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Handling SEC Enforcement Matters

Representing clients in investigations conducted by and cases brought by U.S. Securities and Exchange Commission's (SEC) Division of Enforcement requires strong advocacy skills. Criminal defense practitioners are well suited to SEC work, because strong advocacy is what criminal defense practitioners are called upon every day to provide. It is important, though, to know how the landscape at the SEC differs from criminal defense forums. This article makes the comparisons, points out the contrasts, and for the benefit of criminal defense practitioners who have not yet had the opportunity to deal with SEC Enforcement, demystifies the process.

Created during the New Deal to protect the investing public, the Commission has five members, each of whom is appointed to a five-year term by the president of the United States with the advice and consent of the Senate. Only three commissioners can be from the same political party.[1] In practice, this almost always means that three of the five belong to the same political party as the sitting president. As of this writing, two Republicans, two Democrats, and one independent serve as commissioners.[2]

Operating from SEC headquarters in Washington, D.C., and from 11 regional offices, the attorneys of the Division of Enforcement, sometimes called "the staff," are the approximate equivalent of prosecutors. The staff investigates and, where the staff members believe appropriate, recommends to the Commission that a case be brought. To obtain authority to bring a case, the staff must get the vote of at least three commissioners.[3] After the commissioners vote in favor of a case, Enforcement files it and brings it to trial or works out a resolution, just as a prosecutor does in a criminal case.

I. How an Investigation Begins

There are a host of traditional precipitating causes for SEC investigations. Like a prosecutor in a white collar case, the SEC may react to information published in newspaper articles, referrals made by other agencies or self-regulatory organizations,[4] data derived from market surveillance activities,[5] or complaints received from the public.

A. Whistleblower Tips

One source of information that has gained particular prominence in recent years is the whistleblower tip. After it became public that the staff of the Boston Office of the SEC had failed to follow through on a tip about Bernie Madoff well before his scheme unraveled,[6] the SEC's weaknesses in leveraging tips became a subject of public disgust.[7] In response, via the Dodd-Frank Act of 2010, Congress reformed the SEC's approach to information received from the public. As part of those reforms, the SEC was for the first time authorized to share the proceeds of enforcement actions with tipsters.

The SEC has established an Office of the Whistleblower (OWB), designed to centralize and standardize the SEC's handling of tips. Individuals submit

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confidential tips via an online portal, or by mailing or faxing a "TCR Form." Any tip regarding a potential securities law violation goes into the Tips, Complaints, and Referrals Intake and Resolution System, or the "TCR System," for review by the SEC's Office of Market Intelligence.[8] Tips requiring further investigation or analysis are identified and sent to the appropriate office.

Per Dodd-Frank's anti-retaliation provision, employers are prohibited from retaliating against employee-whistleblowers.[9] The SEC has very broadly construed what actions are considered to be retaliatory, arguably making it virtually impossible to fire whistleblowers.[10]

In 2012, its first full year of collecting data, the OWB received 3,001 tips. By 2017, the number had increased by nearly 50 percent, to 4,484 tips.[11] Sorting through those tips has proved to be a formidable task. And since no one at the SEC wants to miss the next Madoff, many more tips than in the past are followed up with investigation. As of its 2017 update, OWB was actively tracking more than 700 open matters that originated from whistleblower tips.[12]

If a tip leads to an enforcement action with over $1 million in monetary sanctions, whistleblowers are eligible for awards ranging from 10 percent to 30 percent of the sanctions — the larger the sanction, the larger the award.[13] The OWB provides an annual report to Congress chronicling its progress in handing out bounties to those whom the SEC has deemed whistleblowers. And its progress has been significant: by the end of fiscal year 2017, the SEC had awarded approximately $160 million to 46 whistleblowers.[14] In March 2018, the SEC announced the largest whistleblower award to date: two whistleblowers shared nearly $50 million and a third received more than $33 million.[15]

B. Inspections and Exams

Another source of information that can spark investigations is the Office of Compliance Inspections and Examinations (OCIE). OCIE is not part of the Division of Enforcement. OCIE operates the SEC's separate National Exam Program and, as part of that program, conducts on-site inspections and exams of regulated entities, including broker-dealers and asset managers.[16] OCIE inspections and exams often go on for weeks or even months. OCIE obtains and reviews documents without subpoena and witnesses are interviewed without a stenographer and, frequently, without the presence of counsel.

