Bloomberg BNA

Securities Regulation & Law Report™

ENFORCEMENT

SEC Enforcement: 2015 in Review, and a Look Ahead

BY ELAINE GREENBERG AND KEVIN ASKEW

Last year was another strong year for the Securities and Exchange Commission's enforcement efforts. The SEC brought a record 507 independent enforcement actions in the fiscal year ending in September 2015—up from 413 in fiscal year 2014 and 341 in fiscal year 2013—and continued to file a significant volume of actions over the last three months of the calendar year.[1]

In this article we discuss what were, in our view, some of the most noteworthy trends and developments in SEC enforcement over the past year, and we look ahead towards what we expect to see in 2016.

Elaine Greenberg is a partner in the Washington, D.C. office of Orrick, Herrington & Sutcliffe, and a member of the firm's Securities Litigation, Investigations and Enforcement group. She represents financial services firms, underwriters, broker-dealers, issuers, municipal advisors, and other organizations and individuals in connection with SEC and other regulatory matters. Ms. Greenberg previously served as the first Chief of the SEC Division of Enforcement's Municipal Securities and Public Pensions Unit, and as the Associate Director of Enforcement for the SEC's Philadelphia Regional Office.

Kevin Askew is an associate in Orrick's Los Angeles office and a member of the firm's Securities Litigation, Investigations and Enforcement group. He represents companies and individuals in connection with SEC investigations and enforcement actions, securities class actions, shareholder derivative suits and other complex commercial litigation matters.

Challenges to the Constitutionality of Administrative Proceedings

Last year saw a proliferation of challenges to the constitutionality of the SEC's in-house administrative forum. It became *de rigueur* for respondents facing SEC administrative proceedings to file lawsuits asking federal courts to put a halt to the proceedings, arguing primarily that the SEC's process for appointing its administrative law judges runs afoul of the Appointments Clause of the Constitution. According to this argument, administrative law judges are ''inferior officers'' of the executive branch who must be appointed by the President or by the Commission itself, not, as is the current practice, through a process involving the SEC's Chief Administrative Law Judge, the Office of Personnel Management, and the SEC's Office of Human Resources.

[1] SEC Announces Enforcement Results for FY 2015, Release No. 2015-245 (Oct. 22, 2015).

 ISSN 0037-0665

The results of these challenges have been decidedly mixed. So far, two federal district courts have issued preliminary injunctions preventing administrative proceedings from going forward, finding that the challengers were likely to succeed on their claims that the SEC's process for appointing its administrative law judges violates the Appointments Clause. In June 2015, Judge Leigh Martin May of the Northern District of Georgia enjoined the SEC's administrative proceedings against real estate developer Charles Hill,[2] and in a separate ruling in August 2015 barred the SEC from proceeding in its case against investment advisor Gray Financial Group.[3] In New York, Judge Richard Berman granted a motion for preliminary injunction brought by former Standard & Poor's executive Barbara Duka.[4] The injunction in *Duka* followed the SEC's rejection of Judge Berman's invitation to cure any constitutional defect in the appointment process by having the Commission itself appoint its administrative law judges.

Despite these setbacks, the SEC won important victories last year in the D.C. and Seventh Circuits—the first (and so far only) circuit courts to issue rulings in the recent spate of constitutional challenges. But these decisions—*Jarkesy v. SEC* in the D.C. Circuit and *Bebo v. SEC* in the Seventh Circuit—held only that federal courts lack subject matter jurisdiction over constitutional challenges to ongoing administrative proceedings.[5] Neither court reached the actual merits of the constitutional challenges, holding instead that those challenges must be raised in the context of the SEC administrative proceedings themselves, and may be brought before the Courts of Appeals only following a final decision by the SEC. Numerous district courts—including the Southern District of New York in *Tilton v. SEC* and the District of Maryland in *Bennett v. SEC*—reached the same conclusion as the D.C. and Seventh Circuits, refusing to enjoin ongoing administrative proceedings.[6]

