. Drecoll was charged with violations of Section 17(a)(2) of the Securities Act and Rule 13a-14 under the Exchange Act, and Drecoll and Kushner were both charged as control persons. All defendants agreed to a settlement without admitting or denying the allegations. Broadwind agreed to pay a civil monetary penalty of $1 million, Drecoll agreed to pay disgorgement of losses avoided and prejudgment interest of $543,358 and a civil monetary penalty of $75,000, for a total of $628,358. Kushner agreed to an injunction, disgorgement representing losses avoided and prejudgment interest of $23,109, and a civil monetary penalty of $50,000, for a total of $73,109.[115]

On February 10, 2015, the SEC instituted a settled AP against the former CFOs of Saba Software, Inc. (Saba), William Slater and Peter E. Williams III., for alleged accounting fraud. The SEC asserted that Slater and Williams received $337,375 and $141,992 in bonuses and stock sale profits, respectively, during periods when Saba presented materially false and misleading financial statements. Though the SEC did not claim that Slater or Williams were complicit in the alleged misconduct, Slater and Williams, without admitting or denying the allegations, agreed to repay Saba their bonuses and stock

sale profits as required by the clawback provisions of Sarbanes-Oxley.[116]

On February 13, 2015, the SEC instituted an AP against CYIOS Corporation (CYIOS), its CEO, Timothy W. Carnahan, and its contractor CFO, Traci J. Anderson. The SEC had previously barred Anderson from practicing as an accountant or financial manager, and it was asserted that Anderson was unlawfully working with CYIOS in a finance capacity and CYIOS and Carnahan had been wrongfully associating with her. The SEC found that Anderson violated Section 105(c)(7)(B) of Sarbanes-Oxley, which bars suspended individuals from associating with public accounting firms; CYIOS and Carnahan violated Sections 17(a)(2) and 17(a)(3) of the Securities Act and Section 13(a) of the Exchange Act and Rules 13a-1 and 13a-13 thereunder; and Carnahan violated Rules 13a-14 and 13a-15(c) under the Exchange Act. On June 9, 2015, the presiding ALJ found that Anderson violated Section 105(c)(7)(B) of Sarbanes-Oxley; CYIOS violated Section 13(a) of the Exchange Act and Rules 13a-1 and 13a-13 thereunder, and Carnahan violated Rules 13a-14 and 13a-15 under the Exchange Act.[117]

On February 19, 2015, the SEC instituted a settled AP against Logical Wealth Management, Inc. (LWM), a registered investment advisor, and its owner, Daniel J. Gopen. Allegedly, LWM overstated its assets under management so that it could appear to be qualified for registration with the SEC, falsely reported its place of business as Wyoming, did not adopt and implement compliance policies and procedures, and failed to make its books and records available to the SEC. The SEC found that LWM violated Sections 203A, 204(a), 204A and 206(4) of the Advisers Act and Rules 204A-1, 204-2(a)(2), 204-2(a)(6), 204-2(a)(8) and 206(4)-7 thereunder, and that Gopen violated Section 207 of the Advisers Act. LWM's registration as an investment advisor was revoked. Gopen was ordered to pay a civil monetary penalty of $25,000 and barred from associating with an advisor or broker-dealer or working for a registered investment company. The defendants agreed to the penalties without admitting or denying the Commission's findings.[118]

On February 23, 2015, the SEC instituted an AP against Halpern & Associates LLC (H&A), an accounting and auditing firm, and its owner, Barbara Halpern, alleging improper professional conduct related to its audit of Lighthouse Financial Group, LLC's (Lighthouse) financial statements. H&A and Halpern supposedly failed to adhere to Generally Accepted Auditing Standards in their audit by failing to detect the overstatement of Lighthouse's assets and for understating Lighthouse's liabilities. The SEC found that H&A and Halpern violated Section 17 of the Exchange Act and Rule 17a-5(a) thereunder. The AP is pending.[119]

On March 3, 2015, a civil injunctive action was filed against China Infrastructure Investment Corporation (CIIC), its corporate secretary, Wang Feng, and its CEO, Li Xipeng. In 2011, CIIC was allegedly facing a delisting of its shares on NASDAQ. Purportedly, CIIC filed its Form 10-K for 2011 and first quarter Form 10-Q for 2012 with forged signatures and false certifications of its CFO. The forgery was apparently part of a scheme to conceal the fact that its CFO was no longer with the company and that the company had no CFO at the time of filing. The SEC alleged that all defendants violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, that CIIC violated Section 13(a) of the Exchange Act and Rules 12b-20, 13a-1 and 13a-13 thereunder by filing materially false annual and quarterly reports. Xipeng was charged with violating Rule 13a-14 under the Exchange Act and with control person liability. Xipeng and Feng were also alleged to have aided and abetted CIIC's violations and directly violated Rule 13b2-2 under the Exchange Act. The SEC is seeking to permanently bar Xipeng and Feng from serving as an officer or director of a reporting issuer and civil monetary penalties against all defendants. In a related action, the SEC suspended trading in CIIC and instituted proceedings to determine whether the registration of its securities should be suspended or revoked.[120]

On March 4, 2015, the SEC instituted a settled AP against the former Vice President of Finance at Michael's Finer Meats, LLC (MFM). The SEC claimed that the respondent, who was responsible for all accounting functions at MFM, unilaterally and without further investigation adjusted inventory counts when he calculated a profit margin that deviated significantly from historical records. This purportedly improper accounting allegedly resulted in the inaccurate reporting of financial data in SEC filings from the third quarter of 2012 through the third quarter of 2013. The SEC found the respondent violated Section 13(b)(5) of the Exchange Act and

Rule 13b2-1 thereunder. To settle the claims, and without admitting or denying the SEC's findings, the respondent agreed to a civil monetary penalty of $25,000.[121]