A benign outcome from the point of view of a regulated entity is a deficiency letter in which OCIE identifies various areas for improvement. In recent years, between 72 percent and 80 percent of inspections resulted in the identification of deficiencies.[17] But OCIE's inspections and exams can result not only in deficiency letters, but also in referrals to the Division of Enforcement.[18] From 2013 through 2017, between 7 percent and 13 percent resulted in such referrals.[19]

Today, OCIE is more active than ever: in the 2017 fiscal year, OCIE conducted 2,870 examinations, an increase of 18 percent from the 2016 fiscal year.[20] SEC Chairman Jay Clayton has placed a particular focus on adviser oversight; OCIE examined 15 percent of investment adviser firms in fiscal year 2017.[21]

C. MUI Versus Formal Investigation

Enforcement lawyers can open a tentative inquiry known as "matters under inquiry" or a "MUI" (pronounced "MOO-ee"). When looking into a MUI, the staff typically sends letters requesting information to those they are considering investigating further. (The staff cannot send subpoenas at this stage because it is not yet vested with authority to do so.) Letter recipients typically respond because a strong response can head off the opening of what the SEC calls a "formal investigation."

The Commission has delegated to supervisory attorneys within the Division of Enforcement the power to issue a "formal order of investigation."[22] After a formal order is in place, Division of Enforcement is empowered to issue subpoenas.[23]

The threshold for opening a formal investigation is significantly higher than for opening a MUI.[24] A subpoena is a sure sign that there has already been a supervisory-level determination that the investigation is worth pursuing beyond just an initial look. Moreover, the investigation is being tracked via the SEC's bureaucratic processes, consistent with the expectation that the staff will produce results within a reasonable timeframe.[25]

II. Parallel Criminal Investigations

One of the most challenging aspects of SEC practice is trying to figure out whether or not a prosecutor might emerge in the future. The Enforcement staff can make referrals to federal prosecutors or, occasionally, to local district attorney's offices. Particularly in New York, but also across the country, there are close and ongoing collaborative arrangements between local U.S. Attorney's Offices and the SEC.

For a brief period, at least in the Ninth Circuit, the staff was required, if asked, to reveal whether or not a prosecutor was lurking beneath the surface.[26] It is now clear, however, that the staff is under no such obligation.[27] If asked the question, the staff is permitted simply to decline to say. In any event, things can change. This can make the question of whether to have a client assert a Fifth Amendment privilege against self-incrimination an especially difficult one. If a person under SEC investigation takes the Fifth, the evidentiary consequences are just the opposite of those in a criminal investigation. That is, the ultimate finder of fact in an SEC civil lawsuit or administrative proceeding may draw an adverse inference from the fact that a defendant asserts the privilege and, depending on the circumstances, may even draw an inference from the fact that the defendant has done so in the past. The assertion of a Fifth Amendment privilege can, if corroborated by other evidence, itself be of probative value.[28]

But the usual countervailing considerations in favor of asserting the privilege continue to apply when there is a realistic prospect of a parallel criminal investigation. Sometimes, it is obvious that there is or will be a prosecutor involved. That tends to clarify the thinking. Obviously, if there is a real criminal investigation, then considerations concerning the SEC investigation will become less important to the overall strategy.

Ultimately, if the Department of Justice proceeds, the SEC will bring its case the same day that the indictment is unsealed. Then, the DOJ will seek a stay of the SEC case to try to prevent civil discovery from proceeding, an application on which the SEC will studiously abstain from taking a position. Usually, the court will grant the stay application,[29] although there are cases that go both ways on the issue.[30] From the defense point of view, there are pros and cons to having discovery go forward in an SEC case while a criminal case is pending, but in the right matter, getting depositions of cooperating and other witnesses could be beneficial to the defense, and appropriate.

