SHEARMAN & STERLING LLP

Securities Enforcement: 2016 Mid-Year Review

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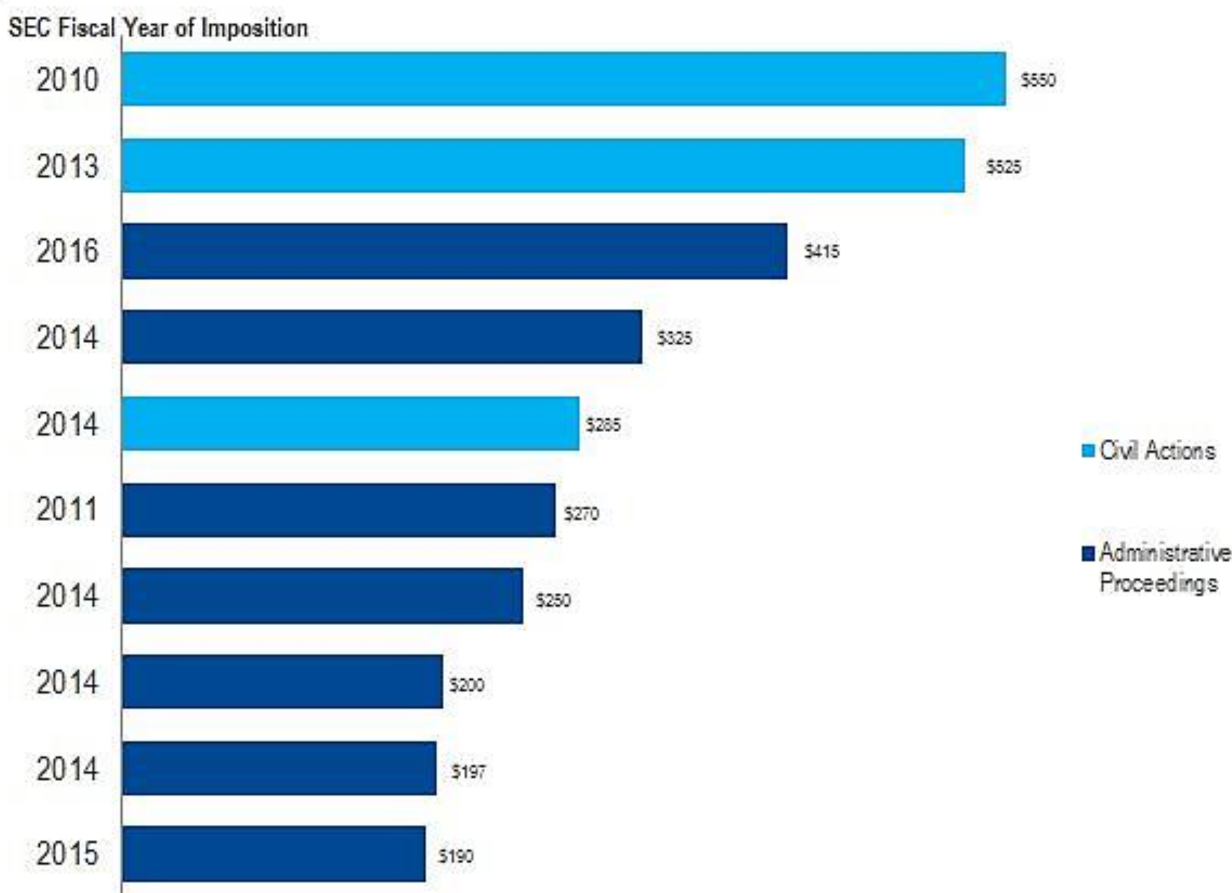
I. Executive Summary

The Securities and Exchange Commission (SEC or Commission) brought over 400 enforcement actions in the first half of fiscal year (FY) 2016, and is on pace to surpass its record of 807 enforcement actions in a single fiscal year, set in FY 2015.[1]

The SEC brought the vast majority of these enforcement actions as administrative proceedings (APs). On May 16, 2016, the NYU Pollack Center for Law & Business (NYU) and Cornerstone Research (Cornerstone) issued a report (Cornerstone Report) that found that in the first half of FY 2016,[2] the SEC brought 88% of actions against public company and related subsidiary defendants as APs. This was a substantial increase from FY 2010, when the SEC only brought 33% of its enforcement actions against public companies and their subsidiaries as APs.

The Cornerstone Report also found that eight of the top ten monetary settlements with public company and related subsidiary defendants from FY 2010 through the first half of FY 2016 were imposed in APs. The continued escalation of the SEC's enforcement activity is particularly noteworthy given that the SEC continues to function without its full slate of five Commissioners.

assuage these concerns, the Commission held a two-day outreach seminar in April to provide guidance on developing compliance policies and perhaps to convince attendees that the SEC was not interested in bringing actions against professionals who do their jobs in good faith.



Statute of Limitations for Disgorgement. A three-judge panel in the Eleventh Circuit limited the ability of the SEC to obtain disgorgement of ill-gotten gains in civil injunctive actions filed more than five years after the allegedly violative conduct, which should prompt the SEC to pay increased attention to bringing investigations to a prompt close and negotiating tolling agreements as needed. The SEC had long contended that disgorgement was exempt from the five-year catch-all statute of limitations as an equitable remedy, but the court concluded it was akin to forfeiture, which is expressly covered.

Whistleblower Program. The SEC's whistleblower program has already made multiple significant whistleblower awards in 2016, including an award for $17 million, the second-highest amount ever, and its first-ever award to a whistleblower whose tip furthered an investigation, as opposed to leading to an investigation.

Admissions. While it is still difficult to ascertain a principled pattern for when the SEC will require a settling defendant to admit wrongdoing, the Commission did obtain admissions in certain cases in the first half of 2016, including three where the underlying investigation was brought in conjunction with other government enforcement entities and one from a large financial institution.

Financial Reporting and Accounting Fraud. The SEC launched a new Corporate Issuer Risk Assessment tool and brought several cases focused on revenue recognition and other traditional areas of accounting fraud, highlighting the SEC's renewed focus on financial reporting and accounting fraud.

Investment Advisers and Private Equity Firms. The SEC continued its focus on investment advisers and private equity firms in the first half of 2016, with cases focused on the failure to disclose fees, misuse of investor funds, and the failure of a fund administrator to appropriately respond to red flags.

Broker-Dealers. In addition to enforcement actions concerning the misuse of investor funds and disclosure failures, the SEC brought several administrative actions against broker-dealers for allegedly failing to implement sufficient anti-money laundering procedures and announced a targeted sweep across all of its divisions to encourage other broker-dealers and investment firms to self-report any potential violations of the Customer Protection Rule.

Insider Trading. A jury found two traders liable for insider trading in a trial that was widely viewed as a test of the SEC's ability to bring enforcement actions against "remote tippees," or traders several steps removed from the source of inside information, following the Second Circuit panel's decision in *United States v. Newman*. In another remote tippee case, however, the SEC elected not to pursue fraud charges, instead claiming that the remote tippee was a "relief defendant" who was nevertheless liable for disgorgement.

FCPA. While most FCPA enforcement activity in 2015 involved smaller-scale actions brought independently by the SEC, 2016 got off to a flying start with a sharp increase in the number of actions brought overall, which included the SEC's first-ever deferred prosecution agreement (DPA) in an FCPA action and a settlement for $167.5 million with a Dutch telecommunications provider. As of June 30, 2016, the SEC has collected $252.3 million in civil monetary penalties and disgorgement in corporate enforcement actions. Together, the SEC and the Department of Justice (DOJ or Justice Department) have collected $523.2 million in civil monetary penalties, criminal fines, and disgorgement, far exceeding the $143.1 million both agencies collected last year.

Cybersecurity. After the SEC announced in early January that cybersecurity would remain a priority for the Office of Compliance Inspections and Examinations (OCIE) in 2016, the Commission brought an action against a prominent investment adviser/broker-dealer with a robust compliance program after the adviser's policies allegedly failed to prevent an employee from inappropriately accessing sensitive customer information.

Municipal Bonds. The SEC notably brought actions against municipal bond advisers for the first time ever in the first half of 2016. In addition, it brought actions against bond servicers and issuers in connection with pay-to-play schemes, misrepresentations, conflicts of interest, and misuse of funds, and brought additional enforcement actions in connection with its Municipalities Continuing Disclosure Cooperation Initiative (MCDC).

These enforcement actions and the Commission's broader enforcement program will be explored more closely in our mid-year review, in which we consider the broader implications of the cases instituted by the Commission along with the public comments of Commissioners and Commission staff in the first six months of 2016.

II. Use of Administrative Proceedings

As we have previously discussed in our 2015 Mid-Year Securities Enforcement Review (2015 Mid-Year Review), the Commission's increased use of APs for disputed actions was criticized and challenged throughout 2015. The Commission's almost unblemished record of success in APs, combined with a former ALJ's claims that she had been pressured to favor the SEC, fueled claims that the SEC preferred APs because the forum's procedures disadvantaged respondents and because presiding ALJs favored the Commission.[3] In addition, district courts last year preliminarily enjoined APs on constitutional grounds for the first time. In the first half of 2016, the SEC responded to claims of ALJ bias by releasing a report by the SEC's Office of Inspector General (OIG) that found no bias by ALJs. In addition, the Commission received favorable rulings from the Second and Eleventh Circuit Courts of Appeals, both of which held that district courts lacked jurisdiction over constitutional challenges to APs. In spite of these efforts, the robust criticism of and repeated constitutional challenges to the SEC's use of APs appears to have affected the SEC's forum selection process for litigating contested enforcement actions, as the SEC appears to have stopped bringing contested actions as APs.

The OIG report was released on January 21, 2016.[4] The OIG's investigation was prompted in large part by a 2015 *Wall Street Journal* article, covered in the 2015 Mid-Year Review, in which former ALJ Lillian McEwen claimed that she had felt pressured by former Chief ALJ Brenda Murray. McEwen claimed that Murray had questioned McEwen's loyalty to the SEC, and also pressured other ALJs to favor the Commission. McEwen said that ALJs were essentially expected to shift the burden of proof onto respondents, who needed to prove that they had not acted as the SEC alleged.