On March 31, 2015, the SEC filed a civil injunctive action against Andrew Miller, the CEO of Polycom, Inc. (Polycom), a Silicon Valley based tech firm. Miller carried out a scheme to use Polycom funds for over $190,000 of personal expenses that were not disclosed to investors. The alleged expenses included fancy meals, luxury hotels, travel and other entertainment enjoyed by Miller and his friends and family that were improperly recorded in Polycom's books and records using false descriptions and business justifications. Miller was charged with violating Sections 17(a)(1), (2) and (3) of the Securities Act, Sections 13(a), 13(b)(2)(A), 13(b)(5) and 14(a) of the Exchange Act, and Rules 12b-20, 13a-1, 13a-14, 13b2-1, 14a-3 and 14a-9 thereunder. The SEC is seeking to bar Miller from serving as an officer or director of a public company, disgorgement of ill-gotten gain, and civil monetary penalties. In a related action, the SEC instituted a settled AP against Polycom without admitting or denying the allegations, agreed to pay $750,000 to settle the charges. [122] The action against Miller is pending.

On April 1, 2015, the SEC instituted a settled AP against Timothy Scronce, the CEO and owner of TelWorx Communications LLC (TelWorx), a North Carolina telecommunications company, TelWorx's former vice president, Marc Mize, and TelWorx's former controller, Michael Hedrick, for allegedly defrauding PCTEL, a telecommunications company. Supposedly, Scronce falsely inflated TelWorx's revenues and earnings in the months leading up to his sale of TelWorx and related companies to PCTEL. Mize and Hedrick purportedly assisted Scronce in recording false transactions. The order found that Scronce, Hedrick and Mize violated Sections 10(b), 13(b)(5), and 20(b) of the Exchange Act and Rules 10b-5 and 13b2-1 thereunder. Without admitting or denying the SEC's findings, Scronce, Hedrick and Mize settled, with Scronce agreeing to pay $545,219.47, consisting of $376,007 in disgorgement, $29,212.47 in prejudgment interest and $140,000 in civil monetary penalties. Mize agreed to pay a $25,000 civil monetary penalty, and Hedrick agreed to pay $27,072.62 in disgorgement prejudgment interest.[123] Total payments by all defendants was $1,169,584.18.

On April 9, 2015, as noted in Section II.B above, the SEC instituted a settled AP against Molex, an Illinois-based company, for allegedly filing inaccurate financial statements and failing to maintain accurate books and records. On the same day, the SEC separately filed a settled civil injunctive action against Katsuichi Fusamae, the former senior accounting officer at Molex's Japanese subsidiary, Molex Japan. The SEC claimed that Fusamae engaged in unauthorized trading in Molex Japan's brokerage accounts, which resulted in over $110 million in losses. Fusamae allegedly concealed the losses by taking out unauthorized and undisclosed loans on behalf of Molex Japan, which he used to replenish trading accounts and make additional trades. Molex allegedly had to recognize $201.9 million in losses as a result of Fusamae's actions.

The SEC claimed that Molex violated Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1 and 13a-13 thereunder by filing misstated financial statements as a result of Fusamae's scheme and periodic reports that did not disclose Fusamae's unauthorized activities, their effect on Molex's financial position, or Fusamae's scheme in general. Molex, without admitting or denying the charges, entered into a cease-and-desist order and was not required to pay disgorgement or penalties. As discussed above, Fusamae admitted wrongdoing and agreed to a permanent officer or director ban and possible future monetary sanctions.[124]

On April 27, 2015, the SEC instituted a settled AP against the former president and CEO, Donald J. Torbert, and former CFO and executive vice president, Nicole S. Stokes, of The Park Avenue Bank (PAB) for allegedly signing off on collateral appraisals that improperly discounted PAB's liabilities. Torbert and Stokes allegedly understated PAB's loan losses, which resulted in PAB reporting positive net income and PAB's holding company recognizing a lower loss on each asset. To settle the Commission's charges, Torbert and Stokes, without admitting or denying liability, agreed to pay civil monetary penalties of $60,000, consisting of a $40,000 civil monetary penalty for Torbert and a $20,000 civil monetary penalty for Stokes.[125]

On May 12, 2015, the SEC filed a civil injunctive action against ITT Educational Services, Inc. (ITT) and its CEO, Kevin M. Modany, and CFO, Daniel M. Fitzpatrick. ITT, which operates for-profit colleges, supposedly guaranteed

loans to finance the education of its students and, when the loans began to sour, allegedly failed to disclose the extent of its exposure to investors and hid losses from its external auditor. The defendants were charged with violating Section 17(a) of the Securities Act, Sections 10(b), 13(a), 13(b)(2) and 13(b)(5) of the Exchange Act and Rules 10b-5, 12b-20, 13a-1, 13a-11, 13a-13, 13a-14, 13b2-1 and 13b2-2 thereunder, and Section 304(a) of Sarbanes-Oxley. Finally, the SEC alleged that Modany and Fitzpatrick were liable as control persons and for aiding and abetting ITT's violations.[126]

C. Auditor Independence

Although the SEC recently emphasized that auditor independence is an issue that it focuses on and estimated that it receives approximately one related query a day,[127] the Commission has brought few enforcement actions concerning auditor independence thus far in 2015.

One enforcement action of note was brought by the SEC on July 1, 2015, when the Commission instituted a settled AP against Deloitte & Touche LLP (Deloitte) for allegedly violating auditor independence rules. According to the SEC, a Deloitte consulting affiliate acquired a proprietary business methodology from a trustee who sat on the boards of three funds for which Deloitte served as the independent auditor. Allegedly, after acquiring the methodology, the Deloitte affiliate worked with the trustee to use the methodology for both internal and external clients. Deloitte did not disclose the business relationship between its affiliate and the trustee and stated in its audit reports that it was independent from the funds.

