Aggressive SEC Enforcement Approach Creates New Challenges for Resolving Investigations

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The U.S. Securities and Exchange Commission (SEC) pursued aggressive enforcement of the securities laws in the past year. Several trends related to the SEC's vigorous approach are likely to continue in 2015.

SEC Whistleblower Program Begins to Pay Significant Awards

The Dodd-Frank Act gave the SEC authority to pay cash awards to whistleblowers to encourage the submission of enforcement tips. The program was seen by practitioners as having the potential to dramatically alter the SEC's traditionally reactive enforcement efforts by providing the agency with real-time evidence of ongoing misconduct. Although senior enforcement officials have lauded the quality of information obtained through the program since its launch, the long gestation period for awards — in many cases, several years — initially made it difficult to assess how effective the program actually had been.

Evidence supporting enforcement officials' claims has begun to come in, as both the number and size of whistleblower awards increased in fiscal year 2014. For example, the SEC issued nine awards, more than all previous years combined,[1] and in September 2014, the SEC authorized an award of more than $30 million, the largest to date, to a single whistleblower, who provided key information that led to a successful enforcement action.[2] Notably, this marked the fourth award to a whistleblower living in a foreign country, demonstrating the program's international reach. Both the size and number of awards are bound to incentivize others to utilize the program.

The Office of the Whistleblower also is coordinating with the Enforcement Division to identify cases of retaliation against whistleblowers. In the first case filed under the agency's new authority to bring anti-retaliation actions, the SEC charged an advisory firm with engaging in prohibited transactions and then retaliating against the employee who reported the activity by removing him from his position and stripping him of his responsibilities.[3]

Settlement Challenges for Financial Firms and Other Corporations

Policy changes adopted in response to the fallout from cases associated with the financial crisis have altered the calculus of settlement of SEC enforcement actions in various ways. Certain SEC commissioners have begun to scrutinize the decision of whether to grant issuers, in particular financial services firms, waivers from certain disqualification provisions otherwise triggered by SEC enforcement actions. Those waivers historically were handled at the staff level and, although not universally issued, were granted under generally predictable standards — a large financial institution that became subject to an enforcement action relating to a segment of its business could obtain an exemption that would permit it to continue to take advantage of certain streamlined offering processes and safe harbors. Criticism by SEC commissioners of this result and the decision to depart from past practice in certain instances has created uncertainties as to the collateral consequences of a settlement with the SEC. Recently, Commissioner Kara M. Stein indicated that the SEC may be moving toward limited and conditional waivers, as was done in a recent case involving Bank of America, but this

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remains an area of great uncertainty.[4] Accordingly, defendant companies may have a difficult time assessing whether proposed settlement terms are acceptable, given the potential business harm resulting from being denied relevant waivers.

Additionally, the SEC has continued its new policy of requiring admissions to settle certain cases. Although “neither admit nor deny” settlements remain the norm, the SEC now requires defendants to admit wrongdoing “in certain cases where heightened accountability or acceptance of responsibility through the defendant’s admission of misconduct may be appropriate,” even if that means the SEC will have to litigate rather than achieve a “prompt” resolution.[5] Since initiating the policy, the SEC has entered into several "admit" settlements, including a $920 million settlement with JPMorgan concerning its so-called "London Whale" trading.[6] It remains challenging to predict which cases may require admissions. However, such cases can have substantially greater collateral consequences, including the use of admissions in a criminal or civil proceeding, professional repercussions or additional fines from other regulatory organizations.

Increased Reliance on Administrative Proceedings

Coincident with its stiffening posture with regard to settlement demands, the SEC has determined to resort more regularly to its in-house administrative tribunal to adjudicate cases that it cannot settle, rather than to federal district court. In fiscal year 2014, the SEC filed 235 administrative proceedings, up 10 percent from the prior year.[7] The SEC likes the administrative forum because the process and procedure generally, but not always, tilt in the SEC's favor.

This increased reliance on administrative proceedings has come under scrutiny. U.S. District Court Judge Jed S. Rakoff recently criticized the proceedings, questioning the fairness of a forum presided over by a judge appointed and paid by the SEC.[8] Insider trading defendants also have filed suit to enjoin the agency from bringing actions as administrative proceedings.[9]

Despite the criticism, Andrew Ceresney, director of the Enforcement Division, has confirmed that the SEC plans to increase the use of administrative proceedings.[10] Ceresney defended the increase, noting that the proceedings offer a more streamlined process, which leads to a quicker hearing and result, and citing the impartiality and expertise of the administrative law judges. It appears the increased reliance on the administrative forum may be here to stay. In June 2014, the SEC nearly doubled the size of its Office of Administrative Law Judges.[11]