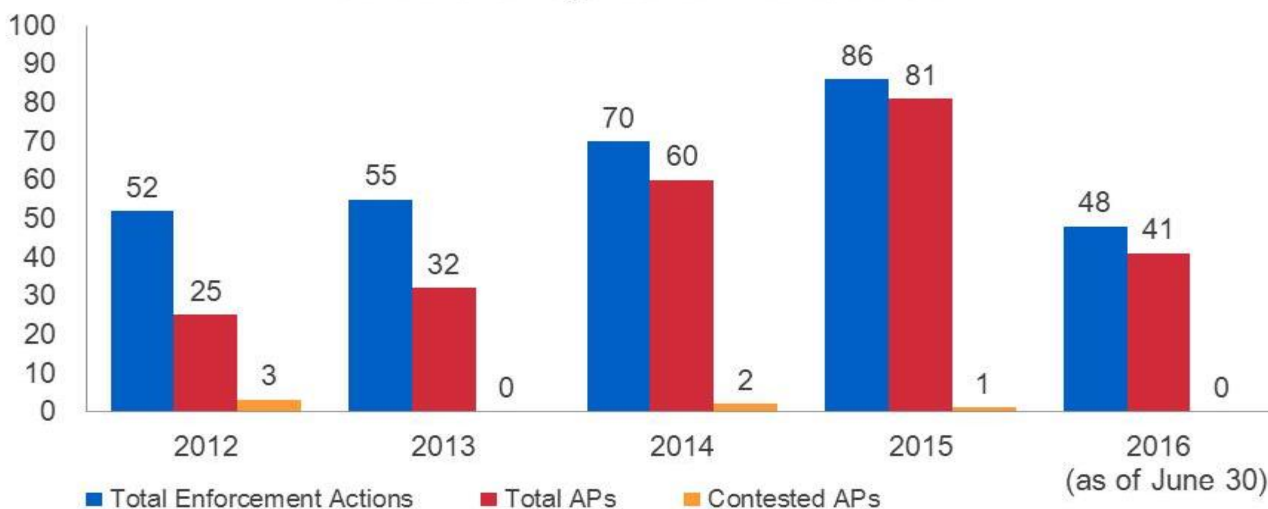
The OIG interviewed 15 individuals as part of its investigation, including current and former ALJs and employees of the Office of ALJs. According to the report, the interviewees consistently said that ALJs made decisions independently and free from influence from Chief Murray, who was only administratively involved in most matters. Indeed, the OIG's report noted that McEwen herself could not name a single case in which Murray criticized or reassigned her because she had ruled against the SEC. In addition, none of the interviewees recalled Murray questioning McEwen's loyalty to the SEC or exhibiting bias in favor of the SEC. The investigation did find some evidence that Murray had criticized ALJ decisions, including decisions by McEwen, but found that Murray's criticisms concerned procedural issues, a failure to follow precedent, and the length of time it took to issue decisions, not the cases' merits.

Meanwhile, as noted above, the SEC appears to have stemmed the tide of litigation against it regarding the constitutionality of APs.

As we described in our 2015 Year-End Securities Enforcement Review (2015 Year-End Review), several respondents in APs petitioned federal courts across the United States in 2015 seeking to preliminarily enjoin APs on the grounds that the SEC's process for hiring ALJs violated the Appointments Clause of Article II of the Constitution. Under the Appointments Clause, "inferior officers," or "government officials exercising significant authority pursuant to the laws of the United States" must be appointed by the President, the federal courts, or the heads of federal departments. In support of their claims, the plaintiffs seeking the injunctions (who were respondents in APs) argued that ALJs are inferior officers and, because they have not been appointed by the President, SEC Commissioners, or a federal court, their appointment is unconstitutional.

In 2015, panels in the Seventh Circuit Court of Appeals and the District of Columbia Circuit Court of Appeals held that district courts lacked subject matter jurisdiction to hear the constitutional challenges. In both cases, the panels held that respondents may only challenge the constitutionality of an AP through the appeals process for APs established by Congress, which allows a respondent to appeal an ALJ's decision to the full Commission, and then to a court of appeals.[5]

Also in 2015, however, Northern District of Georgia Judge Leigh Martin May, in *Hill v. SEC*, *Gray Fin. Grp., Inc. v. SEC*, and *Ironridge Glob. IV, Ltd. v. SEC*, and Southern



District of New York (SDNY) Judge Richard Berman, in *Duka v. SEC*, not only held that district courts had jurisdiction to consider applications for preliminary injunctions, but also preliminarily enjoined APs.[6]

The successful challenges to the constitutionality of APs were quickly undone, however. First, on June 1, 2016, in *Tilton v. SEC*, a divided Second Circuit panel affirmed the dismissal of a constitutional challenge to an AP for lack of subject matter jurisdiction. *Tilton* appeared to conflict with Judge Berman's ruling in *Duka*, and shortly after *Tilton* was issued the Second Circuit resolved the potentially inconsistent decisions by issuing an order that vacated and remanded *Duka* for further proceedings consistent with *Tilton*. On June 17, 2016, the Eleventh Circuit similarly reversed Judge May's decisions in *Hill* and *Gray Financial Group*, citing the D.C. Circuit, Seventh Circuit, and Second Circuit.[7]

While this string of Circuit court victories appears to have resolved the jurisdictional question, at least three other cases involving constitutional challenges to APs have been brought by respondents as part of their appeal of final decisions in APs, and thus do not pose this jurisdictional hurdle. For example, the D.C. Circuit heard oral argument on May 13, 2016 in *Lucia v. SEC*.[8] Other cases in the same procedural posture raising the constitutional issue regarding ALJs are pending before the D.C. Circuit and the Tenth Circuit.[9] The SEC has argued ALJs lack the authority to be "inferior officers" under the Appointments Clause because SEC Commissioners review and finalize every ALJ decision. The Respondents reply, however, that because the ALJs are primary fact-finders whose decisions are reviewed deferentially by SEC Commissioners, the ALJs possess the decision-making authority to qualify as inferior officers under Article II.

Regardless of the outcome of these various legal challenges, the public criticism appears to have had a chilling impact on the SEC's use of APs. Cornerstone's Securities Enforcement Empirical Database, a public online resource that provides data on SEC actions filed against defendants that are public companies and their subsidiaries, suggests that the Commission is bringing fewer contested actions before ALJs. The database shows that the SEC's use of APs to litigate contested enforcement actions against public companies has declined, even though the SEC continues to file more APs than ever before. For example, the SEC filed 52 APs in 2012 against public companies, three of which were contested actions. Conversely, while the SEC brought 41 APs against public companies in the first half of 2016 — nearly double its 2012 rate — not one of those actions was a litigated AP. Also, we are aware of no contested APs brought in 2016 against non-registered persons, which was one of the most contentious issues of 2015, after the SEC began bringing insider trading actions in APs, among other issues. It thus appears that the SEC may be returning to a more traditional use of APs for contested matters against registered entities and individuals.

On July 13, 2016, as we were preparing to publish this review, the SEC announced that it had adopted amendments to its Rules of Practice governing APs that, as described in our 2015 Year-End Review, had been promulgated to "modernize" the AP process. The amendments, among other things, adjust the deadlines by which an ALJ must issue an initial decision, which allows respondents more time for discovery and hearing preparation, and give the parties discretion to take limited depositions during the discovery period.[10] When the Commission initially proposed the amendments on September 24, 2015, it was criticized for not going far enough to remedy concerns that the procedures governing APs were unfair to respondents. It will be interesting to see over the second half of 2016 — and beyond — both how the amendments operate in practice and whether they result in the SEC bringing more contested enforcement actions as APs.

III. SEC Views on Cooperation

For several years, the SEC (like the Department of Justice (DOJ) with the September 9, 2015 issuance of the so-called "Yates Memorandum") has been stressing the importance, and value, of "full" cooperation in its investigations. The first half of 2016 was no different, with numerous speeches and announcements reinforcing the SEC's views.

For example, on February 19, 2016, at a Practicing Law Institute (PLI) conference in Washington, Director of the Philadelphia Regional Office Sharon Binger noted that companies that decide against self-reporting "are taking a gamble" that violations will not be uncovered by the SEC's whistleblower program. Binger added that cooperation with the SEC can bring many benefits, including reductions in monetary penalties, suspensions, and bars, flexibility on charging decisions, and more

favorable treatment in press releases. Binger, however, explained that "the bar for cooperation has been raised" and the decision on how to reward cooperation, if at all, remained largely with the SEC's staff. Later, at an April 29, 2016 PLI conference in New York, SEC Enforcement Director Andrew Ceresney gave essentially the same message, highlighting companies he said have avoided monetary penalties by cooperating with SEC investigations.

But, consistent with the Yates Memorandum, companies that have cooperated have seen the SEC aggressively pursue their employees. For example, on February 16, 2016, as described in detail in Section XII below, computer software company PTC Inc. (PTC) settled claims brought by the SEC alleging that PTC had made nearly $1.5 million in improper payments to Chinese government officials who were employed by the company's government customers. Because PTC paid a $14.54 million criminal fine as part of a settlement with the DOJ, the SEC declined to impose a civil monetary penalty, but did order the company to pay disgorgement of $11.85 million. In addition, the SEC pursued the individual allegedly responsible for the misconduct, Yu Kai Yuan, a sales executive at PTC's Chinese subsidiary. Yuan eventually signed a DPA with the SEC.[11]

Separately, on March 15, 2016, the SEC instituted a settled AP against supply chain services company ModusLink Global Solutions, Inc. (ModusLink), in which the SEC required ModusLink to pay a civil monetary penalty of $1.6 million for breaching contracts to pass rebates onto customers and improperly including those rebates in its net income.[12] The SEC alleged that ModusLink's chief financial officer (CFO) negligently failed to determine whether the rebates should have been passed on to clients and thereby caused the company to overstate its net income. In addition to the civil monetary penalty, ModusLink's CFO agreed to pay a $20,000 civil monetary penalty to settle the SEC's allegations and its chief executive officer (CEO) and CFO both agreed to reimburse the company for the value of their equity and incentive-based compensation for the 12 months following the company's allegedly misstated filings. None of the respondents admitted or denied the SEC's findings.

The SEC also entered into a deferred prosecution agreement with a board chairman who agreed to cooperate against company executives. On March 9, 2016, the SEC announced that it had entered into a DPA with Bernard Marren, the former chairman of the board of touchscreen developer Uni-Pixel, Inc. (Uni-Pixel), to settle claims that Marren had failed to correct misrepresentations in certain Uni-Pixel press releases.[13] According to the SEC, the releases misrepresented the production schedule of a new product, which caused Uni-Pixel's stock price to soar. Under the terms of the DPA, Marren agreed to cooperate fully with the SEC's enforcement actions against certain Uni-Pixel executives and to resign any position he held as an officer or director of a public company. Uni-Pixel agreed to pay a $750,000 civil monetary penalty to settle the claims; the action against the officers is ongoing.