Deloitte was censured for violating the auditor independence standards of Rule 2-02(b) of Regulation S-X and sanctioned for causing the funds to violate Sections 20(a) and 30(a) of the Investment Company Act and Rule 20a-1 thereunder. To settle the charges, Deloitte, without admitting or denying liability, agreed to pay $1,113,916, consisting of disgorgement of audit fees in the amount of $497,438, prejudgment interest of $116,478 and a $500,000 civil monetary penalty.[128]

D. Foreign Corrupt Practices Act

On January 22, 2015, the SEC instituted a settled AP against Walid Hatoum, a former officer at PBSJ Corporation (PBSJ), for violations of the FCPA. The SEC alleged that Hatoum authorized bribes and employment of Qatari officials to secure Qatari government contracts. Hatoum allegedly offered to funnel funds to a local company owned by a foreign official to secure two multi-million dollar Qatari government contracts for PBSJ in 2009. The official then allegedly provided PBSJ with bid and pricing information, which enabled a PBSJ subsidiary to tender winning bids for a hotel resort development project in Morocco and a rail project in Qatar. Specifically, Hatoum allegedly offered a job to a second foreign official in return for assistance as Hatoum's bribery scheme began to unravel and PBSJ lost the hotel resort contract. The SEC found that Hatoum violated Section 13(b)(5) of the Exchange Act and Rule 13b2-1 thereunder and caused violations of Sections 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act by PBSJ. PBSJ was also charged with violating Sections 13(b)(2)(A), 13(b)(2)(B) and 30A of the Exchange Act by failing to (1) keep accurate books and records relating to Hatoum's transactions, (2) maintain internal accounting controls to ensure the transactions were recorded accurately and (3) prepare its financial statements in accordance with GAAP.

PBSJ self-reported the violations, accepted responsibility for its conduct, and entered into a two-year deferred prosecution agreement with the SEC. As part of the DPA, PBSJ agreed to cooperate fully and truthfully with the investigation and any other related enforcement action to which the Commission is a party, toll the statute of limitations for the duration of the agreement, disclose any further violations of the federal securities laws it uncovers, and pay disgorgement of $2,892,504, prejudgment interest of $140,371 and a civil penalty of $375,000, totaling $3,407,875.[129] Without admitting or denying the Commission's findings, Hatoum agreed to pay a penalty of $50,000.

On February 24, 2015, the SEC instituted a settled AP against The Goodyear Tire & Rubber Company for alleged FCPA violations. Goodyear supposedly failed to prevent or detect bribes paid by its subsidiaries to employees of government-owned entities for tire sales in various sub-Saharan African countries. The payments were apparently improperly recorded as legitimate business expenses on the subsidiaries' books and records, which were integrated into Goodyear's books and records. Thus, Goodyear settled to violating Sections 13(b)(2)(A) and

13(b)(2)(B) of the Exchange Act. The Commission noted that Goodyear undertook substantial remedial efforts, including that it divested its ownership interest in and ceased all business dealings with a Kenyan company, began the process of divesting from its Angolan subsidiary, undertook disciplinary action against certain executives of its Europe, Middle East and Africa region who had oversight responsibility for FCPA compliance, and implemented improvements to its compliance program. Goodyear, without admitting or denying the SEC's findings, agreed to pay $16,228,065, consisting of disgorgement of $14,122,525 plus prejudgment interest of $2,105,540, and report its FCPA remediation efforts to the SEC for three years.[130]

On April 8, 2015, the SEC instituted a settled AP against FLIR Systems Inc. (FLIR), an Oregon-based defense contractor, for violations of the FCPA. Allegedly, FLIR's deficient financial controls failed to identify or stop employees from providing expensive gifts to government employees and funding a 20-night "world tour" for Saudi officials of international cities as part of an effort to entice those officials to purchase FLIR products. The SEC found that FLIR violated Sections 13(b)(2)(A), 13(b)(2)(B) and 30A of the Exchange Act. FLIR, without admitting or denying the findings, agreed to pay $9,504,584, consisting of disgorgement of $7,534,000, prejudgment interest of $970,584 and a penalty of $1 million.[131] This settlement is related to the November 17, 2014 settlement we described in our *Securities Enforcement 2014 Year-End Review* against Stephen Timms and Yasser Ramahi, two former Dubai-based employees of FLIR systems.

On May 20, 2015, the SEC instituted a settled AP against BHP Billiton Ltd. (BHP) for allegedly failing to devise and maintain sufficient internal controls over its global hospitality program in connection with BHP's sponsorship of the 2008 Summer Olympic Games in Beijing, China. Allegedly, as part of its global hospitality program, BHP invited government officials, mainly from Africa and Asia, to attend the 2008 Olympics as sponsored guests. The SEC further alleged that the company designed specific internal processes to address the anti-corruption risk inherent in its global hospitality program, but that the controls were deficient. For example, BHP business managers were required to complete applications to screen potential invitees to the Olympics and BHP controls called for a Global Ethics Panel Sub-Committee to review each application. But these reviews allegedly rarely occurred. BHP thus allegedly failed to ensure that the hospitality applications were filled out accurately and completely. Further, although BHP ostensibly offered high-level training on its hospitality program, the company allegedly failed to train business managers on how to complete the hospitality applications or evaluate whether an invitation to a government official complied with BHP's internal code of conduct. BHP also allegedly failed to establish a system to update hospitality applications or reassess invitations when and if conditions changed, or to create a central repository of knowledge for managers to consult with questions about specific partners and guests. Finally, the SEC alleged that the applications only reflected ongoing business between the submitting business unit and the invitee, and BHP had no process to determine whether invitees were also involved in business dealings with other business managers. Based on these allegations, the SEC found that BHP violated Sections 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act. BHP did not admit or deny liability, but agreed to pay a $25 million penalty.[132]