Finally, the Commission itself has weighed in on the Appointments Clause issue. In an opinion upholding an initial decision by an administrative law judge against investment adviser Raymond J. Lucia Cos., the Commission held (perhaps unsurprisingly) that its administrative law judges are not ''inferior officers'' and that the process for their appointment is constitutional.[7] The Commission's decision is currently on appeal to the D.C. Circuit. Because the administrative proceedings against the company are complete, the D.C. Circuit will be forced to consider the merits of the constitutional challenge, rather than resolving the case on jurisdictional grounds as it did in *Jarkesy*.

We expect 2016 to bring some much-needed clarity to this area. In addition to the D.C. Circuit's consideration of the appeal from the Commission's opinion in *Lucia*, other appeals are currently pending before the Second, Fourth and Eleventh Circuits.[8] In the event that the circuits diverge on this issue, we believe there is a fair chance that the Supreme Court will step in to give the final word.

Continued Debate Over the Fairness of Administrative Proceedings

The SEC's growing use of administrative proceedings also kindled debate last year about whether those proceedings are fair to respondents. A chorus of critics claimed that the Commission's Rules of Practice are outdated and unfairly tilt the scales in favor of the Division of Enforcement. Under the current rules, hearings must typically commence no later than four months after charges are brought, even in the most complicated cases. This leaves respondents with little time to analyze the often-voluminous documentary record compiled by the Division of Enforcement, conduct a factual investigation of their own, and prepare for trial. Moreover, unlike in federal court, respondents in administrative proceedings are generally unable to take depositions. In contrast, by the time the Division of Enforcement brings charges, it will have already spent many months (and frequently years) conducting an investigation, with a largely unfettered ability to subpoena witnesses for testimony.

Observers have also noted that the Division of Enforcement historically fares better before the SEC's in-house administrative law judges than it does when it proceeds in federal court. Indeed, a study conducted last year by The Wall Street Journal found that the Division of Enforcement achieved victory against ninety percent of defendants in contested cases decided by administrative law judges from October 2010 through March 2015.[9] Many have suggested that this track record of success is attributable, at least in part, to the procedural difficulties faced by respondents in administrative proceedings.

The SEC took two small steps last year towards addressing these complaints. In May, the Division of Enforcement released a document outlining the factors it considers when evaluating whether to bring charges in administrative proceedings as opposed to federal district court.[10] According to this guidance, when the Division is choosing a forum it considers (among other things) the availability of obtaining complete relief in each forum, as well as the cost-, resource-, and time-effectiveness of litigation in each forum. However, the Division has left itself lots of wiggle room, making clear that ''there is no rigid formula dictating the choice of forum'' and that its decisions will ultimately depend on the facts and circumstances specific to each case.[11]

More significantly, in September the Commission announced and sought comment on proposed amend-

[2] *Hill v. SEC*, No. 15-cv-1801 (N.D. Ga. Jun. 8, 2015).

[3] *Gray Financial Group, Inc. v. SEC*, No. 15-cv-492 (N.D. Ga. Aug. 4, 2015).

[4] *Duka v. SEC*, No. 15 Civ. 357 (S.D.N.Y. Aug. 12, 2015).

[5] *Jarkesy v. SEC*, No. 14-5196 (D.C. Cir. Sept. 29, 2015); *Bebo v. SEC*, No. 15-1511 (7th Cir. Aug. 24, 2015).

[6] *Tilton v. SEC*, No. 15 Civ. 2472 (S.D.N.Y. Jun. 30, 2015); *Bennett v. SEC*, No. 15-cv-3325 (D. Md. Dec. 17, 2015).

[7] *In the Matter of Raymond J. Lucia Cos., Inc., et al.*, File No. 3-15006 (SEC Sept. 3, 2015).