This year, however, has already seen a stark reminder that where the SEC concludes that a cooperating witness has failed to provide "full and complete" cooperation, the consequences can be severe. For example, on June 21, 2016, the SEC sought penalties against a cooperating witness, Thomas Conradt, in an insider trading case because he breached his cooperation agreement by contradicting his prior deposition testimony.

As described further in Section XI below, Conradt had allegedly tipped material non-public information concerning an upcoming acquisition to three of his coworkers.[14] Conradt agreed to cooperate with the SEC in exchange for the Commission forgoing a civil monetary penalty and only seeking disgorgement of his profits. Conradt was called to testify at the trial of two of his tippees, during which the SEC claimed that he downplayed testimony that he had given at an earlier deposition by, among other things, stating on the stand that he did not recall certain details, including statements by the source of the inside information. SDNY Judge Rakoff found that Conradt had intentionally "watered down" his testimony at trial in violation of his agreement and, at the SEC's request, assessed a $980,229 penalty against Conradt, equal to the sum of his tippees' allegedly illicit profits. In other words, even though Conradt agreed to cooperate and was initially only ordered to disgorge $2,533.60 in profits, the SEC was able to claim later that his cooperation thereafter was inadequate and obtained a much harsher penalty against him.

To be sure, statements from the SEC defending cooperation, both in external speeches and in its written APs, hardly present a new approach toward the subject. But the fact that the staff appears focused on the benefits

of cooperation suggests that the staff may be concerned that corporations and the defense bar have not fully accepted the purported benefits of cooperation in the wake of the Yates Memorandum and public statements by Chair White and other SEC officials.

IV. Enforcement Actions Against Compliance Professionals

As we highlighted in our 2015 Mid-Year and Year-End Reviews, the SEC's enforcement activity against compliance professionals was one of last year's most controversial enforcement issues. The SEC's actions were criticized by defendants, commentators, and even former Commissioner Daniel Gallagher as having the potential to chill robust compliance efforts and discourage skilled professionals from pursuing compliance careers. Despite the controversy, in the first half of 2016 the SEC continued to bring actions against compliance professionals.

For example, on March 25, 2016, the Commission upheld an ALJ's ruling against Bernerd Young, the former chief compliance officer (CCO) of investment adviser and broker-dealer Stanford Group Co. (Stanford), in connection with an alleged $7 billion Ponzi scheme.[15] Young allegedly ignored red flags about Stanford's business and directly participated in the firm's misrepresentations about its offerings by approving communications to investors.

The SEC also continued its practice of bringing enforcement actions against individuals who worked in compliance roles in addition to having other responsibilities. On May 27, 2016, the Commission instituted a settled AP against investment advisery firm Biscayne Capital International, LLC (BCI) and its co-founder and beneficial owner, Juan Carlos Cortes, who was also responsible for compliance. The SEC found that the BCI and Cortes had failed to adopt procedures designed to prevent violations of the federal securities laws, and noted that the firm used an "off-the-shelf" compliance manual that was purchased from a third party and was not tailored to the firm's needs. The SEC also alleged that Cortes had no specific compliance training and failed to prevent BCI's violations of the federal securities laws.[16] Cortes agreed to pay a civil monetary penalty of $50,000 to settle the SEC's claims, without admitting or denying the SEC's findings.

There is reason to believe, however, that the SEC has heard and will take on board the compliance community's concerns that enforcement activity could unintentionally chill effective compliance programs. For example, late last year, Director Ceresney stated that the SEC seeks to bring enforcement actions against compliance professionals only where the individual (1) was directly engaged in misconduct unrelated to compliance, (2) attempted to obstruct or mislead the SEC, or (3) exhibited a "wholesale failure" to carry out compliance responsibilities.[17]

In addition, on April 19, 2016, the Commission held a two-day outreach seminar to provide guidance on developing compliance policies. SEC Chair Mary Jo White kicked off the seminar by reiterating Director Ceresney's previous comments.[18] Other presenters also emphasized that the SEC was not targeting compliance officers, but rather viewed them as partners creating a culture of compliance within the industry, and the panel on private fund advisers emphasized the importance of independence, familiarity with all aspects of the business, as well as "palpable buy-in" from the business as keys to success for compliance officers and the programs they administer.[19] Although the enforcement actions filed against compliance officers through June 2016 appear consistent with the principles outlined by Chair White and Director Ceresney, those in the compliance community continue to pay close attention to the Commission's enforcement cases and public comments in this area of the Commission's enforcement program.

V. Statute of Limitations for Disgorgement

On May 26, 2016, a three-judge panel of the Eleventh Circuit held, in *SEC v. Graham*,[20] that 28 U.S.C. § 2462 — the federal catch-all five-year statute of limitations — limits the Commission's ability to obtain disgorgement of ill-gotten gains in civil injunctive actions filed more than five years after the alleged wrongful conduct.

In *Graham*, the SEC alleged that between July 2004 and January 30, 2008, Barry J. Graham, Fred Davis Clark, Jr., Cristal R. Coleman, David W. Schwarz, and Ricky Lynn Stokes sold condominium units to private investors at seventeen properties nationwide.[21] These sales, according to the SEC, violated the federal securities laws because the condominiums were the functional equivalent of securities, but had not been registered. The SEC began investigating the defendants in October 2007, but waited over five years,

until January 30, 2013, to institute a civil injunctive action against them in the Southern District of Florida.

The SEC's complaint sought declaratory and injunctive relief and disgorgement, including: (1) a declaration that the defendants' conduct violated the federal securities laws; (2) a permanent injunction enjoining the defendants from future violations; (3) an order requiring that the defendants disgorge their profits and prejudgment interest; and (4) an order requiring Coleman, Clark, and Stokes to pay civil monetary penalties. Coleman, Clark, Stokes, and Schwarz moved for summary judgment on the grounds that their conduct was not governed by the federal securities laws and the five-year statute of limitations under Section 2462 had expired, barring the SEC's requested forms of relief. Section 2462 is the federal "catch-all" statute of limitations. It provides that, "[e]xcept as otherwise provided by Act of Congress, an action, suit or proceeding for the enforcement of any civil fine, penalty, or forfeiture, pecuniary or otherwise, shall not be entertained unless commenced within five years from the date when the claim first accrued[.]"[22] All federal courts of appeal to consider the issue had held that Section 2462's limitations period does not apply to civil actions seeking disgorgement, or other equitable relief, because such relief is not intended to "punish" defendants.[23]

The federal district judge in *Graham*, however, citing the Supreme Court's ruling in *Gabelli v. SEC*,[24] where the Court signaled that it was receptive to limiting the government's ability to obtain relief for conduct long in the past, granted defendants' summary judgment motion and held that disgorgement was limited by Section 2462. First, the district court held that Section 2462 is a "jurisdictional" statute that precluded a court from hearing a claim for a civil fine, penalty, or forfeiture unless the misconduct at issue occurred within five years of the filing of the complaint. Second, the district court held that Section 2462's five-year statute of limitations applied to all the forms of relief sought by the SEC because: (1) the Supreme Court had recently emphasized in *Gabelli* that it was necessary to establish "a fixed date when exposure to … Government enforcement efforts end[]," and (2) the SEC's claims for declaratory and injunctive relief were

Aggregate award size reflects the approximate amounts publicly announced by the SEC, including subsequent increases where that information is available. The award amount for one award in 2014 H2 is not publicly available.

claims for "penalties" and the Commission's claims for disgorgement were claims for "forfeiture," which are both subject to the limitations of Section 2462. Because the SEC offered no evidence that any of the defendants' wrongful conduct occurred after January 30, 2008, five years before the Commission filed its complaint, the district court held that any alleged wrongdoing by the defendants occurred outside the five-year limitations period and thus, it lacked the power to award any of the relief sought by the SEC. The SEC appealed.

Sidestepping the issue of whether Section 2462 was "jurisdictional," the Eleventh Circuit affirmed the district court in part, holding that Section 2462's limitations period applied to the SEC's claims for penalties, declaratory relief and disgorgement. (The Court held that the limitations period did not apply to "forward-looking injunctions.") Of particular note, the Court held that Section 2462 required the SEC to bring claims for disgorgement within five years of the underlying misconduct, because the use of "forfeiture" in Section 2462 is synonymous with "disgorgement." The Court opined that there was "no meaningful difference," between the ordinary definition of forfeiture, which occurs "when a person is forced to turn over money or property because of a crime or wrongdoing," and the definition of "disgorgement" as defined in legal reference dictionaries and Supreme Court opinions.

The First and D.C. Circuits are the only other federal appellate courts to consider whether disgorgement is limited by Section 2462. Unlike the Eleventh Circuit, however, both courts have ruled that the equitable remedy of disgorgement is not subject to the limitations of Section 2462. Specifically, in 2008, the First Circuit concluded in *SEC v. Tambone* that "the applicable five-year statute of limitations period [the defendant] invokes applies only to penalties sought by the SEC, not its request for injunctive relief or the disgorgement of ill-gotten gains." The D.C. Circuit likewise held in *Riordan v. SEC* that "[t]he five-year statute of limitations in 28 U.S.C. § 2462 applies to an action for the enforcement of a 'fine, penalty, or forfeiture.' Does that list include disgorgement? This Court has said no."[25] Moreover, numerous district courts that have considered this issue have also held that disgorgement is not limited by Section 2462.[26] The Eleventh Circuit may therefore seem like an outlier, but the D.C. Circuit and First Circuit issued their opinions prior to the United States Supreme Court issuing *Gabelli*.

Graham may not materially affect the SEC's enforcement program, given that relatively few actions are filed in the Eleventh Circuit and even fewer are filed where the statute of limitations is at issue. However, in light of the Supreme Court's decision in *Gabelli*, in which the Court made clear that there should be a fixed date "when exposure to . . . Government enforcement efforts ends," other appellate courts could adopt the Eleventh Circuit's reasoning.

VI. Whistleblower Program

In the first six months of 2016, the Commission issued whistleblower awards to 10 claimants in connection with seven enforcement actions, including three awards in a single week in May. The awards ranged from approximately $65,000 to $17 million and included four awards exceeding $1 million, for a total of $28.225 million. Since inception, the Commission has issued 32 whistleblower awards totaling more than $85 million.