The SEC's action against BHP is notable for several reasons. First, it highlights how entertainment and hospitality programs that extend invitations to foreign officials are a particularly hazardous area for FCPA compliance. Efforts to seek general goodwill and relationship-building are not *per se* prohibited under the FCPA, but internal controls must be well-developed and effectively implemented to avoid liability. Second, the SEC's allegations against BHP were unusual in that they departed from typical travel and entertainment enforcement actions, which usually feature allegations of lurid travel extravagances for which violators fabricate justifications.[133] Here, however, the SEC focused on BHP's alleged failure to manage its hospitality program in a way that prevented improper use or abuse. Thus, while internal controls and compliance programs were once considered a means to prevent FCPA violations, they are now apparently an independent source of potential liability. Finally, the SEC's action against BHP underscores that a "check the box" approach to controls and compliance is insufficient, even if no substantive violation occurs. Indeed, the SEC cited FCPA-related books and records violations to sanction BHP corporate practices that — even as alleged — only resulted in the possibility of bribery; the SEC never alleged that bribes were actually paid.

E. Investment Advisors

As we reported in our *Securities Enforcement 2014 Year-End Review*, there were significant developments in 2014 in the investment advisor area, including first-ever enforcement actions concerning investment advisor "pay-to-play" rules and private equity fees and expenses. The SEC's vigorous enforcement efforts in the investment advisor space continued in the first half of 2015, as the Commission brought numerous enforcement actions involving investment advisors.

On January 16, 2015, the SEC instituted a settled AP against investment advisor Consulting Services Group, LLC (CSG), for allegedly failing to disclose a conflict of interest to its pension fund clients. The SEC claimed that CSG provided services to public pension funds and failed to disclose or mischaracterized a $50,000 personal loan between CSG's then-CEO, Edgar Lee Giovannetti, and a third-party investment advisor that CSG had recommended to certain of its clients. The SEC found that CSG violated Sections 206(2) and 207 of the Advisers Act. CSG, without admitting or denying the SEC's findings, agreed to pay a $150,000 civil monetary penalty.[134]

On January 21, 2015, the SEC instituted a settled AP against Du Pasquier & Co., Inc. (Du Pasquier) for allegedly failing to maintain adequate compliance policies and procedures or meet certain Form ADV disclosure requirements. The SEC claimed that Du Pasquier relied on an "off-the-shelf" template as its compliance manual, did not adapt it to the firm's business, and failed to fully implement compliance procedures it did adopt, annually review its compliance policies and procedures, or conduct adequate reviews of its personnel's securities transactions. The SEC found that Du Pasquier violated Sections 204, 204A, 206(4) and 207 of the Advisers Act and Rules 204-1(a)(1)-(2), 204-3(b), 204A-1 and 206(4)-7(a)-(b) thereunder. Du Pasquier agreed to pay a $50,000 civil monetary penalty without admitting or denying the SEC's findings.[135]

On February 4, 2015, the SEC denied former hedge fund manager Matthew Sample's request for permission to resume working for his former employer, Kingsroad Financial Insurance Services Inc. (Kingsroad). Sample consented to a permanent bar from the securities industry in April 2014 in an SEC settlement that alleged that he managed an unregistered hedge fund, misrepresented his intended use of investor funds, misappropriated investor funds, and concealed trading losses in violation of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder and Sections 206(1), (2) and (4) of the Advisers Act and Rule 206(4)-8 thereunder. The SEC denied Sample's request because his application failed to demonstrate "extraordinary circumstances" under Rule 193(c).[136]

On March 16, 2015, the SEC instituted a settled AP against Stilwell Value LLC (Stilwell Value), a New York-based investment advisor, and its owner and managing member, Joseph Stilwell, for allegedly failing to adequately disclose conflicts of interest arising out of the interfund loans made between certain private funds managed by Stilwell Value. Supposedly, although the loans were repaid and the disclosures contained information about certain borrowed funds, the disclosures were inadequate because they failed to disclose that the borrowed funds were Stilwell Value funds and that some were in default. The SEC further claimed that Stilwell Value's compliance manual failed to sufficiently adopt and implement policies and procedures that would address the risks posed by the interfund loans. The SEC found that Stilwell and Stilwell Value violated Sections 206(2), 206(4) and 207 of the Advisers Act and Rules 206(4)-7 and 206(4)-8 thereunder. Without admitting or denying the Commission's findings, Stilwell agreed to pay a $100,000 civil monetary penalty, and Stilwell Value agreed to pay a $250,000 civil monetary penalty and $239,157 that will be distributed to investors, for total payments of $589,157.[137]

On March 30, 2015, the SEC instituted an AP against Lynn Tilton and four firms that she managed, Patriarch Partners LLC, Patriarch Partners VIII LLC, Patriarch Partners XIV LLC, and Patriarch Partners XV LLC (the Patriarch Firms), for securities fraud. The SEC alleged that Tilton and the Patriarch Firms breached their fiduciary duty and defrauded clients by failing to value assets using the methodology presented to investors in offering documents and by failing to inform investors of the poor performance of loan assets in three collateralized loan obligation funds known as the Zohan Funds. According to the SEC, instead of objectively valuing the managed assets in the Zohan Funds (as the funds' disclosure documents stated would be done), Tilton allegedly made a subjective assessment of a company's future at her discretion and, as a result, Tilton and the Patriarch Firms allegedly collected

almost $200 million in fees to which they were not entitled. The SEC further alleged that Tilton's exercise of subjective discretion over valuation levels created a conflict of interest that was never disclosed. The SEC charged Tilton and the Patriarch Firms with violations of Sections 206(1), 206(2) and 206(4) of the Advisers Act and Rule 206(4)-8 thereunder.[138] On April 1, 2015, Tilton filed a complaint in federal court asking that the AP be enjoined on constitutional grounds. On June 30, 2015, Tilton's complaint was dismissed for lack of subject matter jurisdiction. The action against Tilton and the Patriarch Firms continues as an AP.[139]