III. Pre-Charge Advocacy

A. White Papers and Other Presentations

In contrast to the DOJ, at the SEC there is no concept of subject, witness or target and, if asked, Enforcement lawyers will almost invariably be quite tight-lipped about their thinking. That having been said, it is usually quite easy to figure out where they are headed,

based on the scope of their subpoenas and the tenor of their questioning.

The staff is fairly open to receiving presentations, either in person or in writing, during the course of an investigation. That is a favorable aspect of SEC practice. Perhaps because the SEC resolves many of its matters via settlement, the staff likes to get a dialogue going early on. Indeed, the SEC recently updated its Enforcement Manual, available online, to allow for the submission of white papers and "other materials," including PowerPoint decks, legal memoranda, and letter briefs.[31]

The strategy is a bit different when appearing before the SEC rather than a criminal forum, but much will be familiar to criminal defense lawyers.

There are always strategic considerations as to when and in what manner it is wise to submit white papers and other presentations. But in the right circumstances, they can be very effective.

B. Wells Submissions

When the staff has neared the end of an investigation and has determined that it intends to seek authority from the Commission to bring a case, the staff almost always calls the attorneys for the individual potentially facing charges to let them know (a "Wells call"). The staff then follows up with a confirming letter (a "Wells Notice").[32] At a minimum, a Wells Notice states what the proposed charges are and offers the opportunity to make a submission to the Commission as to why charges ought not to be brought.

Almost invariably, the staff initially says that the Wells submission is due in two weeks, irrespective of how long the matter has been under investigation, how voluminous the record is, or how complex the issues are. The deadline can usually be negotiated, even when the staff expresses initial reluctance. While the Commission usually does not vote down a proposed case after Enforcement has recommended it be brought,[33] senior staff within Enforcement are loath to make the recommendation without first considering a Wells submission and expect the line staff to allow defense counsel a reasonable time to prepare one.

Wells submissions are a bit civil practice and a bit criminal practice in feel. A successful Wells submission can be likened to a successful motion for summary judgment. The number of factual disputes is downplayed, and the argument is often that, even assuming that the facts are more or less as the staff says, no genuine triable issue of fact exists. And, like successful presentations to prosecutors, the winning Wells submission hammers home the central message that, if a case were brought, it would be a loser for the government. The conventional wisdom has it that a Wells submission built on factual disputes has a low likelihood of success, whereas a Wells submission that makes substantial legal or policy arguments will tend to fare much better.

Making a Wells submission is far from a sure thing. Approximately 80 percent of Wells Notice recipients eventually find themselves charged.[34] That there are 20 percent who can prevent the case from being brought, though, shows the appropriate attention accorded to good Wells submissions.

IV. Cooperation by Individuals

Cooperation by individuals is not remotely as big of a factor in SEC cases as it is in criminal cases.

In a criminal investigation, of course, no adverse inference is permitted to be drawn from a person's silence. The Fifth Amendment therefore gives individuals a bargaining chip. In exchange for immunity or leniency, individuals can provide information that they otherwise could withhold without consequence. The government needs information, and the individual needs immunity or leniency. This can be a simple recipe for cooperation.

Not so before the SEC.[35] A person who hopes for a good outcome with the SEC has to speak eventually or else risk an adverse inference by the staff, the Commission, and ultimately the finder of fact. Such a person cannot rely on the Constitution to withhold information indefinitely and thus has little to no leverage. As a result, "cooperation" most often takes the form of simply testifying as required in response to subpoena.