Three awards issued thus far in 2016 have been particularly noteworthy. First, on January 15, 2016, the Commission announced an award of more than $700,000 to a company outsider who "conducted a detailed analysis that led to a successful SEC enforcement action."[27] The whistleblower reportedly approached the Commission with an analysis showing that stock quotes from the NYSE were delayed compared to the proprietary feed paid for and received by many high frequency traders.[28] The whistleblower's analysis led to a first-of-its-kind fine of $5 million against the NYSE on September 14, 2012.[29] The timing of the whistleblower's claim is unusual in that he provided the SEC with his analysis in 2010, which led to a 2012 enforcement action, but the whistleblower did not file his claim until 2013. In announcing the award, the Commission noted that the "voluntary submission of high quality analysis by industry experts can be every bit as valuable as first-hand knowledge of wrongdoing by company insiders."[30]

Second, on May 13, 2016, the Commission announced an award of $3.5 million to a company insider whose tip "bolstered" an ongoing investigation.[31] The tip at issue did not initiate the investigation, which was opened in response to media reports concerning potential misconduct, but in its order issuing the award, the Commission noted that the tip nevertheless caused the SEC to focus on specific conduct that "significantly contributed" to the success of the enforcement action. The claimant successfully challenged a preliminary

determination by the Claims Review Staff to deny the award, though it is not clear why the claim had initially been rejected. In addition, according to the Commission's award order, the large size of the award was justified in part because of the hardships the whistleblower suffered after coming forward with his tip, including his inability to find employment since reporting the misconduct. Each of these issues — and perhaps the SEC's desire to publicize them — highlights once again the lengths to which the SEC apparently is willing to go to encourage assistance from the public in the identification and investigation of potential federal securities law violations.

Third, on June 9, 2016, the Commission announced an award of $17 million to a company insider whose tip substantially advanced an investigation by providing information previously unknown to the SEC's staff.[32] The award is the second largest ever awarded by the Commission, behind only the aforementioned $30 million award issued in September 2014.

The SEC also, for only the second time, brought an enforcement proceeding against a company for allegedly using employee agreements that prevented employees from voluntarily providing information to the Commission.[33] On June 23, 2016, as described in Section X below, the SEC instituted a settled AP against a large financial institution for allegedly violating the Consumer Protection Rule, under which broker-dealers are prohibited from using customer funds and securities to finance overhead and trading and underwriting activities. In addition to alleging that the firm had improperly accessed investors' funds, the Commission alleged that the firm's severance agreements precluded former employees from disclosing confidential information unless the disclosure was authorized by the firm or required by law. In addition, the SEC noted that even after the agreements' language was amended to allow communications to the SEC, the employees were allowed to disclose only the facts and circumstances of the severance agreement itself.

The awards and settlements will undoubtedly continue to serve to incentivize and encourage would-be whistleblowers, including company outsiders who may have the capacity to assess financial misconduct.

VII. Admissions

The SEC requested additional resources from Congress for FY 2016 in part because the Commission's policy of requiring admissions of wrongdoing in certain cases may require additional resources. According to the Commission, when it insists that a defendant admit wrongdoing, a defendant is more likely to litigate a case than settle, and litigation generally requires a substantial amount of staff time.[34] Even though the SEC's budget request suggests that it is committed to its policy of obtaining admissions when settling enforcement actions, cases where the SEC successfully obtains admissions continue to be the exception, not the rule.

In the first half of 2016, the Commission obtained admissions in several actions brought in parallel to enforcement actions by other government agencies. For example, on January 31, 2016, a large financial institution admitted wrongdoing in connection with settling claims arising out of its operation of a so-called "dark pool," or alternative trading system that allows anonymized trading.[35] As described in more detail below in Section X, the firm agreed to settle the SEC's charges by paying a $35 million civil monetary penalty, as well as an additional $35 million to settle a parallel action brought by the New York Attorney General (NYAG).

Similarly, on February 16, 2016, a Massachusetts-based technology company and its Chinese subsidiaries agreed to settle parallel civil and criminal actions involving allegations that the subsidiaries provided non-business-related travel and other improper payments, including gifts and entertainment expenses, to Chinese government officials to win business contracts.[36] In addition to admitting wrongdoing, the technology company agreed to pay $13.622 million, consisting of $11.858 million in disgorgement and $1.764 million in prejudgment interest, and its two China subsidiaries agreed to pay a $14.54 million fine to the DOJ in a parallel action.

Finally, on February 18, 2016, as described in Section XII below, the SEC, the DOJ and Netherlands regulators announced a global settlement of allegations that a global telecommunication services provider paid at least $114 million in bribes to an Uzbek government official as it sought to enter the Uzbek telecommunications market. As part of the settlement, the company admitted to falsifying its records to conceal the bribery scheme.[37] As part of the settlements of the various investigations, the company

agreed to pay over $795 million in fines and penalties to settle the various actions, consisting of $167.5 million to the SEC, $230.1 million to the DOJ, and $397.5 million to Dutch regulators.

These cases fall into a separate category of admissions, however, given that the Justice Department had also instituted parallel criminal proceedings that the defendants settled by admitting the allegations the government asserted against them. But the SEC also obtained admissions of wrongdoing in enforcement actions it brought independently.

For example, on April 14, 2016, the SEC instituted a settled AP against Reid Johnson, the founder and sole owner of The Planning Group of Scottsdale, LLC (TPGS), which alleged that Johnson caused the firm to make false representations on its Form ADV and to violate the custody rule by failing to maintain appropriate custody of client funds or maintain proper compliance policies and procedures regarding custody rules. [38] In addition to admitting to the SEC's findings, Johnson settled the SEC's claims by agreeing to pay a $45,000 civil monetary penalty and consenting to an industry bar for at least one year.

In addition, on June 23, 2016, the SEC obtained an admission from a large financial institution where the alleged misconduct had the potential to harm a large number of investors.[39] As described in detail in Section X below, the SEC instituted a settled AP that alleged that the financial institution violated the SEC's Customer Protection Rule, which forbids broker-dealers from using customer funds and securities to finance firm overhead and trading and underwriting activities.

The SEC required an admission of wrongdoing even though, according to the SEC, the financial institution cooperated fully with the SEC's investigation and engaged in extensive remediation, including retaining an independent compliance consultant to review its compliance with the Customer Protection Rule. The institution agreed to pay $415 million to settle the SEC's claims, consisting of a $358 million civil monetary penalty, disgorgement of $50 million, and prejudgment interest of $7 million.

As we have noted in prior enforcement reviews, it is difficult to draw any meaningful conclusions regarding the Commission's admissions program from these settlements, as the circumstances when the SEC will insist on an admission continue to vary widely based on the individual circumstances of each settlement.

VIII. Accounting and Financial Disclosures

On January 25, 2016, Director Ceresney left little doubt that the Commission would continue its vigorous accounting and financial reporting enforcement this year when he told attendees at the 2016 Directors Forum that "[t]he Commission is committed to holding accountable those whose actions prevent investors from receiving timely and reliable information that enables them to make informed investment decisions."[40] Ceresney also told the attendees that SEC accounting and financial reporting enforcement actions had more than doubled since 2013, and highlighted that the Commission had charged over 175 individuals in reporting and disclosure matters in the last two fiscal years. It was thus no surprise that the SEC brought prominent accounting and reporting actions against entities and individuals in the first half of 2016.

On January 13, 2016, the SEC filed a complaint in the Northern District of Florida against 11 former executives and board members of Superior Bank, which failed in 2011, and its holding company, Superior Bancorp.[41] The SEC alleged that the defendants engaged in various schemes to conceal the extent of loan losses that Superior Bank was experiencing in the wake of the financial crisis. According to the SEC, the executives and board members attempted to cover up the bank's financial condition by improperly extending, renewing, and rolling over bad loans to avoid impairment and the need to report ever-increasing allowances for loan and lease losses in its financial accounting. The board members served on the board's loan and investment committee, approved the bad loans and knew that the loans were deteriorating, and personally engaged in transactions with the bank in spite of their insider status. Nine of the 11 defendants, including the board members, have agreed to settle the SEC's charges in exchange for paying civil monetary penalties ranging from $10,000 to $250,000. Two actions are pending.

On April 19, 2016, the SEC instituted a settled AP against Logitech International (Logitech) and several of its executives for allegedly fraudulently inflating Logitech's fiscal year 2011 financial results and committing other accounting-related violations over a five-year period. [42] The SEC also filed a complaint in federal court against Logitech's then-CFO and then-acting controller, which

alleged that the executives intentionally minimized the write-down of millions of dollars of excess product parts. According to the SEC, the executives falsely assumed the company would build all of the components into finished products despite their knowledge to the contrary. Without admitting or denying liability, the company agreed to pay a civil monetary penalty of $7.5 million to settle the claims, while the executives agreed to pay civil monetary penalties ranging from $25,000 and $50,000.

Similarly, on June 6, 2016, the SEC settled an AP against the CFO of Miller Energy Resources, Inc. (Miller), for allegedly overvaluing certain Miller assets.[43] The SEC alleged that Miller's CFO failed to adhere to generally accepted accounting principles (GAAP), which resulted in the valuing of certain oil wells at $480 million, more than 100 times what Miller had paid for them, and which also resulted in Miller being listed on the New York Stock Exchange. Without admitting or denying the allegations, the CFO agreed to a five-year officer and director bar and to pay $294,800, consisting of a civil monetary penalty of $125,000, disgorgement of $158,000 and prejudgment interest of $11,800.

In addition to these enforcement actions, the SEC's Division of Corporation Finance also updated its Compliance and Disclosure Interpretations (C&DIs) on May 17, 2016. The new C&DI's tightened the use of non-GAAP in financial reports under Regulation G[44] and included guidance on the circumstances under which the Commission would consider adjustments misleading and how non-GAAP financial measures should be disclosed. We expect that, in the future, the SEC will claim that a failure to comply with these C&DIs justifies enforcement actions.

The Commission has also continued to use data mining and other technologies to detect potential financial misconduct before it becomes public. The SEC had announced the formation of the Financial Reporting and Audit Group (FRAud Group) and introduced its Corporate Issuer Risk Assessment program (CIRA) in 2015,[45] and the markets may not need to wait much longer for enforcement actions arising out of FRAud Group's use of CIRA. On March 1, 2016, former Asset Management Unit Co-Chief Sprung said in public remarks that the FRAud Group had already identified 270 issuers of interest for further review through its use of CIRA.[46]

IX. Investment Advisers and Private Equity

With respect to investment advisers, the first half of 2016 saw, as usual, the standard fare of enforcement actions alleging the improper disclosure of fee structures, misrepresentation of investment strategies, and misappropriation of investor funds.