[8] *Tilton v. SEC*, No. 15-2103 (2d Cir., argued Sept. 16, 2015); *Duka v. SEC*, No. 15-2732 (2d Cir.); *Bennett v. SEC*, No. 15-2584 (4th Cir.); *Hill v. SEC*, No. 15-12831 (11th Cir., argued Feb. 24, 2016); *Gray Financial Group, Inc. v. SEC*, No. 15-13738 (11th Cir., argued Feb. 24, 2016).

[9] *SEC Wins With In-House Judges*, The Wall Street Journal, May 6, 2015.

[10] Division of Enforcement Approach to Forum Selection in Contested Actions, *available at* https://www.sec.gov/divisions/enforce/enforcement-approach-forum-selection-contested-actions.pdf

[11] *Id.*

  SRLR ISSN 0037-0665

ments to its Rules of Practice governing the conduct of administrative proceedings.[12] If implemented, these changes would double the time allowed for pre-trial preparation in the most complicated cases—from four months to eight months—and would also allow respondents to take up to three pre-trial depositions (or five depositions in a case involving multiple respondents). Although these proposed rule changes likely do not go far enough to address all of the critics' concerns (particularly with respect to complex cases involving millions of documents and dozens of witnesses), they nonetheless demonstrate that the Commission has not been immune to the public criticism.

Whistleblowers

The SEC paid substantial awards last year to whistleblowers who provided tips leading to successful enforcement actions, awarding more than $37 million in fiscal year 2015 to eight individuals.[13] Meanwhile, tips continued to pour in. The SEC received nearly 4,000 whistleblower tips in fiscal year 2015 alone.[14] These tips are not just coming from corporate insiders: according to a report by the SEC's Office of the Whistleblower, fewer than half of the award recipients to date have been current or former employees of the companies on which they reported information.[15] Indeed, the SEC recently announced an award of more than $700,000 to an outsider ''industry expert'' who provided the Commission with a ''detailed analysis'' that led to an enforcement action—suggesting that the universe of possible whistleblowers is vast.[16]

The SEC also this year signaled its intent to police the use of employment and confidentiality agreements which may have the potential to stifle whistleblower claims. In an action against engineering firm KBR, the SEC contended that KBR's use of confidentiality agreements—which required witnesses in internal investigations to seek permission from the company's legal department before discussing the matters under investigation with outside parties—violated Rule 21F-17, which prevents companies from impeding whistleblower reports to the SEC.[17] In settling the SEC's charges, KBR agreed to amend its agreements to make clear that employees are free to make reports of potential violations to the SEC.

Waivers

The Commissioners continued to express divergent views regarding the circumstances and the terms under which the Commission should grant waivers of the automatic disqualification provisions of the securities laws to financial institutions found to have engaged in wrongdoing. In particular, Commissioner Kara Stein authored a number of strong dissents from Commission orders in which waivers were granted, expressing an opinion that the Commission's frequent exercise of its waiver authority ''has effectively rendered criminal convictions of financial institutions largely symbolic,'' and urging the Commission to impose more stringent conditions when granting waivers.[18] Chair Mary Jo White, on the other hand, made clear her view that ''waivers were never intended to be, and [the Commission] should not use them as, an additional enforcement tool.''[19]

The terms of a conditional waiver recently granted to JPMorgan Chase[20] (with the approval of Commissioner Stein) may provide a preview of the types of waivers we can expect to see in 2016. That waiver requires that: (1) the bank retain an independent consultant, one with no business relationship with the bank, to review the bank's procedures relating to Rule 506 and produce an annual report; (2) the bank's principal executive officer and principal legal officer certify that they have reviewed the consultant's report annually; and (3) the Commission publish the consultant's annual report on its website. In a statement issued alongside the waiver, Commissioner Stein said that she was agreeing to the waiver because it represented a ''more outcome-focused approach.''[21]

Financial Reporting and Issuer Disclosures

Enforcement Division Director Andrew Ceresney recently touted the SEC's success in ''significantly increasing the quality and number of financial reporting cases,'' pointing out that from fiscal year 2013 through the end of fiscal year 2015, the SEC more than doubled the number of actions relating to issuer reporting and disclosures—from 53 in 2013 to 114 in 2015.[22] Included in last year's totals were actions against a number of large issuers (and their executives), including a settled action brought against Computer Sciences Corporation (in which the company paid a $190 million penalty),[23]

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[12] Amendments to the Commission's Rules of Practice, Release No. 34-75976.