The SEC's formal Enforcement Cooperation Program, announced in 2010, has done little to nothing to change this dynamic. In a statement introducing it, the Chief of Enforcement laid out whom the SEC had in mind as a cooperator:

> The reality is that when you engage in misconduct, you now have to think even harder about the possibility of others coming forward to report to the SEC your secret conversations, your hushed plans, your schemes and deceptions. And for those thinking about cooperating, you should seriously consider contacting the SEC quickly, because the benefits of cooperation are reserved for those whose assistance is both timely and necessary.[36]

The worried person described in this statement is far more likely to be worried about personal liberty than about a potential civil enforcement action by the SEC. As a result, that person is likely to be focused on trying to work things out with prosecutors rather than on cooperating with the SEC.

On the other hand, a person who is not worried about prosecution is likely an individual who is not interested in a formal cooperation agreement with the SEC, especially one that requires acceding to charges. Such a person will simply testify with no understandings, and thereby lay out a position as to why no charges would be warranted.

Defense counsel can use cooperation as a tool, though, on behalf of the client who does not fear criminal prosecution but is nonetheless looking to settle SEC charges. It is far from a sure thing, but cooperation can at times drive a favorable resolution in the pre-charge context.

V. The Forum for Trial

A disturbing aspect of SEC practice is that the SEC is allowed to choose whether to pursue its cases in federal court or in the SEC's own administrative forum.

In the administrative forum, there is no jury. Instead, an administrative law judge (ALJ) employed by the SEC finds the facts and rules on the law in what is called an "initial decision." The ALJ's initial decision is reviewable "*de novo*" by the Commission, the very body that authorized bringing the charges in the first place. Only after the Commission issues an opinion endorsing its own ALJ's initial decision endorsing the Commission's own case does a respondent receive independent review by a federal court of appeals. By then, the findings of fact and even conclusions of

law can be almost impossible to disturb.

The remedies that the SEC can seek to have imposed as a result of proceedings in the two different forums are virtually indistinguishable, and there is no rule governing which cases may be brought where.[37] In response to criticism, including criticism that the SEC was shunting its most questionable, weakest cases to its own forum, the SEC promulgated a list of factors that it says it considers in deciding on the forum. Those factors are so obviously malleable, though, as to underscore the SEC's absolute discretion.[38]

It should not be so surprising that the SEC's forum is just that — the SEC's. Indeed, the *Wall Street Journal* has exposed how infrequently the SEC loses before ALJs as compared to before juries and federal judges.[39] A 2015 study concluded that the SEC won around 90 percent of its in-house cases over a nearly five-year period, as compared to 69 percent in federal court over the same period.

Though the SEC has at times touted its own forum as specialized or expert,[40] the reality is that ALJs are not necessarily even previously trained in securities law. Applicants seeking to become ALJs need only apply to the government's Office of Personnel Management. The process requires would-be jurists to take a test through which they apply for a position as an ALJ working for any agency with need, and the examination, therefore, does not test agency-specific knowledge.[41] Where there is a vacancy, the sitting Chief SEC ALJ chooses from the top three candidates identified by the Office of Personnel Management.[42]

In an effort to extricate themselves from the administrative forum, respondents in cases brought there have challenged this selection method on Separation of Powers grounds. The challenges hinged on the Constitution's Appointments Clause, which requires that "inferior officers" be appointed by the Commission (as opposed to being hired by the OPM system, which is appropriate — and constitutional — only for "employees").

Brune Law P.C., together with another firm, pursued the very first such challenge on behalf of client Lynn Tilton.[43] Her challenge was rebuffed at the district court and circuit court levels as premature.[44] She eventually prevailed at trial before an ALJ, and thus had no need to continue to press the issue. But investment advisor Raymond J. Lucia lost before an ALJ and thereafter his challenge made its way to the Supreme Court, which held in June 2018 that ALJ's are in fact "Officers of the United States" who must be appointed in accordance with the Appointments Clause.[45]

The Supreme Court's decision may prove to be an important administrative law precedent, but it is unlikely to have much effect on future cases, given that the Commission has since changed its ALJ selection practices.[46] But the decision potentially has helped Lucia, who has gotten a do over before a different ALJ,[47] as well as some 50 other respondents with cases pending before ALJs.[48]

Appointments Clause concepts aside, though, it is obviously unfair to be required to go to trial without a jury and before a judge selected by the prosecution. Unfortunately, it has been well settled that administrative proceedings can comport with due process.[49] That having been said, the *Lucia* case could signal the Supreme Court's willingness to revisit established processes at the SEC, and could signal a beginning of a judicial reassessment. After all, when Ms. Tilton's and Mr. Lucia's challenges were brought, they too seemed to be long shots.