For example, on January 28, 2016, the SEC instituted a settled AP against QED Benchmark Management, L.L.C. (QED), and its manager, Peter Kuperman, for allegedly misleading investors about the investment strategy and historical performance of a QED fund.[47] The QED and Kuperman allegedly used a mixture of hypothetical and actual performance returns when discussing the fund's performance history with investors, then deviated from their purported strategy by investing most of the fund's assets in a single stock. QED and Kuperman then allegedly misled investors about the stock's value and liquidity.[48] Without admitting or denying liability, the respondents agreed to pay $2.877 million to reimburse investors. Kuperman also agreed to pay a $75,000 penalty and to an indefinite industry bar, although he can apply for readmission.

On February 23, 2016, the SEC instituted a settled AP against Cantella & Co (Cantella), an investment adviser and broker-dealer, for allegedly making misrepresentations to its customers by advertising a third-party investment strategy whose historical performance had been inflated.[49] According to the SEC, Cantella advertised the strategy by negligently relying on a third-party's representations about the strategy's performance without obtaining sufficient documentation to substantiate the strategy's track record. Cantella agreed to settle the SEC's claims by paying a civil monetary penalty of $100,000, without admitting or denying liability.

On March 2, 2016, the Commission instituted a settled AP against Marco Investment Management, LLC (MIM) and Steven Marco, MIM's CEO and CCO, for allegedly charging certain clients fees that were calculated in a manner different from the description of fee calculations in the clients' advisory agreements.[50] According to the SEC, the respondents charged management fees on total asset balances for 25 customers without adjusting for sales proceeds or other credits applied against the customers' margin balance. The respondents claimed that they had an understanding with the affected customers, but this understanding was allegedly not reflected in the

customers' adviser agreements. The respondents agreed to settle the claims without admitting or denying liability. As part of the settlements, MIM agreed to pay $232,346, consisting of a civil monetary penalty of $100,000, $124,750.44 in disgorgement, and $7,595.94 in prejudgment interest, as well as hire a new CCO and retain an independent compliance consultant. Marco agreed to pay a civil monetary penalty of $50,000 and to be barred from working as a compliance officer for three years.

On March 14, 2016, the Commission instituted a settled AP against three investment advisers, Royal Alliance Associates, Inc., SagePoint Financial, Inc. and FSC Securities Corporation, that allegedly charged unnecessary fees to at least 1,000 mutual fund clients.[51] According to the SEC, the firms steered customers into higher-fee fund share classes and kept customers in accounts with "wrap fees" that are charged even if a client has minimal trading activity. Without admitting or denying liability, the firms agreed to settle the Commission's claims by jointly and severally paying $9,549,859, consisting of a civil monetary penalty of $7.5 million, disgorgement of $1,956,460 and prejudgment interest of $93,399.

On April 19, 2016, the SEC instituted an AP against TPG Advisors LLC (TPG) and Larry Phillips, TPG's sole owner and principal, for allegedly engaging in a fraudulent "cherry-picking" scheme.[52] The SEC alleged that Phillips allocated profitable trades to a set of accounts held by his friends, relatives, and long-term profitable clients, but allocated unprofitable trades to accounts held by other customers. The action is pending.

On May 27, 2016, the SEC instituted a settled AP against investment adviser Federated Global Investment Management Corp. (Federated) for allegedly failing to properly monitor whether its third-party consultants misused material non-public information.[53] According to the SEC, Federated was not aware that one of its consultants, who made biotechnology and pharmaceutical stock recommendations for Federated, served on the boards of four companies in whose stocks Federated traded. In addition, the consultant allegedly traded in stocks owned by Federated's funds "in close proximity" to the funds' trades, and should have been subjected to "blackout periods." Without admitting or denying wrongdoing, Federated agreed to settle the SEC's claims by paying a civil monetary penalty of $1.5 million.

On May 31, 2016, the SEC filed a lawsuit in the District Court of Connecticut against Connecticut-based investment adviser Momentum Investment Partners LLC (Momentum) for allegedly failing to disclose certain fees to its clients.[54] The SEC alleged that Momentum and one of its principals, Ronald Fernandes, moved investors into a newly created fund without notice, which increased the fees paid by investors, but did not change the investors' investment strategies. The move to the new fund allegedly caused investors to pay an additional $111,000 in fees between May 2013 and March 2014. The action is pending.

On June 1, 2016, the SEC filed a lawsuit in the Northern District of Georgia alleging that investment advisory firm Hope Advisers Inc. (Hope) and its owner, Karen Bruton, improperly collected additional monthly fees from two hedge funds that they managed.[55] According to the SEC, Hope and Bruton executed trades in a manner that allowed them to realize additional profits under Hope's fee structure, which charged fees only when the funds' monthly profits exceeded losses. The SEC alleged that the trading allowed the fund to avoid over $50 million in losses. This action is pending.

In addition, the SEC seems particularly focused on the private equity industry. SEC officials brought attention to its enforcement focus on private equity firms through numerous public comments in the first half of 2016. On May 12, 2016, for example, Director Ceresney emphasized the need for private equity enforcement given how private equity differs from other asset classes.[56] Specifically, Director Ceresney suggested that it was necessary to focus on private equity firms because of the "unique characteristics" of private equity funds, including the structures that make it difficult for investors to withdraw their investments. He also stated that increased investment in private equity by institutional investors like public pension plans warranted additional protection efforts. Ceresney added that the SEC's private equity enforcement has already had positive effects, observing that private equity advisers have changed fee and expense practices and become generally more transparent about fees and expenses.

The SEC is backing up those comments with enforcement actions. For example, on March 30, 2016, the SEC instituted a settled AP against private equity firm Burrill Capital Management (BCM) and its principal, Steven

Burrill, chief legal officer, Victor Hebert, and controller, Helena Sen, for allegedly misappropriating investor funds from a fund managed by BCM.[57] Without admitting or denying the allegations, BCM and Burrill agreed to jointly and severally pay $5.785 million, consisting of a civil monetary penalty of $1 million, disgorgement of $4.6 million, and prejudgment interest of $185,000. Hebert and Sen agreed to pay civil monetary penalties of $185,000 and $90,000, respectively. Burill, Hebert, and Sen also consented to permanent industry bars. Speaking in reference to the settlement, Director Ceresney declared, "[e]ven though they are exempt from registration, venture capital advisers like [the respondents] have fiduciary obligations to their clients that we will enforce."

In addition, on June 1, 2016, the SEC announced a settled AP with private equity fund advisory firm Blackstreet Capital Management, LLC (BCM), and its principal, Murry Gunty, for allegedly charging adviser fees without registering with the SEC.[58] Without admitting or denying liability, BCM and Gunty agreed to pay jointly and severally $3,122,737, consisting of a civil monetary penalty of $500,000, disgorgement of $2.3 million, $504,588 of which will be distributed back to affected clients, and $283,737 in prejudgment interest.

On June 16, 2016, the SEC instituted a settled AP against a private equity fund administrator Apex Fund Services (US) Inc. (Apex) for allegedly missing red flags and failing to correct faulty accounting by two of its clients.[59] According to the SEC, Apex missed or ignored clear indications of fraud by the funds and issued false reports concerning the funds' financial positions and performance, which the funds then communicated to their investors. Without admitting or denying the SEC's findings, Apex agreed to retain an independent consultant and pay $352,449, consisting of a civil monetary penalty of $75,000, disgorgement of $96,800, and prejudgment interest of $8,813 in connection with one fund and a $75,000 civil monetary penalty, disgorgement of $89,050 and prejudgment interest of $7,786 in connection with the other fund.

Although the focus on private equity advisers is not new, there appears to be a new focus on privately held start-ups, which may be funded and/or managed by private equity firms. Chair White announced, in an address in March of this year, that the SEC would be increasingly focused on Silicon Valley's privately held "unicorns" (private start-up companies with valuations exceeding $1 billion).[60] Chair White observed that there has been a recent trend for companies to remain privately held and cautioned that being a private company still comes with "serious obligations to investors and the markets." She noted that private company distortion and inaccuracy in financial results and company disclosures may be more risky, since privately held start-up companies often have fewer internal and corporate governance procedures. Most notably, a privately held health-technology and medical-laboratory-services company based in Palo Alto, California, with a valuation that peaked at more than $9 billion announced in April 2016 that it is being investigated by the SEC. The investigation is currently ongoing.

X. Broker-Dealers

As we described in our 2015 Year-End Review, the Commission has markedly increased its enforcement activity against broker-dealers over the past ten years. In the first half of 2016, the SEC continued a steady stream of actions, including actions involving registration violations, misappropriation of investor funds, and disclosure failures.

On January 6, 2016, the SEC instituted a settled AP against a broker-dealer affiliated with a large financial institution for allegedly misrepresenting the nature of compensation for its registered representatives.[61] Although the firm stated publicly that its brokers' compensation depended upon the performance of its clients' investments, the SEC alleged that in fact its brokers' compensation was not tied to portfolio performance. The broker-dealer agreed to settle the SEC's claims, without admitting or denying liability, by paying a civil monetary penalty of $4 million.

On January 31, 2016, the SEC instituted settled APs against two large financial institutions for allegedly misleading investors in dark pools (alternative trading systems that allow anonymized trading) that the institutions operated. The Commission alleged that the firms misrepresented that investors would be protected from predatory high-frequency trading tactics.[62]

One firm, for example, allegedly told investors it had a "liquidity profiling" service that allowed traditional investors to opt out of trading with high-speed traders. According to the SEC, however, the service was subject to a variety of exceptions that allowed high speed traders to interact with traditional investors. As described in

Section X above, the firm agreed to settle the SEC's claims by admitting wrongdoing and by paying $35 million in penalties (and additional $35 million to the NYAG).

The second firm allegedly told investors that its dark pool could characterize subscriber order flow on a monthly basis in an objective and transparent manner, when in fact the characterization of the flow used subjective elements, was not transparent, and did not categorize all subscribers on a monthly basis. The second firm also allegedly misrepresented that it used software to identify "opportunistic" traders and restrict their access to its electronic communications network. In reality, according to the SEC, the firm did not use the software in the first year the communications network was operational, and the software had weaknesses that allowed "opportunistic" subscribers to continue to trade. The firm, without admitting or denying liability, agreed to settle the SEC's claims by agreeing to pay $54,315,154, consisting of $30 million in civil monetary penalties, $20,675,510 in disgorgement, and $3,639,643 in prejudgment interest.

