Bloomberg BNA

Securities Regulation & Law Report™

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ENFORCEMENT

Securities Enforcement: 2013 in Review

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I. Introduction

The year 2013 was a busy year in securities law litigation. This article highlights some of the key developments, trends, and stories from 2013, with a focus on Securities and Exchange Commission enforcement actions. These include: the Supreme Court's ruling on the statute of limitations for enforcement actions; the SEC's change in settlement policy; the government's continued focus on insider trading; the SEC's victory in the Fabrice Tourre trial; and the continued development of the case law governing the extraterritorial reach of the securities laws.

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II. The Supreme Court Constricts the Statute Of Limitations for Enforcement Actions

2013 saw one especially major development in the law governing securities enforcement actions, which came in the Supreme Court's decision in *Gabelli v. SEC*.[1] In *Gabelli*, the SEC alleged that the two defendants allowed an investor to engage in ''market timing'' in a mutual fund in return for its investment in a hedge fund run by one of the defendants. The SEC claimed the defendants failed to adequately disclose the market timing or the *quid pro quo* arrangement and thereby aided and abetted violations of the 1940 Investment Advisers Act. The SEC sought civil penalties.

The defendants moved to dismissed on timeliness grounds. The applicable statute of limitations is 28 U.S.C. § 2462, which provides a default five-year limitations period for any ''action, suit or proceeding for the enforcement of any civil fine, penalty, or forfeiture'' (except as otherwise provided by Congress). Under § 2462, the limitations period begins to run on ''the date when the claim first accrued.'' Defendants argued that the limitations period had been exceeded because the suit was filed in April 2008, but the SEC did not allege that any market timing had occurred after August 2002.

The dispute before the Supreme Court centered on what it means for a claim to have ''accrued'' under § 2462. The SEC argued for application of the ''discov-

[1] 133 S. Ct. 1216 (2013).

ery rule,'' under which a cause of action accrues not when the alleged misconduct occurs but only when the plaintiff actually discovers or reasonably could have discovered that the cause of action exists. The Court rejected this argument, holding unanimously that the discovery rule is inapposite in actions brought by the SEC, as opposed to private plaintiffs. Where a fraud is concealed, private parties may have no way of knowing they have been injured until long after misconduct occurred. In contrast, the SEC's ''very purpose'' is to investigate potential securities law violations, and it is given ''many legal tools . . . to aid in that pursuit.'' Moreover, the SEC as a plaintiff ''seeks a different kind of relief'' than a private party: the civil penalties sought by the SEC ''go beyond compensation,'' and ''are intended to punish, and label defendants wrongdoers.'' Finally, the Court reasoned, there is no practicable way to determine when a government agency, as opposed to a private party, reasonably should have discovered something.[2]

Several courts have already dismissed civil penalty claims brought by the SEC based on *Gabelli*'s bright-line rule.[3] Furthermore, there may have been suits in the pipeline that the SEC would have otherwise filed but that are now time-barred. Indeed, the *Gabelli* rule looms especially large now for any potential new cases arising from around the 2008 financial crisis. The SEC has indicated that it may try to address this issue through agreements with investigation targets to waive the deadline in financial crisis cases, and it may be that a result of *Gabelli* will be the increased use of such waivers.

Two significant legal questions remain unanswered by *Gabelli*. The first question is: what exactly constitutes a civil penalty? The SEC will likely argue that *Gabelli* does not affect its ability to bring claims for injunctive relief, officer- and director-bars, or disgorgement. But courts both before and after *Gabelli* have questioned whether even the non-monetary remedies commonly sought in SEC enforcement actions might not sometimes be appropriately considered punitive, as opposed to equitable, in nature.[4] The second question is: can the SEC get around the *Gabelli* rule by use of equitable tolling or related tolling doctrines? The Supreme Court explicitly reserved judgment on this issue, so *Gabelli* on its face only addresses when the § 2462 clock begins to run, and not whether the clock, once started, can be suspended. Traditionally, courts have allowed claims to be tolled where a defendant has taken additional steps beyond the alleged misconduct in order to conceal the alleged misconduct that delayed the plaintiff's ability to bring suit.[5] The SEC will likely try to build up evidence of such separate concealment efforts in order to save cases from *Gabelli*'s reach. But much of the reasoning in *Gabelli* would appear to apply with equal force to such fact patterns.[6]