The SEC has, as a matter of discretion, recently reduced its use of the administrative forum. But, inevitably, as long as the SEC has the power to use this forum, it will.

VI. Discovery

A. *Brady* and Impeachment Material

In 2016, the SEC amended its Rules of Practice, the procedural rules that govern administrative trials.[50] Some of the amendments are around the edges; others, such as the right to take depositions, are positive improvements. Still, the administrative forum is obviously far worse for the defense than federal court.

One of the few benefits to litigating against the SEC in an administrative proceeding rather than in federal court, though, is the right to *Brady* material. Under the Rules of Practice, the SEC must provide defendants with "documents obtained by the Division prior to the institution of proceedings, in connection with the investigation leading to the Division's recommendation to institute proceedings."[51] While the Rules list exceptions to this requirement, they also specify that "[n]othing … authorizes the Division of Enforcement in connection with an enforcement or disciplinary proceeding to withhold, contrary to the doctrine of *Brady v. Maryland*, … documents that contain material exculpatory evidence."[52] As a practical matter, then, that means that respondents in administrative cases routinely get *Brady* and impeachment material, including prior witness statements.

In federal court, though, the SEC's position is that it does not have to provide *Brady* material because the Supreme Court's holding in *Brady* is limited to defendants in criminal proceedings and the Rules of Practice do not apply to federal court cases. That means that what one would hope would not happen frequently does: government lawyers hide the ball.

But SEC defendants in federal court should not despair entirely. Savvy defense counsel can find other ways to access the necessary information. Rule 30(b)(6) of the Federal Rules of Civil Procedure states: "In its notice or subpoena, a party may name as the deponent a … governmental agency … and must describe with reasonable particularity the matters for examination." In a 2012 Southern District of Florida case, *SEC v. Merkin*, Magistrate Judge Jonathan Goodman ruled that the SEC was not exempt from complying with Rule 30(b)(6) and that, in that case, the defendant had the right to take the Commission's deposition, demanding the equivalent of *Brady* material.[53] In ruling for the defendant, the magistrate judge held that "[a]lthough the government sometimes enjoys privileges not available to private parties, these unique privileges do not usually generate an automatic, across-the-board immunity from 30(b)(6) depositions."[54]

Seeking to depose the SEC will always be an uphill battle; the Commission has fought vigorously to avoid being deposed in the past and will almost certainly continue to do so. But *Merkin* opens the door to taking the SEC's deposition and thereby provides defendants with leverage to obtaining the *Brady* material that they need. Other civil discovery devices, including interrogatories and requests for admission, may likewise help to pry loose needed information.

B. Making Corporate Cooperation Work for Everyone

Corporations routinely cooperate with the SEC, just as they do with prosecutors. Per the SEC's Enforcement Manual, full cooperation requires disclosure of all relevant facts within the cooperator's knowledge.[55] At the same time, the Manual discourages the SEC from requiring a privilege waiver: "[t]he staff should not ask a party to waive the attorney-client privilege or work product protection without prior approval of the Director or Deputy Director."[56] Thus, the SEC's official conclusion is ambiguous: "the SEC does not view a party's waiver of privilege as an end in

itself, but only as a means (where necessary) to provide relevant and sometimes critical information to the staff."[57]

The result of all of this double talk is that companies often convey privileged information without formally waiving the privilege. To accomplish this, a common practice is for counsel for companies to provide to the SEC what have come to be known as "oral downloads." Company counsel read to the staff its memos or compendiums of its memos of interviews of relevant witnesses, "downloading" privileged and work-product materials in the process.