On May 3, 2016, the SEC filed a civil complaint in the Eastern District of New York against ten investment advisers and brokers alleging that the defendants offered bribes and other kickbacks to registered representatives and unregistered brokers who solicited investors to buy stock in an energy company that was listed on the NASDAQ.[63] Despite the schemes, the company was eventually delisted. The action is pending.

On May 4, 2016, the SEC filed a complaint in the district of New Jersey alleging that two purported brokers, James Trolice and Lee Vaccaro, who were not registered with the Commission or any other state regulator, allegedly misused investor funds.[64] According to the Commission, the pair raised over $6 million from investors by creating a false sense of urgency and exclusivity around a purported offering and by flaunting their apparent wealth. Rather than invest the funds, however, the SEC alleged that the unregistered brokers used investor funds to gamble and pay personal debts. The action is pending.

On June 22, 2016, the Commission filed a complaint in the SDNY that alleged that United Kingdom resident Idris Dayo Mustapha hacked into the online brokerage accounts of United States investors.[65] According to the SEC, after he accessed the accounts, Mustapha made unauthorized stock trades that allowed him to profit on trades in his own account. The SEC alleged that Mustapha reaped at least $68,000 profits for himself and caused losses in the victims' accounts of at least $289,000. The SEC obtained an emergency court order to freeze Mustapha's assets, and the case is pending.

The SEC's broker-dealer enforcement activity in the first half of 2016 is likely most notable, however, for its focus on anti-money laundering (AML) compliance. The SEC had launched a new anti-money laundering initiative in 2015 after a task force identified large gaps in Suspicious Activity Report (or SAR) filings by broker-dealers. The task force discovered instances where broker-dealers failed to file SARs, as well as instances where firms filed incomplete or untimely SARs; the findings led to dozens of referrals across the country for investigations by the Division of Enforcement. In her February 2016 address at SEC Speaks, Antonia Chion, Associate Director and Co-Head of the Broker-Dealer Task Force, encouraged firms to review their SAR filing policies, which she said require a "high level of commitment from industry professionals."

On February 4, 2016, the SEC instituted a settled AP against financial services firm E.S. Financial Services (ESF) concerning alleged AML violations.[66] The SEC alleged that ESF allowed foreign entities to buy and sell securities but failed to verify the identities of the non-U.S. citizens who owned them in violation of federal law, which requires companies to maintain a customer identification program (CIP) ensuring they know their customers and do not become a conduit for money laundering or terrorist financing. Without admitting or denying liability, ESF agreed to pay a $1 million civil monetary penalty to settle the SEC's claims.

Thus far in 2016, the SEC has instituted enforcement actions against several broker-dealers for failing to comply with their SAR obligations. On June 1, 2016 the SEC instituted a settled AP against broker-dealer Albert Fried & Company for allegedly failing to sufficiently monitor the suspicious trading activity of certain of its customers and failed to file SARs with bank regulators for more than five years. According to the SEC, this was the first case against a firm solely for failing to file SARs.[67]

The Commission also introduced a new area of enforcement involving broker-dealers in the first half of 2016: the Consumer Protection Rule, which forbids broker-dealers from using customer funds and securities to

finance firm overhead and trading and underwriting activities. On June 23, 2016, the Commission instituted a settled AP against a large financial institution, which alleged that the institution violated the Consumer Protection Rule by misusing its customers' funds to generate profits for the institution. According to the SEC, the institution engaged in complex options trades that lacked economic substance and artificially reduced the amount of customer cash the institution was required to deposit in its reserve account. This allegedly allowed the institution to access billions of dollars per week in customers' funds from 2009 to 2012. [68] As noted in Section VII above, the financial institution admitted to the SEC's findings and agreed to pay $415 million, consisting of a $358 million civil monetary penalty, disgorgement of $50 million, and prejudgment interest of $7 million to settle the SEC's claims.

In announcing the settlement, the SEC announced a targeted sweep across all of its divisions to encourage other broker-dealers and investment firms to self-report any potential violations of the Customer Protection Rule. It will be interesting to see if the sweep leads to additional settlements in the second half of 2016, and whether the SEC requires respondent firms to admit wrongdoing and identify individuals responsible for the wrongful conduct.

XI. Insider Trading

Eighteen months have passed since the Second Circuit's landmark decision in *United States v. Newman*, which held that, to be liable for insider trading, a "remote tippee" must know that the source of the tip disclosed confidential information in exchange for a personal benefit, and that an inference of a benefit solely from the relationship between the tipper and tippee is permissible only where there was "proof of a meaningfully close personal relationship that generates an exchange that . . . represents at least a potential gain of a pecuniary or similarly valuable nature."[69] In those 18 months, the SEC has continued to bring insider trading enforcement actions at essentially the same rate as it did before the decision. Indeed, the SEC brought insider trading actions against over 40 individuals in the first half of FY 2016, after bringing 80 insider trading actions in FY 2014 and 87 in FY 2015 — the year *Newman* was announced.[70]

There were major developments in insider trading enforcement in the first half of 2016. For example, on January 19, 2016, the Supreme Court granted *certiorari* in *United States v. Salman*. The Court's decision in *Salman* is likely to resolve the debate that arose in the wake of *Newman* as to whether a tippee can be liable for insider trading when the tipper made a gift of the confidential information.

The defendant in *Salman*, Bassam Yacoub Salman, allegedly received and traded on material non-public information concerning upcoming corporate transactions that he received from his brother-in-law, Michael Kara. Michael allegedly obtained the non-public information from his older brother, Maher, who worked as an investment banker. There was no evidence that Maher received a pecuniary benefit from Michael in exchange for disclosing the information, but the government alleged that Salman was aware that the information originated with Maher and that Salman and Michael profited from trading in securities just before major transactions were announced. Salman was convicted at trial.

On appeal to the Ninth Circuit, Salman argued that, under *Newman*, the evidence was insufficient to show that Maher had disclosed the information to Michael in exchange for a pecuniary personal benefit, or that Salman knew of any such benefit. SDNY Judge Rakoff, who was sitting by designation on the Ninth Circuit, rejected Salman's arguments and held, among other things, that *Newman* did not undermine the holding of *Dirks v. SEC*, the decision that established insider trading liability for tippers and tippees, and held that a tipper may obtain a personal benefit when he or she "makes a gift of confidential information to a trading relative or friend."[71] The Supreme Court will hear oral arguments in *Salman* this fall.

As noted above, though, the SEC clearly has not waited for the Supreme Court to clarify the law. On February 29, 2016, the SEC's ability to bring cases against remote tippees, or tippees several steps removed from the source of a tip received a significant boost when a jury in the SDNY found former brokers Daryl Payton and Benjamin Durant liable for insider trading. This was a "test case" of sorts for the Commission following *Newman*, particularly because prosecutors had dropped all charges against Payton and Durant after the decision.

As described in our 2015 Mid-Year Review, the case against Payton and Durant started with both a criminal prosecution and a civil enforcement action. The claims centered on trading related to a corporate acquisition. The "insider," an associate at the law firm representing the buyer, allegedly disclosed confidential information about

the acquisition to his close friend, Trent Martin, a research analyst at an investment bank. Martin allegedly passed the information to his roommate, Thomas Conradt, who worked as a broker. Conradt, in turn, allegedly provided this information to his fellow brokers, including Payton and Durant. All five defendants allegedly traded in the securities of the target before the acquisition was announced on July 28, 2009.

Before the Second Circuit's decision in *Newman*, Martin, Conradt, and Payton pled guilty to criminal insider trading. In the wake of *Newman*, however, Judge Andrew L. Carter vacated the guilty pleas and the prosecutors moved to dismiss the indictments. Martin, Conradt, and Weishaus settled the SEC's claims, but Payton and Durant moved to dismiss, arguing that the SEC's allegations that Martin (the source) received a personal benefit were insufficient under *Newman* and that they did not know whether Martin received any benefits. SDNY Judge Jed Rakoff, who wrote the Ninth Circuit opinion in *Salman*, declined to decide whether *Newman* applies to SEC civil actions, and instead denied Payton and Durant's motion to dismiss by finding that the SEC's allegations were sufficient under *Newman*.[72]

At trial, the SEC relied on the witness testimony of Conradt, phone records, text messages, internet chats, emails, and trading records, while the defendants argued that Martin did not breach any duty of trust or confidence to Dallas and Martin did not disclose the MNPI to Conradt in exchange for a personal benefit. The defense also argued that even if there was sufficient evidence of a benefit, neither Payton nor Durant knew, or should have known, about it. While both Payton and Durant testified at trial that they thought that the information was "a rumor," Durant acknowledged that he did not ask Conradt questions to determine the source of the "rumor."[73]

Judge Rakoff emphasized in his opinion denying the defendants' motion to dismiss that insider trading can be proven by "conscious avoidance" under the appropriate circumstances. At trial, Judge Rakoff instructed the jury that "the defendant[s] you are considering need not have known the specific details of the benefit as long as he knew or had reason to know that a benefit was provided. Also, this requirement can be satisfied if you find that the defendant you are considering was aware of a high probability that someone had improperly disclosed the inside information to Conradt for personal benefit, and that the defendant, not actually believing otherwise, deliberately avoided learning the truth."[74] This instruction (and the preponderance of the evidence standard that applies in SEC actions) may have proven the death knell for the defense case — after less than a day of deliberations, the jury found Payton and Durant liable for insider trading. Payton and Durant are appealing the jury's verdict.

Notwithstanding its victory at trial against Payton and Durant, the SEC's decision not to institute enforcement proceedings against an alleged remote tippee in another action in 2016 suggests that the Commission may be exploring an alternative means of requiring remote tippees to disgorge their profits. On May 19, 2016, the SEC and DOJ filed actions in federal district court alleging that William Walters, a professional gambler, had traded on inside information on Dean Foods from its then CFO Thomas Davis. Among other things, the complaint alleged that Walters had passed this information on to professional golfer Phil Mickelson, who traded on it as well. The SEC claimed that defendants Davis and Walters had engaged in insider trading, but named Mickelson only as a "relief defendant." By naming Mickelson as a relief defendant, the SEC only was required to prove that he profited from Walters and Davis's alleged insider trading, not that Mickelson had actually engaged in insider trading himself.[75] The SEC's charging decision to name Mickelson as a relief defendant was likely motivated, at least in part, by (i) the lingering uncertainty of how *Newman* applies to civil SEC actions and (ii) the difficulty of proving that Mickelson had the requisite mental state — that is, at least recklessness — as a remote tippee.