[13] 2015 Annual Report to Congress on the Dodd-Frank Whistleblower Program, *available at* https://www.sec.gov/whistleblower/reportspubs/annual-reports/owb-annual-report-2015.pdf

[14] *Id.*

[15] *Id.*

[16] SEC Awards Whistleblower More Than $700,000 for Detailed Analysis, Release No. 2016-10 (Jan. 15, 2016).

[17] *In the Matter of KBR, Inc.*, File No. 3-16466 (Apr. 1, 2015).

[18] Commissioner Kara M. Stein, Dissenting Statement Regarding Certain Waivers Granted by the Commission for Certain Entities Pleading Guilty to Criminal Charges Involving Manipulation of Foreign Exchange Rates (May 21, 2015); *see also* Commissioner Luis A. Aguilar and Commissioner Kara M. Stein, Dissenting Statement in the Matter of Oppenheimer & Co., Inc. (Feb. 4, 2015); Commissioner Kara M. Stein, Dissenting Statement in the Matter of Deutsche Bank AG, Regarding WKSI (May 4, 2015).

[19] Chair Mary Jo White, Understanding Disqualifications, Exemptions and Waivers Under the Federal Securities Laws: Remarks at the Corporate Counsel Institute, Georgetown University (Mar. 12, 2015).

[20] *In the Matter of JPMorgan Chase Bank, N.A.*, Securities Act Release No. 33-9993 (Dec. 18, 2015).

[21] Commissioner Kara M. Stein, Statement in the Matter of JPMorgan Chase Bank, N.A., Regarding Order Under 506(d) of the Securities Act of 1933 Granting a Waiver of the Rule 506(d)(1)(iii) Disqualification Provision (Dec. 18, 2015).

[22] Andrew Ceresney, Directors Forum 2016 Keynote Address (Jan. 25, 2016).

[23] *In the Matter of Computer Sciences Corp.*, File No. 3-16575 (Jun. 5, 2015).

and an action filed in federal court against ITT Educational Services.[24]

We can expect continued focus on financial reporting actions in 2016. Notwithstanding the decline in recent years in the number of issuer restatements, the Division of Enforcement remains focused on issues including revenue recognition, valuation and impairment issues, earnings management, missing or insufficient disclosures, and internal accounting controls.[25] Already this year, the SEC has brought settled actions involving financial reporting issues against mortgage servicer Ocwen Financial Corp.,[26] biopesticide company Marrone Bio Innovations,[27] and Monsanto Company.[28]

FCPA Enforcement

The SEC continued to aggressively pursue possible violations of the Foreign Corrupt Practices Act (FCPA), bringing charges against a number of companies including BHP Billiton,[29] Hitachi[30] and Bristol-Meyers Squibb.[31] We expect to see more of these actions in 2016. The SEC has indicated that it has additional significant FCPA cases in the pipeline,[32] and already this year charges have been filed against numerous entities, including software company SAP SE in connection with alleged payments to a Panamanian government official,[33] telecommunications provider VimpelCom (alleged to have paid bribes to officials in Uzbekistan),[34] technology company PTC (in connection with alleged payments to Chinese officials),[35] and Qualcomm (alleged to have hired relatives of Chinese officials).[36]

Among the FCPA cases brought last year was an action against BNY Mellon in connection with internships allegedly provided to family members of foreign government officials connected to a Middle Eastern sovereign wealth fund.[37] This action reflects the Division of Enforcement's view that ''the FCPA is properly read to cover providing valuable favors to a foreign official, as well as providing cash, tangible gifts, travel or entertainment.''[38]