[2] *Id.*

[3] *E.g.*, *SEC v. Kovzan*, No. 11-2017, 2013 BL 284535, at *2 (D. Kan. Oct. 15, 2013); *SEC v. Wyly*, No. 10-cv-5760, 2013 BL 147825, at *4-5 (S.D.N.Y. June 6, 2013);

[4] *See, e.g.*, *SEC v. Bartek*, 484 F. App'x 949, 956-57 (5th Cir. 2012); *Johnson v. SEC*, 87 F.3d 484, 487-488 (D.C. Cir. 1996); *Kovzan*, 2013 BL 284535, at *4.

[5] *E.g.*, *Cada v. Baxter Healthcare Corp.*, 920 F.2d 446, 450-51 (7th Cir. 1990).

[6] *See Wyly*, 2013 BL 147825, at *4-5.

III. The SEC Changes Its Policy Regarding Admissions in Settlements

A second major development in 2013 was the SEC's highly publicized change in settlement policy. Until recently, the SEC's policy had been to allow defendants in nearly all enforcement actions to settle without admitting (or denying) any factual allegations.[7] In the wake of the financial crisis, this policy of regularly using no-admit, no-deny settlements—coupled with the perception that the SEC was unwilling or unable to take most cases to trial—led to increasingly vocal criticism, from jurists, politicians, and commentators.[8] The SEC vigorously defended its policy as a necessary exercise of agency discretion and as the best way to maximize its enforcement resources and quickly aid harmed investors.[9]

Then, the SEC changed its policy. In a June 18, 2013 speech, then-new SEC Chairman Mary Jo White announced that the SEC would begin requiring admissions of liability in settlements for certain ''egregious'' cases, because ''public accountability in particular kinds of cases can be important.''[10] White did not detail in her speech how the SEC would determine which cases would fall into this category. But a subsequent internal SEC memorandum provided three examples of the type of misconduct that would prompt the SEC to demand settlement admissions: ''(1) misconduct that harmed large numbers of investors, or placed investors or the market at risk of potentially serious harm, (2) egregious intentional misconduct, or (3) when the defendant engaged in unlawful obstruction of the commission's investigative processes.''[11]

Reactions to the policy change, and predictions as to its effect, have run the gamut. Some believe it is an important step in the right direction, and that forcing defendants in the most critical enforcement actions to choose between making actual admissions in a settlement or else proceeding to trial will promote deterrence and accountability among the big financial players. Others are concerned that the policy change may have unintended but significant negative consequences.[12] The biggest concern among critics is that the new

[7] In January 2012, the SEC announced that it would start requiring admissions for settlements of enforcement actions where the defendant had already pled guilty in a parallel criminal proceeding, but the SEC characterized this change as narrow in scope and as only affecting a small number of cases.

[8] *See, e.g.*, *SEC v. Citigroup Global Mkts. Inc.*, 827 F. Supp. 2d 328, 333-35 (S.D.N.Y. 2011); Letter from Sen. Elizabeth Warren to SEC Chairman Mary Jo White (May 14, 2013), *available at* http://www.warren.senate.gov/documents/LtrtoRegulatorsre2-14-13hrg.pdf.

[9] *See, e.g.*, Yin Wilczek, *SEC Chairman Strongly Defends 'No Admit/No Deny' Settlement Policy*, 45 Bloomberg BNA Sec. Reg. & L. Rep. 1112 (June 17, 2013); Brief of the SEC, Appellant/Petitioner, *Citigroup*, 673 F.3d 158 (2012) (No. 11-5227), 2012 WL 1790380.

[10] Christopher L. LaVigne, Mark D. Lanpher, & Jason M. Swergold, *New SEC Admission Policy May Be Tested Sooner Than Later*, Law360, July 16, 2013, www.law360.com/articles/457673/.