Focus on Holding Individuals Accountable Under the leadership of Chairwoman Mary Jo White, the SEC has reiterated its focus on taking enforcement action against individuals who are responsible for securities law violations, rather than solely proceeding against the companies where they work. Ceresney recently affirmed the Enforcement Division’s focus on individuals, stressing the heightened deterrent impact of actions against individuals as compared to those solely against entities.[12]

One new approach adopted by the SEC is the use of Section 20(b) of the Securities Exchange Act of 1934 (Exchange Act), which imposes primary liability on a person who, directly or indirectly, does anything "by means of any other person" that would be unlawful for that person to do on his or her own. The use of Section 20(b) allows the SEC to avoid restrictions imposed by the Supreme Court's decision in *Janus Capital Group, Inc. v. First Derivative Traders*, 131 S. Ct. 2296 (2011), which held that only the maker of a statement may be liable for a fraudulent statement under Section 10(b) of the Exchange Act and that a maker is the person or entity with "ultimate authority" over that statement, including its contents and whether and how to communicate it. For example, in a recent administrative proceeding, the SEC alleged that an oil and gas company and its CEO violated Section 20(b) by providing a stock promoter with false information that "[t]hey knew or were reckless in not knowing" the stock promoter would use in promoting the company's stock to investors.[13]

The focus on individuals is apparent in the SEC's aggressive pursuit of individuals' assets to satisfy financial remedies. In one recent matter, for example, the SEC has sought $455 million, potentially one of the largest judgments ever issued against an individual defendant, from Texas businessman Sam Wyly for his involvement in an offshore fraud scheme.[14] In order to secure the judgment, the SEC asked the court to freeze his and 12 relatives' assets.

The continuing evolution of the SEC's enforcement approach toward more aggressive demands, particularly with regard to settlements, alters the calculus for dealing with the agency. Where it was once a plausible strategy to consent to a disposition in which the SEC asserted factual and legal positions that it might not be able to sustain in litigation, the rising cost of such settlements justifies a deeper consideration of the case merits. In some situations, it will be appropriate to consider forgoing a settlement and putting the SEC to its proof in litigation.

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[1] U.S. Sec. & Exch. Comm'n, *2014 Annual Report on the Dodd-Frank Whistleblower Program* (2014).

[2] *Claim for Award in Connection with Redacted*, Exchange Act Release No. 73,174, Whistleblower Award Proc. No. 2014-10 (Sept. 22, 2014). The SEC noted that the award in this matter could have been larger, but the SEC reduced the sum because the whistleblower delayed reporting the misconduct after first learning of it.

[3] *Paradigm Capital Management, Inc.*, Exchange Act Release No. 72,393, Investment Advisers Act Release No. 3857, Admin Proc. No. 3-15930 (June 16, 2014).

[4] *See* Kara M. Stein, Commissioner, U.S. Sec. & Exch. Comm'n, Remarks Before the Consumer Federation of America's 27th Annual Financial Services Conference (Dec. 4, 2014).

[5] *See* Mary Jo White, Chairman, U.S. Sec. & Exch. Comm'n, Speech at the *Wall Street Journal* CFO Network Conference (June 18, 2013).

[6] *In the Matter of JPMorgan Chase & Co.*, Exchange Act Release No. 70,458, Accounting and Auditing Enforcement Act Release No. 3490, Admin. Proc. File No. 3-15507 (Sept. 19, 2013).

[7] Report on Administrative Proceedings for the Period April 1, 2014 through September 30, 2014, Exchange Act Release No. 73,458 (Oct. 29, 2014), *available at* http://www.sec.gov/reportspubs/special-studies/34-73458.pdf.

[8] Stephen Joyce, *SEC to Use Administrative Cases More, Despite Defense Bar Complaints, Officials Say*, Bloomberg BNA (Nov. 17, 2014), http://www.bna.com/sec-administrative-cases-n17179911882/.

[9] *See*, *e.g.*, *Peixoto v. SEC*, No. 14-cv-8364 (S.D.N.Y. filed Oct. 20, 2014).

[10] Joyce, *supra* note 55.

[11] Press Release, U.S. Sec. & Exch. Comm'n, SEC Announces New Hires in the Office of Administrative Law Judges (June 30, 2014).

[12] See Andrew Ceresney, Director, Division of Enforcement, U.S. Sec. & Exch. Comm'n, Remarks at the 31st International Conference on the Foreign Corrupt Practices Act (Nov. 19, 2014).

[13] *Houston American Energy Corp.*, Exchange Act Release No. 72,749, Admin. Proc. No. 3-16000 (Aug. 4, 2014).

[14] *SEC v. Wyly*, No. 10-5760 (S.D.N.Y. filed 2014).