Municipal Securities

In the municipal securities arena, the SEC last year brought a first-ever action alleging pricing-related fraud in the primary market for municipal bonds, contending that brokerage firm Edward Jones improperly offered bonds to its customers at prices above the ''initial offering price''—the price negotiated between the issuer and underwriter.[39] In addition, with respect to Edward Jones' trading of municipal bonds in the secondary market, the SEC separately charged the firm with failing to establish an adequate supervisory system to determine whether the markups it charged on certain transactions were reasonable. To resolve the action, the firm agreed to pay approximately $5.2 million in disgorgement, as well as a $15 million penalty, and additionally agreed to begin disclosing to customers in writing the amount of any markup or markdown on all of its fixed income trades. After a number of years in which the SEC's most high-profile municipal securities actions involved disclosure-related violations, the *Edward Jones* case indicates that we can now expect continued focus on municipal bond pricing.

In addition, the SEC recently completed its third and final round of settlements with municipal underwriting firms under the Municipalities Continuing Disclosure Cooperation (MCDC) Initiative, a voluntary self-reporting program first announced in 2014.[40] In total, 72 underwriters agreed to settle charges that they failed to conduct sufficient due diligence with respect to disclosures by bond issuers regarding compliance with continuing disclosure obligations. To date, the MCDC Initiative has resulted in charges against only one issuer,[41] so we would expect to see one or more rounds of settlements this year involving other issuers who voluntarily reported their continuing disclosure failures, in addition to potential actions against non-reporting underwriters, issuers and individuals.

Insider Trading

The SEC's docket of insider trading cases continued to be affected last year by the Second Circuit's landmark December 2014 decision in *United States v. Newman*.[42] In *Newman*, the Second Circuit held that the government must prove that a tipper disclosed confidential information in exchange for a ''personal benefit,'' and that such a benefit may be inferred from the mere existence of a personal relationship only when the relationship is ''meaningfully close'' and ''generates an exchange that is objective, consequential, and represents at least a potential gain of a pecuniary or similarly valuable nature.''

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[24] *SEC v. ITT Educational Services, Inc.*, No. 15-cv-00758 (S.D. Ind. May 12, 2015).

[25] Andrew Ceresney, Directors Forum 2016 Keynote Address (Jan. 25, 2016).

[26] *In the Matter of Ocwen Financial Corp.*, File No. 3-17060 (Jan. 20, 2016).

[27] *SEC v. Marrone Bio Innovations, Inc.*, No. 16-cv-00321 (E.D. Cal. Feb. 17, 2016).

[28] *In the Matter of Monsanto Company*, File No. 3-17107 (Feb. 9, 2016).

[29] *In the Matter of BHP Billiton Ltd.*, File No. 3-16546 (May 20, 2015).

[30] *SEC v. Hitachi, Ltd.*, No. 15-cv-01573 (D.D.C. Sept. 28, 2015).

[31] *In the Matter of Bristol-Meyers Squibb Company*, File No. 3-16881 (Oct. 5, 2015).

[32] Andrew Ceresney, ACI's 32nd FCPA Conference Keynote Address (Nov. 17, 2015).

[33] *In the Matter of SAP SE*, File No. 3-17080 (Feb. 1, 2016).

[34] *SEC v. VimpelCom*, No. 16-cv-01266 (S.D.N.Y. Feb. 18, 2016).

[35] *In the Matter of PTC Inc.*, File No. 3-17118 (Feb. 16, 2016).

[36] *In the Matter of Qualcomm Inc.*, File No. 3-17145 (Mar. 1, 2016).

[37] *In the Matter of The Bank of New York Mellon Corporation*, File No. 3-16762 (Aug. 18, 2015).