On March 30, 2015, the SEC instituted an AP against formerly registered investment advisors Aegis Capital, LLC (Aegis Capital) and Circle One Wealth Management, LLC (Circle One) for allegedly failing to file timely and accurate reports with the Commission from January 2010 to December 2011 or maintain required books and records between 2009 and 2011. The SEC claimed that Aegis Capital and Circle One overstated their assets under management and their total number of client accounts and that their books and records were mixed together with affiliated entities at the parent holding company level. The SEC claimed that Aegis Capital and Circle One violated Sections 204 and 207 of the Advisers Act and Rules 204-1(a)(1) and 204-2(a) thereunder. The action is pending.[140]

On April 7, 2015, the SEC brought a civil injunctive action against Pacific West Capital Group Inc. (Pacific West) and its owner, Andrew B. Calhoun IV, for allegedly engaging in fraud in the sale of so-called life settlement investments, which are insurance policies that allow investors to receive a portion of the policy holder's death benefit. The SEC claimed that Pacific West and Calhoun misrepresented the investments to make them appear more successful than they were, including by minimizing risks and exaggerating annual returns. The SEC further claimed that additional defendants failed to register as securities brokers. The SEC alleged that Pacific West and Calhoun violated Section 17(a) of the Securities Act and Sections 10(b) and 15(a) of the Exchange Act and Rule 10b-5 thereunder, all but one other defendant violated Section 15(a) of the Exchange Act, Calhoun alone violated Section 20(a) of the Exchange Act, and all defendants violated Sections 5(a) and 5(c) of the Securities Act.[141] The action is pending.

On April 16, 2015, the SEC filed a civil injunctive fraud charges action against Michael J. Oppenheim, a private client advisor at a major New York financial institution. The SEC claimed that Oppenheim convinced certain of the financial institution's customers to withdraw millions of dollars from their accounts by promising to purchase municipal bonds on their behalf. According to the SEC, Oppenheim instead bought cashier's checks and deposited them into his own brokerage account, or his wife's brokerage account that he controlled, and began making large equity trades that resulted in large losses. The SEC charged Oppenheim with violations of Section 10(b) of the Exchange Act and Rules 10b-5(a)-(c) thereunder and Sections 206(1)-(2) of the Advisers Act. The SEC also charged Oppenheim's wife with receipt of ill-gotten gains. The day before the SEC filed its complaint, the government filed a criminal complaint against Oppenheim.[142] The actions are pending.

On May 6, 2015, the SEC filed a civil injunctive action against Iftikar Ahmed for alleged fraud and self-dealing at Oak Investment Partners (Oak), the venture capital firm where he worked. Allegedly, Ahmed advised Oak to pay inflated prices for investments in which he held a beneficial interest and obtained approximately $27.5 million in illegal profits at the expense of investors in Oak funds. The SEC further claimed that, in 2013, an Oak fund, at Ahmed's advice, invested $25 million in a U.S.-based e-commerce company, but that Ahmed did not disclose that he held an interest in a different company that held a significant stake in this e-commerce company. The SEC alleged that Ahmed violated Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Sections 206(1), 206(2), 206(3) and 206(4) of the Advisers Act and Rule 206(4)-8 thereunder. The SEC is seeking an emergency asset freeze against Ahmed and two firms allegedly controlled by Ahmed, a permanent injunction, and disgorgement with prejudgment interest and civil penalties.[143] The action against Ahmed is pending.

On June 4, 2015, ALJ James E. Grimes dismissed allegations that Houston-based investment advisor The Robare Group, Ltd. (Robare Group), and two of its owners, Mark L. Robare and Jack L. Jones, Jr., violated Sections 206(1), 206(2) and 207 of the Advisers Act for allegedly failing to disclose conflicts around payments the firm indirectly received from Robare Group's custodian,

Fidelity Investments (Fidelity), for steering clients into certain mutual funds. The SEC claimed that Fidelity paid about $440,000 in commissions over an eight-year period, but the Robare Group's disclosures over this time only stated that its owners *may* receive commissions in their capacity as registered representatives of an affiliated broker-dealer. ALJ Grimes found that while the Robare Group for a period of time did not make disclosures on its Form ADV, it told clients about potential commissions in other forms. ALJ Grimes also found that the SEC did not prove that Robare or Jones had made investing decisions for clients simply to earn compensation from Fidelity or that they had acted with scienter or negligently.[144]

On June 16, 2015, the SEC filed a civil injunctive action against Interinvest Corporation, Inc. (Interinvest), a Boston-based investment advisor and its owner, president, CCO, and Chief Investment Officer, Hans Peter Black. The SEC alleged that Interinvest and Black moved over $17 million in client assets into four Canadian penny stock companies for which Black served as a board member, without disclosing Black's relationship with the companies. The SEC further alleged that Black misrepresented the character of the penny stock company investments, ignored client instructions, and knowingly and deceptively departed from a conservative investment strategy that Interinvest promoted and its clients expected, which resulted in losses of as much as $12 million of the clients' $17 million investment. Interinvest and Black were charged with violations of Section 206(1) and 206(2) of the Advisers Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Section 17(a) of the Securities Act.[145] The action is pending.