[11] *Id.*; *see also* Yin Wilczek, *White Announces Revision of SEC 'No Admit' Settlement Policy*, 45 Bloomberg BNA Sec. Reg. & L. Rep. 1150 (June 24, 2013).

[12] *See e.g.*, Yin Wilczek, *In Seeking Admisions, SEC Will Not Factor in Defendants' Collateral Impacts*, 8 Bloomberg BNA White Collar Crime Rep. 728 (Oct. 18, 2013).

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policy will result in the SEC being able to pursue far fewer violations. They reason that requiring admissions will make defendants much less likely to settle, because of the potential collateral consequences from such admissions. This will result in the SEC being forced to allocate much more of its necessarily limited resources to expensive and time-consuming trials, with fewer resources being left for pursuing other cases and new investigations and for enacting prophylactic regulations. Still others believe that the policy change will not actually have much of a practical effect, one way or the other. The SEC will likely continue to use no-admit, no-deny settlements in most cases. And, in those cases where the new policy is applied, the settlements may end up being negotiated and wordsmithed such that the resulting admissions are as narrow and insignificant as possible.

It is likely too early to meaningfully gauge the effect of the SEC's policy change. In the half year since the new policy was announced, the SEC has successfully secured two high-profile settlements that included factual admissions. The first was its $18 million settlement in August with Philip Falcone of Harbinger Capital Partners; the second was its $200 settlement the following month with J.P. Morgan Chase.[13]

IV. The SEC Continues to Focus on Insider Trading

2013 also saw a continued focus by the SEC on insider trading. Although the number of insider trading enforcement actions pursued by the SEC was actually somewhat lower in 2013 than it was in 2012, a number of the agency's most high-profile cases this year concerned insider trading.[14]

None were higher profile than the series of SEC enforcement actions involving the hedge fund SAC Capital, its affiliated entities, and its employees and executives—which have proceeded in parallel with a series of related criminal cases. In March, CR Intrinsic Investors LLC, an SAC affiliate, agreed to pay $600 million to settle an SEC enforcement action arising from an alleged scheme to trade on inside information from an Alzheimer's drug trial.[15] The same month, the SEC also reached a $14 million settlement with another SAC affiliate, Sigma Capital Management, over an alleged scheme to trade on inside information about quarterly earnings at technology companies Dell Inc. and Nvidia Corp.[16] In July, SAC, CR Intrinsic, and Sigma, were criminally indicted.[17] In November, the companies pled guilty and agreed to pay fines totaling $1.8 billion.

The government also pursued the individuals involved in the alleged schemes. The SEC sued CR Intrinsic portfolio manager Matthew Martoma for his role in the Alzheimer's drug scheme.[18] That action has remained in its early stages while the parallel criminal case has proceeded.[19] The government alleges that Martoma received inside information from a neurology professor about poor results for the trials of certain drugs, and that trading based on this resulted in $276 million in illegal profits or avoided losses. Martoma's criminal trial began in January 2014. The SEC also brought suit against Sigma portfolio manager Michael Steinberg for his role in the Dell and Nvidia scheme.[20] As with its case against Martoma, the SEC's case against Steinberg has remained on the back-burner while the parallel criminal case proceeded to trial in November.[21] Steinberg was accused of trading on inside information regarding earnings at Dell and Nvidia, which he allegedly received from Sigma analyst Jon Horvath, who, in turn, received the information from various other sources. Steinberg argued at his criminal trial that he never knew the information he received was confidential; and admissions at trial from Horvath, the government's key witness, appeared to support this. Steinberg was convicted after a month of trial and two days of jury deliberation. Finally, in July 2013, the SEC brought an administrative action against SAC's founder, Steven A. Cohen.[22] The SEC alleged that Cohen failed to properly supervise Martoma and Steinberg, without accusing him of actually participating in the scheme. Cohen has not been sued in court by the SEC or charged criminally.