[38] Andrew Ceresney, ACI's 32nd FCPA Conference Keynote Address (Nov. 17, 2015).

[39] *In the Matter of Edward D. Jones & Co., L.P.*, File No. 3-16751 (Aug. 13, 2015).

[40] *SEC Completes Muni-Underwriter Enforcement Sweep*, Release No. 2016-18 (Feb. 2, 2016).

[41] *In the Matter of Kings Canyon Joint Unified School District*, File No. 3-15966 (Jul. 8, 2014).

[42] 773 F.3d 438 (2d Cir. 2014).

  SRLR ISSN 0037-0665

Chair White has publicly downplayed *Newman*'s impact on the SEC's insider trading cases, arguing that the case has ''had more of an impact on the criminal side than it does on the SEC civil side because [the SEC has] different burdens of proof that make it somewhat easier[.]''[43] Chair White also pointed out that the SEC is continuing to aggressively pursue insider trading violations, filing over 30 insider trading cases just since the decision in *Newman*.[44]

The SEC's record post-*Newman* has been mixed. In a rare loss for the Division of Enforcement in administrative proceedings, in September 2015 Administrative Law Judge Jason Patil dismissed insider trading claims against Joseph Ruggieri on the grounds that the Division had not met its burden of establishing a personal benefit under the standard set forth in *Newman*.[45] The Commission has agreed to hear an appeal from Judge Patil's ruling. In addition, a New York federal district court vacated a previous settlement in the SEC's insider trading case against Level Global Investors, in light of *Newman*, with the SEC agreeing to repay $21.5 million that was paid as part of the settlement.[46]

More recently, however, the SEC won a jury trial in New York federal district court against Daryl Payton and Benjamin Durant, who were alleged to have traded on insider information in advance of IBM's 2009 acquisition of SPSS Inc.[47] The SEC had pursued its case against Payton and Durant even after criminal charges against the pair were dismissed in the wake of *Newman*, suggesting that the SEC will continue to use the lower burden of proof in civil cases to aggressively go after those who trade on insider information.

Looking ahead to 2016, the Supreme Court is likely to provide clarity on the ''personal benefit'' issue addressed in *Newman*. Although the Court declined to take up the government's appeal in *Newman*, it recently granted certiorari in an appeal from a Ninth Circuit decision, *United States v. Salman*, which departed from *Newman* in holding that in a case involving a close familial relationship, the government need not show the potential for a pecuniary gain.[48]

Looking Ahead

In the coming year, all indications point to the SEC continuing to bring a significant volume of enforcement actions across the full spectrum of the securities markets.

Meanwhile, President Barack Obama's proposed budget for fiscal year 2017 requests an increase of $200 million in funding for the SEC—which would enable the SEC to add more than 50 positions to the Enforcement Division—with a further goal of doubling the SEC's budget by the fiscal year starting October 2020.[49] Although an increase of that size seems unlikely given the current political climate, even a more modest increase would strengthen the SEC's hand in enforcement.

Furthermore, with the arrival of two new Commissioners in 2016, differing viewpoints and priorities will likely emerge and it will be interesting to observe how they may impact the SEC's enforcement program in the year ahead.

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[43] A Conversation with Chair Mary Jo White, 43rd Annual Securities Regulation Institute (Jan. 26, 2016).

[44] *Id.*

[45] *In the Matter of Gregory T. Bolan, Jr. and Joseph C. Ruggieri*, File No. 3-16178, Initial Decision (Sept. 14, 2015).

[46] *SEC v. Adondakis*, No. 12-cv-409 (Jan. 26, 2016).

[47] *SEC v. Payton, et al.*, No. 14-cv-4644 (S.D.N.Y.) (jury verdict on Feb. 29, 2016).

[48] 792 F.3d 1087 (9th Cir. 2015).

[49] White House: Budget Request Will Include Doubling SEC, CFTC Funding by 2021, Wall Street Journal (Feb. 8, 2016).