On June 23, 2015, the SEC instituted a settled AP against investment advisor Pekin Singer Strauss Asset Management Inc. (Pekin Singer) for allegedly failing to conduct timely annual compliance program reviews or implement or enforce provisions of its policies, procedures and code of ethics. The SEC claimed that Pekin Singer failed to seek "best execution" for its clients or to adequately disclose that it had selected a share class for its clients that would generate greater fees. Pekin Singer violated Sections 204A, 206(2), 206(4) and 207 of the Advisers Act and Rules 204A-1 and 206(4)-7 thereunder. Pekin Singer and its principals agreed to pay a $285,000 civil monetary penalty without admitting or denying the Commission's findings.[146]

On June 25, 2015, the SEC instituted a settled AP against accounting firm Cotterman-Wilson CPAs, Inc. (Cotterman-Wilson) and CPA Michael S. Wilson, a 50% shareholder of Cotterman-Wilson, for allegedly failing to complete surprise examinations as required by the custody rule of the Advisers Act. Allegedly, Cotterman-Wilson was engaged by investment advisor Professional Investment Management, Inc. (PIM) to perform required annual surprise examinations, but Cotterman-Wilson failed to complete or withdrew from the examinations. The SEC found that Cotterman-Wilson caused violations of Section 206(4) of the Advisers Act and Rule 206(4)-2 thereunder and engaged in improper professional conduct pursuant to Section 4C(a)(2) of the Exchange Act and Rule 102(e)(1)(ii) of the Rules of Practice. Cotterman-Wilson and Wilson agreed to pay $86,897 to settle the claims, consisting of a $75,000 civil monetary penalty, $10,868 in disgorgement and $1,029 in prejudgment interest without admitting or denying the Commission's findings.[147]

On June 29, 2015, the SEC instituted an AP against investment advisor Welhouse & Associates Inc. (W&A) and its owner, Mark Welhouse, for allegedly disproportionately allocating profitable trades to certain accounts. Welhouse supposedly purchased options in an omnibus account and waited to allocate the purchases to either his or his clients' accounts until after he saw whether the securities at issue appreciated in value. Trades that appreciated in value were purportedly allocated to Welhouse or his firm's accounts while the depreciating trades were allocated to clients. The SEC charged W&A and Welhouse with violations of Section 10(b) of the Exchange Act, Sections 206(1) and 206(2) of the Advisers Act and Rule 10b-5 thereunder.[148] The action is pending.

As reported in our *Securities Enforcement 2014 Year-End Review*, the SEC indicated that it would focus on expense allocation in private equity firms when it brought an enforcement action against Lincolnshire Management for failing to properly allocate expenses between two of the funds Lincolnshire managed.[149] Apparently reflecting this continuing focus on expense allocation, on April 26, 2015, the SEC instituted a settled AP against Alpha Titans LLC (Alpha Titans), a California-based hedge fund advisory firm, its principal, Timothy P. McCormack, and its general counsel, Kelly D. Kaeser, for allegedly improperly allocating fund assets to pay undisclosed operating

expenses, and against Simon Lesser, the firm's outside auditor, who allegedly audited the funds' financial statements.

The SEC found that Alpha Titans violated Sections 206(2), 206(4) and 207 of the Advisers Act and Rule 206(4)-8 thereunder; McCormack violated Sections 206(2), 206(4) and 207 of the Advisers Act and Rule 206(4)-8 thereunder, and aided and abetted Alpha Titans' violation of Section 206(4) of the Advisers Act and Rules 206(4)-2 and 206(4)-7 thereunder. Kaeser aided and abetted Alpha Titans' and McCormack's violations of Sections 206(2) and 206(4) of the Advisers Act and Rule 206(4)-8 thereunder and Alpha Titans' violations of Section 206(4) of the Advisers Act and Rule 206(4)-2 thereunder. Lesser aided and abetted and caused Alpha Titans' violations of Section 206(4) of the Advisers Act and Rule 206(4)-2 thereunder and engaged in improper professional conduct within the meaning of Section 4C of the Exchange Act and Rule 102(e)(1)(iv)(B)(2) of the Rules of Practice. Without admitting or denying the SEC's findings, Alpha Titans and McCormack agreed to pay disgorgement of $469,522, prejudgment interest of $28,928 and a penalty of $200,000, McCormack and Kaeser agreed to a one-year bar from the securities industry, Kaeser agreed to a one-year suspension from representing a regulated entity and Lesser agreed to pay a penalty of $75,000 and consented to an order suspending him from practicing as an accountant on behalf of a regulated entity for at least three years. In all, respondents paid $773,450 to settle the claims.[150]

On June 29, 2015, the SEC instituted a settled AP against Kohlberg Kravis Roberts & Co. (KKR) alleging that KKR misallocated broken deal expenses to one of the private equity funds it managed. The SEC alleged that KKR had incurred $338 million in broken deal or diligence expenses related to unsuccessful buyout opportunities and other deals from 2005 to 2011, but had not allocated any of those expenses to KKR's co-investors, which included KKR executives. The SEC also alleged related disclosure violations. The Commission charged KKR with violating Sections 206(2) and 206(4) of the Advisers Act and Rule 206(4)-7 thereunder. KKR neither admitted nor denied the SEC's findings, but agreed to settle the charges by paying $28,677,409, consisting of $14,165,968 in disgorgement, $4,511,441 in prejudgment interest and a $10 million penalty.[151] The SEC's action against KKR could be one of several similar cases in the coming months as the SEC continues to probe fund firms' fees.