In a recent case, *SEC v. Herrera*, Brune Law P.C. sought via a motion to compel for a corporation to provide interview notes and memoranda that it had generated during an internal investigation and orally downloaded to the SEC. The presiding magistrate, the same Magistrate Judge Goodman who had previously ruled on 30(b)(6) depositions as discussed above, concluded that the corporation had waived work product protection because "there is little or no substantive distinction for waiver purposes between the actual physical delivery of the work product notes and memoranda and reading or orally summarizing the same written material's meaningful substance to one's legal adversary."[58] As a result, Brune Law was able to get access to the same material that the SEC had received as a result of the corporation's cooperation.

VII. Settlement Versus Trial

Settling, like pleading guilty, is sometimes the best thing for a client to do, given the few, bad choices presented by the circumstances.

The SEC's burden of proof is only by a preponderance of the evidence. (As a matter of fairness, it really should at least be by clear and convincing evidence, given the reputational effects of an adverse verdict.) Moreover, though the SEC always trumpets Fraud (with the metaphorical capital "F") in its press releases when it brings the charges, Enforcement lawyers sometimes retreat to what they call "non-scienter fraud" when they are called upon to prove those same charges. To criminal practitioners, non-scienter fraud seems like an impossibility, but there is much case law supporting that the SEC need prove only negligence or recklessness to prevail.[59]

In SEC practice, it is usually possible for the client to settle on a neither-admit-nor-deny basis, which eliminates potential *res judicata* effects of the settlement. This can matter when there is a potential for follow-on civil liability in private suits.

Like the initiation of a case, settlements need to be approved by a vote of the Commission and are publicized on the SEC's website.[60] That means as a practical matter that when the Commission believes that broader issues are at stake, favorable settlements can be hard to achieve.

Going to trial can be the right call. In federal court, Enforcement's win-loss record is lower by far than that of federal prosecutors.[61] Even in the administrative forum, the defense has from time to time been able to prevail of late.[62]

As in criminal practice, charges that were easy to lodge can turn out to be hard to prove.

VIII. Remedies

In any case, the SEC seeks potential "remedies." These remedies include fines, disgorgement of "ill-gotten gains," and industry bars and suspensions.[63] Depending on whether the case is in federal court or the administrative forum, the SEC also seeks and routinely obtains injunctions forbidding future violations of the securities laws or orders to cease and to desist from the same.

That the SEC may obtain fines is well established.[64] The fines that the SEC is authorized to seek are set out by statute[65] as adjusted for inflation.[66] There are three "tiers" for each violation, depending on the seriousness of the conduct. Since fines can be stacked when there are multiple violations proved and since almost every SEC complaint pleads multiple violations based on the same conduct, the tier system is not a very strong predictor of what the fines will turn out to be. The SEC publishes and updates annually a list of all the monetary penalties that it administers, ranging from the low thousands to many millions, for securities law violations.[67]

As for the other remedies, all of which can be said to sound in equity, the SEC may not be on such a firm footing. In July 2017, the Supreme Court ruled in *Kokesh v. SEC* that disgorgements qualify as "penalties" and are therefore subject to a five-year statute of limitations.[68] That result, while clearly correct, is not exactly a game changer. A footnote in the decision signals, however, that bigger changes may be on the way. As the Court stated, "[n]othing in this opinion should be interpreted as an opinion on whether courts possess authority to order disgorgement in SEC enforcement proceedings or on whether courts have properly applied disgorgement principles in this context."[69]

The SEC is authorized to seek "equitable relief" that is "for the benefit of investors."[70] But if disgorgement of ill-gotten gains is not equitable at all and instead is a penalty, then the SEC may not be authorized to seek it. Similar arguments could be made to assail the basis for other remedies as well.