Although the Commission's decision to name Mickelson as a relief defendant was novel, it does not appear to reflect a reluctance to bring actions against remote tippees because the Commission recently filed three new insider trading complaints in federal court that named remote tippees as defendants.

On June 14, 2016, the SEC filed a complaint in the District of Massachusetts that alleged that Schultz Chan, a director of a biopharmaceutical company, bought shares in the company and tipped both his wife and a friend ahead of a company release announcing promising study results for the company's leading drug candidate.[76] Similarly, on June 15, 2016, the SEC filed a complaint in the SDNY that alleged that a former Food and Drug Administration

(FDA) employee obtained confidential information on drug approvals from friends and associates at the FDA and disclosed that information to a hedge fund manager, who in turn tipped a fellow fund manager.[77] Finally, on June 16, 2016, the SEC filed a complaint in the Northern District of Indiana that alleged that Christopher Salis, then a global vice president at software company SAP America, received thousands of dollars in kickbacks for disclosing an upcoming acquisition to a friend, who in turn tipped his brother and a mutual friend.[78] It will be interesting to see if the SEC can maintain these actions if the convictions it obtained against Payton and Durant in February are overturned on appeal.

XII. FCPA

Halfway through 2016, the SEC has already brought more corporate and individual FCPA enforcement actions combined than it did during all of 2015 — or in any of the last four years. The SEC has brought eleven corporate FCPA enforcement actions as of June 30, 2016 — and four cases against individuals — including a first-of-its-kind DPA with an individual.

On February 16, 2016, the SEC announced its first-ever DPA with an individual in connection with an enforcement action brought against technology company PTC, Inc. (PTC), and its Chinese subsidiaries.[79] The SEC alleged that PTC's subsidiaries violated the anti-bribery provisions of the FCPA by giving Chinese government officials improper travel, gifts, and entertainment in the hopes of retaining or receiving business. The SEC further alleged that the companies violated the FCPA books-and-records and internal controls provisions because the allegedly improper payments were inaccurately booked as commissions or other business expenses. As described in Section VII above, the companies admitted the SEC's allegations, and the technology company agreed to pay $13.622 million, consisting of $11.858 million in disgorgement and $1.764 million in prejudgment interest. The companies simultaneously entered into a non-prosecution agreement (NPA) and agreed to pay a $14.54 million fine to the DOJ in a parallel action

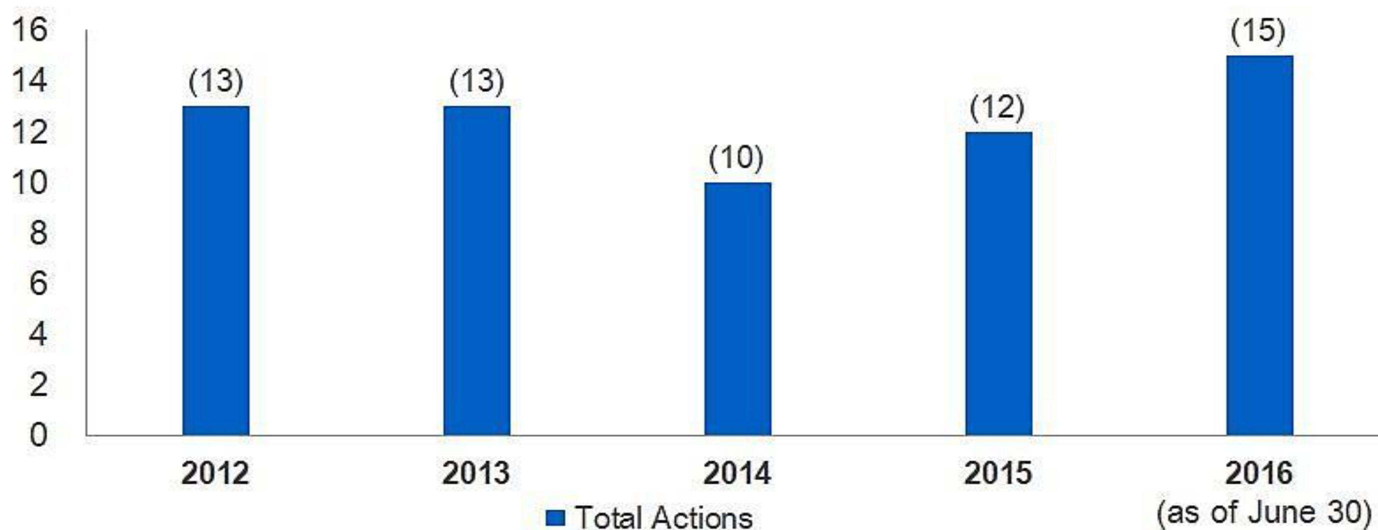
As part of the resolution of its action against PTC, the SEC entered into its first-ever FCPA DPA with Yu Kai Yuan, a Chinese sales executive who the SEC alleged caused PTC's and its subsidiaries' internal controls and books-and-records violations. Nothing in the public record indicates that Yuan participated in the alleged bribery, and the SEC stated that it offered Yuan a DPA as a result of his "significant cooperation" with the Commission's investigation. Under the DPA, the SEC's claims will be deferred for three years, during which time Yuan must continue to cooperate fully with any further investigation or related litigation; if the SEC concludes that Yuan has not done so, it reserves the right to initiate an enforcement action.

The DPA may suggest that the SEC would generally be willing to consider DPAs as an alternative to actually bringing enforcement actions against individuals who are allegedly responsible for internal controls and books-and-records violations but not the underlying corrupt conduct, but because the nature of the individual's cooperation is non-public it is difficult to be certain. In any event, individuals who find themselves as targets of an investigation and who are similarly situated to an individual who entered into the DPA — perhaps with some degree of responsibility for internal controls or a company's books and records, but uninvolved in actual corruption — may wish to pursue a comparable resolution to any potential SEC claims.

Consistent with the government's focus on individuals, in the first half of 2016, the SEC entered into NPAs with, and the DOJ declined to prosecute, internet services provider Akamai Technologies, Inc. (Akamai) and building product manufacturer Nortek, Inc. (Nortek) for alleged FCPA violations, in part because the companies identified individuals responsible for the alleged wrongdoing (although there is no indication yet that either the SEC or the DOJ is pursuing claims against those individuals).[80] Akamai's foreign subsidiary allegedly arranged payments of $40,000 to induce Chinese government-owned entities to buy superfluous services, and gave gift cards, meals, and entertainment to officials at these state-owned entities to obtain or retain business. Nortek's subsidiary allegedly made approximately $290,000 in improper payments and gifts — including cash payments, gift cards, meals, travel, accommodations, and entertainment — to Chinese officials in exchange for preferential treatment, relaxed regulatory oversight, or reduced customs duties, taxes, and fees.

The declination letters from the DOJ (which the DOJ made public in an apparent effort to provide a roadmap for future cooperation) expressly stated that the companies had identified the individuals who engaged in the misconduct

and agreed to cooperate in any investigations of those individuals. The SEC also noted that the companies self-reported the misconduct and turned over witness interview summaries and chronologies, which would normally be withheld from the government as protected attorney work product.



Although the NPAs with the SEC required Akamai to pay $671,885, consisting of $652,452 in disgorgement plus $19,433 in interest, and Nortek to pay $322,058, consisting of $291,403 in disgorgement plus $30,655 in interest, the SEC did not seek to impose civil monetary penalties. The SEC's rationale for these outcomes may be indicative of future trends in the nature of the cooperation that will be required to avoid prosecution.

During the first half of 2016, the SEC's investigation of so-called "princeling" employment arrangements has continued.[81] On March 1, 2016, the SEC instituted a settled AP against wireless telecommunications company Qualcomm Incorporated (Qualcomm) alleging that the company hired and provided gifts and travel to family members or other referrals of Chinese officials — some of whom were referred to as "must place" or "special hires" — for the purpose of trying to obtain business from these officials.[82] This enforcement action was also notable because it suggests that the SEC believes that the provision of gifts, travel, and entertainment to family members of foreign officials is sufficient to violate the anti-bribery provisions of the FCPA. Without admitting or denying the allegations, Qualcomm agreed to pay a $7.5 million civil monetary penalty to settle the claims. Multiple financial institutions have disclosed that the SEC and the DOJ have instituted investigations related to princeling employment arrangement as well.

A prominent FCPA settlement in the first half of 2016 also involved cooperation among U.S. and foreign regulatory authorities. On February 16, 2016, the SEC, along with the DOJ and Dutch regulators, entered into a global settlement with global telecommunications provider VimpelCom Ltd. (VimpelCom) for FCPA violations.[83] The company allegedly paid $114 million bribes in an effort to enter the Uzbekistan telecommunications market. The payments, which were allegedly concealed as, among other things, sham contracts and charitable donations, were made to a high-ranking Uzbek official to obtain government-issued licenses, frequencies, channels and number blocks. Again, as with the princeling action described above, the SEC alleged that VimpelCom violated the FCPA's anti-bribery provisions even though the donations to charities were not alleged to have given money directly to the Uzbek official.

In announcing the settlement, Kara Brockmeyer (Chief of the Enforcement Division's FCPA unit) noted that the settlement was "closely coordinated" and that "[i]nternational cooperation among regulators is critical" to successfully pursuing companies engaged in bribery schemes. The press release acknowledged assistance and cooperation from at least fifteen different foreign regulatory agencies. VimpelCom admitted wrongdoing, as described in Section VII above, and agreed to pay over $795 million in fines and penalties to settle the various actions, consisting of $167.5 million to the SEC, $230.1 million to the DOJ, and $397.5 million to Dutch regulators.

The SEC also settled several notable FCPA actions involving companies in the healthcare industry during the first half of 2016. For example, on February 4, 2016, the SEC instituted a settled AP against SciClone Pharmaceuticals, Inc., (SciClone) for alleged FCPA violations.[84] The SEC alleged that employees of the SciClone's China subsidiaries gave money, gifts, and things of value to healthcare professionals employed at state-owned hospitals in China to increase sales of the company's pharmaceutical products. The transactions were allegedly falsely reported as legitimate business expenses. In addition to falsifying books and records, SciClone allegedly failed to maintain sufficient internal accounting controls and lacked an effective anti-corruption compliance program. Without admitting or denying the allegations, SciClone agreed to pay $12.826 million, consisting of a $2.5 million civil monetary penalty, $9.426 million in disgorgement and $900,000 in prejudgment interest, to settle the claims.