On July 1, 2015, the SEC instituted a settled AP against AlphaBridge Capital Management (AlphaBridge), its owners, Thomas T. Kutzen and Michael J. Carino, and a broker-dealer representative for the firm, Richard L. Evans, for inflating the prices of securities in hedge fund portfolios managed by AlphaBridge. The SEC claimed that AlphaBridge told investors and its auditor that it had obtained independent price quotes from broker-dealers for certain residential mortgage-backed securities, but then gave valuations created by AlphaBridge to broker-dealer representatives to pass off as their own. Moreover, the SEC alleged further that the inflated valuation of these assets resulted in the funds paying excessive management and performance fees to the firm.

The SEC charged AlphaBridge with violating Sections 206(1), 206(2) and 206(4) of the Advisers Act and Rules 206(4)-7 and 206(4)-8 thereunder, and charged Kutzen, Carino and Evans (as AlphaBridge's broker-dealer representative) with aiding, abetting and causing AlphaBridge's violations. Without admitting or denying the SEC's allegations, AlphaBridge, Kutzen, Carino and Evans settled the SEC's charges. AlphaBridge was censured and agreed to close down the implicated funds. Kutzen was censured, and Carino consented to a three-year bar from the securities industry. AlphaBridge, Kutzen, and Carino jointly and severally agreed to pay $4,025,000 in disgorgement. In addition AlphaBridge agreed to pay a $725,000 civil monetary penalty, Kutzen agreed to pay a $50,000 civil monetary penalty and Carino agreed to pay a $200,000 civil monetary penalty. Evans agreed to pay a $15,000 civil monetary penalty and to be barred from working in the securities industry for at least one year.[152]

F. Broker-Dealers

Although SEC enforcement activity concerning broker-dealers was relatively quiet in the first half of 2015, the Commission still brought significant cases involving dark pools and an equity offering in the energy sector.

On January 15, 2015, the SEC filed a settled AP against UBS Securities LLC (UBS Securities) for failing to disclose the existence of an order type called PrimeryPegPlus to the subscribers operating in its dark

pool. The SEC claimed that the order type permitted high-frequency traders or market makers to whom the order type was marketed to place orders at an increment smaller than one cent and also enabled a fractional order to jump in front of whole penny bids. The SEC further claimed that UBS Securities did not disclose to all subscribers the presence of an algorithmic tool that would ensure orders were not crossed with market makers or high frequency traders. UBS Securities' conduct allegedly violated Section 17(a)(2) of the Securities Act, Section 17(a) of the Exchange Act and Rule 17a-4(b)(1) thereunder, Rules 301(b)(2), 301(b)(5)(ii)(A), 301(b)(5)(ii)(B), 301(b)(5)(ii)(D), 301(b)(8), 301(b)(10) and 303 of Regulation ATS, and Rule 612 of Regulation NMS. Pursuant to the settlement order, UBS neither admitted nor denied liability, but agreed to pay $14,476,388.64, consisting of a $12 million penalty, disgorgement of $2,240,702.50 and prejudgment interest of $235,686.14.[153]

On February 19, 2015, the SEC instituted a settled AP against VCAP Securities, LLC (VCAP) and its CEO, Brett Thomas Graham, for allegedly committing fraud when conducting auctions to liquidate collateralized debt obligations. The SEC claimed that VCAP and Graham arranged for a third-party broker to win bond auctions for the benefit of the funds they managed. The SEC found that VCAP and Graham violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. Without admitting or denying the findings, VCAP agreed to pay disgorgement and prejudgment interest of $1,149,599 and Graham agreed to pay disgorgement and prejudgment interest of $127,733 plus a penalty of $200,000, for a total payment of $1,477,332. The SEC barred Graham from the securities industry for at least three years.[154]

On March 27, 2015, the SEC brought a settled civil injunctive action against a financial services firm and its former managing director and investment banker. The SEC alleged that the firm acted as lead underwriter for a secondary offering of Puda Coal, Inc. (Puda) in which Puda's offering materials allegedly falsely indicated that Puda had a 90% interest in a Chinese coal company. Further, during the due diligence process, the managing director and investment banker both allegedly received a report that called into question Puda's 90% ownership, but failed to act on the information. The SEC charged the defendants with violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act. The firm agreed to settle the SEC's charges by agreeing to pay $15 million, which consisted of $10,728,525 in disgorgement, $1,271,475 in prejudgment interest and a civil penalty of $3 million, and to set up a Fair Fund to compensate investors who purchased shares in the offering. The managing director and investment banker also settled for $212,711 and $35,000, respectively. Pursuant to the settlement, the managing director will be barred from supervisory positions in the securities industry and the investment banker will be barred entirely from the industry for a period of five years.[155]

On June 17, 2015, the SEC instituted a settled AP against Sand Hill Exchange (Sand Hill) and its founders, Gerrit Hall and Elaine Ou, for allegedly unlawfully offering complex derivative products to retail investors. Sand Hill, Hall and Ou allegedly wrongfully sold security-based swaps outside the regulatory framework of a national securities exchange and before registration statements were effective. The SEC found that Sand Hill, Hall, and Ou violated Section 5(e) of the Securities Act and Section 6(I) of the Exchange Act. Sand Hill, Hall and Ou neither admitted nor denied the filings, and Sand Hill agreed to pay a $20,000 penalty to settle the claims.[156]

G. Financial Crisis Cases

Although the SEC continues to wind down its financial crisis-related enforcement activities, the first half of 2015 saw two significant developments.