There was also significant activity on the appellate level. *United States v. Newman*,[23] currently pending before the U.S. Court of Appeals for the Second Circuit, is an appeal from the 2012 criminal convictions of Todd Newman and Anthony Chiasson, two of the other individuals (not affiliated with SAC) involved in the chain of information that allegedly brought Dell and Nvidia inside information to Steinberg, Horvath, and Sigma. The issue in *Newman* is whether the government must prove that a person receiving inside information knew that the person providing the information stood to benefit personally from the disclosure. District court rulings on this issue have been inconsistent, and the Second Circuit's decision may have a significant effect on the type of evidence the SEC will have to marshal in future insider trading enforcement actions.

Also this year, in June, the Second Circuit affirmed the insider trading conviction of Raj Rajaratnam.[24] The Second Circuit rejected Rajaratnam's challenge to the government's use of wiretaps in his case, as well as his challenge to the district court's instruction to the jury that it could convict if it found that inside information ''was a factor, however small, in the defendant's decision to purchase or sell stock.''

[13] Yin Wilczek, *SEC to Announce More Admissions of Wrongdoing, Enforcement Official Says*, 45 Bloomberg BNA Sec. Reg. & L. Rep. 2111 (Nov. 18, 2013).

[14] *See* Press Release, Securities and Exchange Commission, SEC Announces Enforcement Results for FY 2013 (Dec. 17, 2013); Sec. & Exch. Comm'n, Year-by-Year SEC Enforcement Statistics, *available at* www.sec.gov/news/newsroom/images/enfstats.pdf.

[15] *SEC v. CR Intrinsic Investors, LLC*, No. 12-cv-8466 (S.D.N.Y.); Maria Lokshin, *SAC Affiliate Agrees to Pay $600M to SEC in Largest Insider Trading Settlement*, 45 Bloomberg BNA Sec. Reg. & L. Rep. 475 (Mar. 18, 2013).

[16] Lokshin, *supra* note 15; *SEC v. Sigma Capital Mgmt., LLC*, No. 13-cv-1740 (S.D.N.Y.).

[17] *United States v. S.A.C. Capital Advisors, L.P.*, No. 13-cr-541 (S.D.N.Y.).

[18] *CR Intrinsic Investors*, No. 12-cv-8466.

[19] *United States v. Martoma*, No. 12-cr-973 (S.D.N.Y.).

[20] *SEC v. Steinberg*, No. 13-cv-2082 (S.D.N.Y.).

[21] *United States v. Steinberg*, No. 12-cr-121 (S.D.N.Y.).

[22] *In re Cohen*, SEC, Admin. Proc. File No. 3-15382 (July 19, 2013); Stephen Joyce, *SEC Says Hedge Fund Adviser Cohen Failed to Supervise Insider-Trading Execs*, 45 Bloomberg BNA Sec. Reg. & L. Rep. 1331 (July 22, 2013).

[23] No. 13-1837 (2d Cir. 2013).

[24] *United States v. Rajaratnam*, 719 F.3d 139 (2d Cir. 2013).

V. The SEC Defeats Fabulous Fab But Perhaps Begins to Wind Down Its Focus on Financial Crisis Cases

The SEC won what it characterized as a major victory in August 2013 in a case arising from the 2008 financial crisis. A jury in the U.S. District Court for the Southern District of New York ruled for the SEC in its enforcement action against Fabrice Tourre, a former Goldman Sachs Group Inc. executive.[25] The SEC claimed that Goldman created a collateralized debt obligation transaction and allowed a hedge fund to play a key role in selecting the residential mortgage backed securities underlying the CDO, while misleadingly representing to investors that the underlying securities had been selected by a disinterested third-party entity. Tourre was alleged to have been principally responsible for structuring and marketing the CDO at issue. Tourre famously wrote e-mails in which he referred to himself as ''Fabulous Fab'' and joked about selling notes to ''widows and orphans.'' The SEC's victory in *Tourre* stood in marked contrast to its 2012 defeats in two similar cases it brought against bankers for CDO transactions.[26] Tourre's motion for a new trial was recently denied, and an appeal may be forthcoming.