Moreover, on March 23, 2016, the SEC instituted a settled AP against another pharmaceutical company, Novartis AG (Novartis), whose Chinese subsidiaries allegedly engaged in transactions and provided things of value to influence Chinese healthcare professionals to increase sales.[85] Without admitting or denying the allegations, Novartis agreed to make periodic reports of its remediation efforts to the Commission, including a semi-annual written report and two follow-up reviews, pay $25,050,104, consisting of a $2 million civil monetary penalty, $21,579,217 in disgorgement, and $1,470,887 in prejudgment interest. The SEC claimed that these transactions were falsely recorded as entertainment, travel, marketing, and other legitimate business expenses.

Finally, on June 21, 2016, the SEC instituted a settled AP against medical device manufacturer Analogic Corp. (Analogic) and its Danish subsidiary BK Medical ApS's (BKM) CFO, Lars Frost, for allegedly violating the books-and-records and internal controls provisions of the FCPA.[86] According to the SEC (and the DOJ, in a parallel action), from at least 2001 to early 2011, one of BKM's distributors would overpay BKM and then direct BKM to transfer the excess funds to third parties. BKM allegedly made hundreds of these payments to third parties around the world without knowing the purpose of the payments or anything about the ultimate recipients. BKM entered into an NPA with the DOJ and agreed to pay a $3.4 million criminal penalty, while Analogic, without admitting or denying the allegations, paid $11.5 million to settle the SEC's claims, consisting of $7.7 million in disgorgement and $3.8 million in prejudgment interest.

For an in-depth discussion of FCPA enforcement activity in the first half of 2016, please see *FCPA Digest: Recent Trends and Patterns in the Enforcement of the Foreign Corrupt Practices Act*, published July 5, 2016.

XIII. Municipal Bonds

The SEC has picked up in 2016 where it left off in 2015 by continuing to institute enforcement actions against various participants in the municipal bond market. Notable developments include actions against municipal bond servicers, issuers, and — for the first time ever — advisers in connection with pay-to-play schemes, misrepresentations, conflicts of interest, and misuse of funds.

On January 14, 2016, the SEC instituted a settled AP against a financial institution and one of its senior vice presidents (SVPs) for allegedly engaging in a pay-to-play scheme to win contracts to service Ohio public pension funds.[87] The SEC alleged that the institution used a third-party lobbyist to enter into an agreement with Ohio's then-deputy treasurer in which the institution would make cash payments and political campaign contributions and receive three lucrative sub-custodian contracts to safeguard the funds' investment assets and settle securities transactions. To settle the claims, the SVP agreed to pay $274,202, consisting of a $100,000 civil monetary penalty and $174,202 in disgorgement and prejudgment interest, and the bank agreed to pay $12 million, consisting of an $8 million civil monetary penalty and $4 million in disgorgement. Neither respondent admitted or denied the

SEC's allegations. The SEC also filed a complaint in the Southern District of Ohio against the lobbyist in connection with the scheme. That action is pending.

On February 2, 2016, the SEC announced actions against 14 municipal bond underwriters in connection with its Municipalities Continuing Disclosure Cooperation (MCDC) initiative, a program, launched on March 10, 2014, intended to encourage municipal bond underwriters and issuers to self-report misstatements and omissions in municipal bond offerings. The underwriters agreed to pay civil penalties based on the number and size of affected offerings, and to retain an independent consultant. The SEC also announced that the MCDC initiative was complete after charging 72 underwriters, but that the Commission would continue to look for issuers who may have provided investors with inaccurate information about their compliance with continuing disclosure obligations.

On March 9, 2016, the SEC instituted a settled AP against California's largest agricultural water district (the District), its general manager, and its former assistant general manager for misleading investors about the District's financial condition in connection with a $77 million bond offering.[88] The SEC alleged that the District improperly reclassified funds from reserve accounts to maintain a 1.25 debt service coverage ratio — a measure of a bond issuer's ability to make future bond payments. To settle the claims, the District, the general manager, and the former assistant general manager paid civil monetary penalties of $125,000, $50,000 and $20,000 respectively. None of the respondents admitted or denied the SEC's findings. The SEC claimed that the District was only the second municipal bond issuer ever to pay a financial penalty in connection with an SEC enforcement action.

On March 15, 2016, the SEC instituted a settled AP against Kansas-based municipal bond advisor Central States Capital Markets, LLC (CSCM), its CEO, John Stepp, and two of its vice presidents, Mark Detter and David Malone, for failing to disclose a conflict of interest to a municipal client.[89] The SEC alleged that Stepp, Detter and Malone did not tell the unnamed municipality that they also worked for the bond dealer that was underwriting $14.68 million of the municipality's bonds. Without admitting or denying the allegations, CSCM agreed to settle the SEC's claims by paying $374,827, consisting of an $85,000 civil monetary penalty, $251,650 in disgorgement and $38,177 in prejudgment interest. Stepp, Detter, and Malone also neither admitted nor denied the SEC's allegations, but agreed to settle the claims by paying civil monetary penalties of $17,500 to $25,000 and consenting to industry bars.

On April 14, 2016, the SEC filed a complaint in the SDNY against Ramapo, New York, along with the town's local development corporation and four of the town's officials, for allegedly hiding the town's true financial situation.[90] According to the SEC, the officials concealed the impact of building a baseball stadium and other declining sales and property tax revenues on the town's finances by "cooking the books" so that the town's primary operating fund falsely showed positive balances when the town was actually running deficits of up to $14 million. The action is pending.

On May 19, 2016, the SEC filed a complaint in the Northern District of Illinois against the mayor of Harvey, Illinois, in connection with a series of allegedly fraudulent bond offerings.[91] Harvey officials allegedly took funds that designated for the construction of a hotel and used them for the city's payroll and other operational costs. The mayor settled the action on the day it was filed by agreeing to pay a $10,000 civil monetary penalty and by consenting to be permanently barred from participating in municipal bond offerings.

On June 21, 2016, the Commission filed another complaint in the Northern District of Illinois, this time against the former president of the United Neighborhood Organization of Chicago (UNO) for allegedly misleading investors in connection with a $37.5 million bond offering.[92] The former president allegedly signed a bond offering statement that omitted information about contracts between charter schools and the brother of UNO's chief operating officer (COO) and certified in grant agreements with the Illinois Department of Commerce that no conflicts of interest existed. The former president agreed to settle the action on the same day it was filed by agreeing to pay a $10,000 civil monetary penalty and by consenting to be permanently barred from participating in municipal bond offerings.

On June 13, 2016, the SEC instituted a settled AP against municipal advisory firm School Business Consulting, Inc. (SBC), Keygent LLC (Keygent), and certain of their executives alleging that the firms and executives used deceptive practices when soliciting business from five California school districts.[93] According to the SEC, when

Keygent was bidding for advisory contracts, SBC shared confidential information with Keygent, including questions to be asked in Keygent's interviews with the school districts and details of competitors' proposals. The school districts did not know that Keygent had received this information, and ultimately granted Keygent the municipal advisory contracts. To settle the claims, without admitting or denying the allegations, SBC agreed to pay a $30,000 civil monetary penalty, SBC's president agreed to an industry bar and to pay a $20,000 civil monetary penalty, Keygent agreed to pay a $100,000 civil monetary penalty, and two Keygent principals agreed to pay civil monetary penalties of $30,000 and $20,000, respectively.

XIV. Focus on Cybersecurity

OCIE made it clear that cybersecurity would remain a priority for the Commission at the outset of 2016 when it placed cybersecurity at the top of its list of market-wide risks on which it would focus.[94] Cybersecurity concerns also appeared to underlie OCIE's second priority, Regulation Systems Compliance and Integrity (SCI), for which OCIE will examine the resiliency of data and computing infrastructure in SCI entities.

This emphasis on cybersecurity follows two rounds of industry-wide examinations of broker-dealers and investment advisers. As we reported in our 2015 Mid-Year Review, OCIE's findings from the first round of review, published in February 2015, criticized the written policies of various firms for failure to prevent cyberattacks.[95] The second round of cybersecurity examinations, announced on September 15, 2015 and addressed in our 2015 Year-End Review, identified governance and risk assessment, access rights and controls, data loss prevention, vendor management, training, and incident response as areas of interest for OCIE.[96] OCIE also provided relatively detailed descriptions of security measures that will be considered in each area. If the SEC adheres to these descriptions as a roadmap for assessing the adequacy of cybersecurity controls, whether in the context of another industry review or in event-driven investigations, these details may provide much-needed context to companies in implementing cybersecurity policies and procedures that meet SEC requirements.

On June 2, 2016, the SEC named Christopher R. Hetner as the Senior Advisor to the Chair for Cybersecurity Policy. In this newly created role, Mr. Hetner serves as a senior advisor to Chair White concerning cybersecurity policy and coordinates cybersecurity efforts across the SEC.[97] In his prior role, Mr. Hetner was the Cybersecurity Lead for the Technology Control Program within OCIE, where he coordinated OCIE cybersecurity efforts and advised on enforcement. The SEC's creation of a new senior advisor position focused exclusively on cybersecurity underscores that the SEC is investing long-term resources in its cybersecurity policy.

A recently announced settled AP with an affiliate of an investment bank reinforces that the SEC may be positioning itself to bring enforcement actions in the wake of data breaches. On June 8, 2016, the SEC announced a settled AP with the investment bank affiliate for allegedly failing to adopt written policies and procedures reasonably designed to protect customer records, in violation of Rule 30(a) of Regulation S-P under the Securities Act of 1933, otherwise known as the Safeguards Rule.[98] Specifically, the SEC alleged that an employee exploited vulnerabilities in two of the firm's intranet portals by downloading to a personal home server customer data for approximately 730,000 accounts between 2011 and 2014. As part of the settlement, in which the investment bank affiliate neither admitted nor denied the SEC's findings, the SEC assessed a civil penalty of $1 million.

XV. Conclusion

In the first half of 2016, the Commission fought back against claims that the ALJs hearing enforcement actions in APs were biased, won an important appeals decision that turned away a constitutional challenge to its process of hiring ALJs, defended the value and importance of cooperation, obtained admissions as a part of settlements, continued to make substantial whistleblower awards, and continued to bring enforcement actions concerning compliance professionals, insider trading, FCPA violations private equity, cybersecurity, accounting and financial fraud, and broker-dealers. While judicial decisions on these and other issues could affect enforcement decisions going forward, it appears a safe bet that the SEC will break, or come close to breaking, the record for enforcement actions it set just last year.

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