On April 14, 2015, District Judge Richard Sullivan approved a settlement between the SEC and former Freddie Mac CEO Richard F. Syron, Chief Business Officer Patricia L. Cook and senior executive Donald J. Bisenius. The SEC had charged Syron, Cook and Bisenius in 2011 with misrepresenting that Freddie Mac's exposure to subprime mortgage loans was between $2 billion and $6 billion, when in fact it was much higher. Under the terms of the settlement, the executives, who were not required to admit liability, will donate a total of $310,000 to a fund dedicated to reimbursing investors in amounts proportional to the stock and option awards granted to the executives in fiscal years 2006 and 2007. Syron, Cook and Bisenius also agreed not to sign company reports filed with the SEC for periods of 24, 18 and 12 months, respectively.[157] Interestingly, the settlement stated that the parties agreed that neither party prevailed and that it was

not in the interest of justice to continue to litigate the matter, language that rarely, if ever, appears in SEC settlements. Commentators have correctly pointed out that the settlement suggests that the SEC came to recognize that its case against the executives was not strong.

On May 26, 2015, the SEC instituted a settled AP against Deutsche Bank AG for allegedly overvaluing a portfolio of derivatives consisting of so-called Leveraged Super Senior (LSS) trades from 2005-2007, which allegedly resulted in Deutsche Bank issuing incorrect financial statements for 2008 and the first quarter of 2009. According to the SEC, Deutsche Bank initially acquired LSS trades that appropriately reflected gap risk, or the risk that the bank's value of the full notional trade would exceed the value of the collateral, but as the credit markets deteriorated in 2008, Deutsche Bank altered its methodologies for measuring gap risk and effectively reduced its gap risk value. Without admitting or denying liability, Deutsche Bank settled the SEC's charges and agreed to pay a $55 million civil penalty.[158]

H. Mutual Funds

The first half of 2015 also saw the SEC bring enforcement actions in connection with mutual funds for violations of the Investment Company Act.

On February 12, the SEC instituted a settled AP against Water Island Capital LLC (WIC), an alternative mutual fund investment advisor, for allegedly failing to properly ensure that $247 million of cash collateral belonging to funds managed by WIC was maintained with the funds' custodial bank, as required by the Investment Company Act. The SEC claimed that WIC had improperly permitted the funds' broker-dealer counterparties to hold the cash collateral, which resulted in violations of Sections 12(b) and 17(f)(5) of the Investment Company Act and Rules 12b-1(h) and 38a-1 thereunder. WIC consented to the SEC's order and agreed to pay a $50,000 civil monetary penalty without admitting or denying the SEC's allegations.[159]

On May 14, 2015, the SEC instituted a settled AP against Nationwide Life Insurance Company (Nationwide) for the alleged wrongful processing of daily purchase and redemption orders for variable insurance contracts and underlying mutual funds over a period of 15 years. The rules governing the pricing of mutual fund shares require investment companies to compute the value of their shares each day at a pre-determined time. Nationwide allegedly stated that mutual fund orders received before 4 p.m. would receive the current day's price and orders received after 4 p.m. would receive the following day's price. The SEC claimed, however, that Nationwide arranged to retrieve mail from post office boxes for its variable contracts business after 4 p.m. so that it could assign orders sent to those boxes prices for the following day. The SEC found that Nationwide willfully violated Rule 22c-1 under the Investment Company Act, and Nationwide, without admitting or denying the SEC's findings, agreed to pay a civil monetary penalty of $8 million to settle the SEC's claims.[160]

On June 17, 2015, the SEC instituted a settled AP against mutual fund advisor Commonwealth Capital Management (CCM), CCM's affiliated administrator, Commonwealth Shareholder Services (CSS), and CCM's majority owner, John Pasco III, as well as against J. Gordon McKinley III, Robert R. Burke, and Franklin A. Trice III, trustees for the boards of World Funds Trust (WFT) and World Funds, Inc. (WFI), which managed mutual funds advised by CCM. CCM supposedly failed to satisfy its statutory obligation to provide information to the boards of WFT and WFI regarding advisor fees and the nature and quality of CCM's services. McKinley, Burke and Trice allegedly approved advisory contracts without the requisite information to evaluate the contracts. The SEC further asserted that CSS had failed to provide WFT and WFI with information that WFT and WFI were required by law to deliver to fund shareholders. The SEC found that CCM, McKinley, Burke and Trice violated Section 15(c) of the Investment Company Act and that Pasco had caused CCM's violations. The SEC further found that CSS caused WFT and WFI to violate Section 30(e) of the Investment Company Act and Rule 30e-1 thereunder. Without admitting or denying the allegations, CCM, CSS and Pasco agreed to jointly and severally pay a $50,000 penalty, and McKinley, Burke and Trice each agreed to pay $3,250 penalties, for a total payment among all respondents of $59,750.[161]

I. Exchanges

On January 12, 2015, the SEC instituted a settled AP against EDGA Exchange, Inc. (EDGA) and EDGX Exchange, Inc. (EDGX) for allegedly failing to completely and accurately describe the order types being used on their exchanges. EDGA and EDGX were charged with negligently describing how their orders functioned and only disclosed information about order types to certain members, which created a risk that some market participants would not fully understand how the order types operated. The SEC further claimed it had SEC-approved orders that used a single "displayed price sliding process," but that EDGA and EDGX offered three different price sliding order types instead. The SEC found that EDGA and EDGX violated Sections 19(b) and 19(g) of the Exchange Act. EDGA and EDGX agreed to pay a $14 million civil monetary penalty without admitting or denying the SEC's findings.[162]

VI. Conclusion

In the first half of 2015, challenges to the Commission's policy of bringing litigated enforcement actions as APs, demands for greater transparency regarding enforcement decisions, and public disagreements among commissioners over certain enforcement priorities and policies could be read to suggest that pressure may be building for the SEC to adopt a less aggressive enforcement posture. But the SEC was also prominently criticized by some members of Congress and certain of its own commissioners in the first half of the year for being too lenient. On balance, it seems safe to say that while debate over certain aspects of enforcement activity will likely continue during the rest of 2015, nothing thus far in 2015 suggests that the SEC will alter its focus on and approach to enforcement.

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