While touting its success in the *Tourre* case, and the fact that to date it has brought enforcement actions against approximately 170 individuals and entities arising from the financial crisis,[27] the SEC also hinted that it may be shifting its focus to new matters. In a July 16, 2013 speech, then-SEC Division of Enforcement Co-Director Andrew Ceresney stated that while the SEC continues to work on cases arising from the financial crisis, it was transitioning its focus to a ''new wave'' of enforcement issues, such as those relating to high frequency trading.[28]

VI. The SEC's Extraterritorial Reach is Expanded

2013 also saw the SEC continue to try to expand its reach over foreign nationals, especially in Foreign Corrupt Practices Act (''FCPA'') cases. It won a victory on this front in *SEC v. Straub*.[29] In *Straub*, the SEC charged three executives of a Hungarian company with violating the FCPA by allegedly engaging in a scheme to bribe public officials in Macedonia. The defendants moved to dismiss for lack of personal jurisdiction, arguing that they were foreign nationals and were not in the U.S. at the relevant time. The district court rejected this argument, finding that the necessary minimum contacts existed because the defendants' company's stock was publicly traded in the U.S. and the defendants certified misleading statements to the company's auditors that they knew or had reason to know would end up in filings with the SEC. The district court also rejected the defendants' statute of limitations defense, although it was undisputed that the five-year limitations period under § 2462 had elapsed. The court ruled based on the language of § 2462 that the limitations period never started running because the defendants were not in the U.S. at the relevant time. Taken together, the *Straub* court's rulings on minimum contacts and § 2462 may significantly limit the ability of foreign nationals to fight claims brought against them by the SEC.

Straub's holding on minimum contacts was bolstered in *SEC v. Sharef*,[30] another district court opinion issue shortly thereafter. In *Sharef*, the SEC charged a German citizen who was an executive at Siemens AG with violating the FCPA by allegedly encouraging another Siemens executive to authorize bribes to officials in Argentina. The court dismissed the case for lack of personal jurisdiction. But in so doing it agreed with the holding in *Straub*, finding only that minimum contacts were lacking because this defendant, unlike the *Straub* defendants, was not alleged to have had any role in falsifying the company's financial statements.

On the other hand, the extension of the government's extraterritorial reach in securities law was tempered somewhat by the Second Circuit's decision in *United States v. Vilar*.[31] In *Vilar*, the defendants were charged with criminal violations of Section 10(b). The issue before the court was whether the Supreme Court's holding in *Morrison v. National Australia Bank Ltd.*[32] that Section 10(b) does not apply to extraterritorial conduct in the civil context applies equally in the criminal context. The court held that it does. This line of cases is based on the language of 1934 Securities Exchange Act Section 10(b) and therefore does not directly affect the jurisdictional reasoning in FCPA cases like *Straub*; but it will be interesting to see whether these competing trends of expanding and contracting the extraterritorial reach of the securities laws will come to a head at some point in the future.

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[25] *SEC v. Goldman Sachs & Co.*, No. 10-cv-3229 (S.D.N.Y.); Phyllis Diamond, *Ex-Goldman Exec Tourre Found Liable Over Role in 2007 CDO*, 45 Bloomberg BNA Sec. Reg. & L. Rep. 1428 (Aug. 5, 2013).

[26] *SEC v. Stoker*, No. 11-cv-7388 (S.D.N.Y.); *SEC v. Steffelin*, No. 11-cv-4204 (S.D.N.Y.).

[27] *See* Press Release, *supra* note 14.

[28] *See* Stephen Joyce, *SEC Adjusted No Admit, No Deny Policy As Some Cases Demanded Accountability*, 8 Bloomberg BNA White Collar Crime Rep. 526 (July 26, 2013).

[29] 921 F. Supp. 2d 244 (S.D.N.Y. 2013).

[30] 924 F. Supp. 2d 539 (S.D.N.Y. 2013).

[31] 729 F.3d 62 (2d Cir. 2013).

[32] 561 U.S. 247 (2010).

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ISSN 0037-0665