As for injunctions and cease and desist orders, litigants have argued with limited success that they are unjustified unless the SEC has truly established that there is a realistic prospect of future violations.[71]

IX. Conclusion

The SEC is a creature of administrative law. The "administrative state" is unpopular with those who would like to shrink government. The SEC is unpopular with those who, as a matter of political leaning, would like to get government "off business's back." As a result, SEC practitioners must keep in mind that even law that seems well-settled against the defense can turn out to be unstable in ways that can prove helpful to the defense.

Lucia and *Kokesh*, discussed above, were about procedure and penalties, respectively. But substance can be mutable as well.

In 2011, in *Janus Capital Group, Inc. v. First Derivative Traders*,[72] the Supreme Court held that only the "maker" of a fraudulent statement can be held liable for fraud under the main fraud statute upon which the SEC relies. The decision was obviously quite adverse to the SEC's broad notions of who should be held liable. Since then, though, most courts have allowed the SEC to plead around *Janus* with an alternate fraud theory: so-called scheme liability.

In *Lorenzo v. SEC*,[73] the D.C. Circuit affirmed the Commission's affirmance of an ALJ's initial decision that a broker had committed fraud. The vote at the D.C. Circuit, though, was two to one, with Judge Brett Michael Kavanaugh the dissenter. Judge Kavanaugh, referring to some of the administrative procedures that brought about the Commission decision, remarked, "The bad news is that the majority opinion — invoking a standard of deference that, as applied here, seems akin to a standard of 'hold your nose to avoid the stink' — upholds much of the SEC's decision on liability."[74] Per Judge Kavanaugh, the scheme liability theory upon which the SEC's case primarily rested was just another of "the SEC's attempts to unilaterally rewrite the law."[75]

In June of this year, a little over a week before Justice Kennedy announced that he would be retiring, the Supreme Court

granted certiorari, almost certainly meaning that at least four and potentially five of the sitting justices agreed with Judge Kavanaugh that the SEC was trying to circumvent *Janus*. How *Lorenzo* will unfold remains to be seen, given that if Judge Kavanaugh is confirmed as a justice, he will almost surely recuse himself. But the bigger point stands: there is an emerging judicial appetite for reining in the SEC.

The levers and therefore the strategy are a bit different at the SEC than in the criminal forum. But there is much that is familiar to the criminal defense practitioner. As in any criminal defense matter, strong advocacy can make a real difference for clients dealing with SEC Enforcement.

Notes

1. 15 U.S.C. § 78d(a).

2. Benjamin Bain, *SEC Close to Full Strength as Senate Confirms GOP Commissioner*, Bloomberg (Sept. 5, 2018), https://www.bloomberg.com/news/articles/2018-09-05/sec-close-to-full-strength-as-senate-confirms-gop-commissioner.

3. 17 C.F.R. § 200.41 ("A quorum of the Commission shall consist of three members; provided, however, that if the number of Commissioners in office is less than three, a quorum shall consist of the number of members in office; and provided further that on any matter of business as to which the number of members in office, minus the number of members who either have disqualified themselves from consideration of such matter pursuant to § 200.60 or are otherwise disqualified from such consideration, is two, two members shall constitute a quorum for purposes of such matter.").

4. U.S. Sec. & Exch. Comm'n, Div. of Enforcement, Enforcement Manual, § 2.3.1 at 12 (Nov. 28, 2017), *available at* https://www.sec.gov/divisions/enforce/enforcementmanual.pdf [hereinafter Enforcement Manual].

5. U.S. Sec. & Exch. Comm'n, SEC Office of Investor Education and Advocacy, Investor Bulletin: SEC Investigations (Oct. 22, 2014), https://www.sec.gov/oiea/investor-alerts-bulletins/ib_investigations.html.

6. U.S. Sec. & Exch. Comm'n, Office of Investigations, Investigation of Failure of the SEC to Uncover Bernard Madoff's Ponzi Scheme, Report No. 509 (Aug. 31, 2009), *available at* https://www.sec.gov/news/studies/2009/oig-509.pdf.

7. Harry Markopolos, No One Would Listen (2011).

8. U.S. Sec. and Exch. Comm'n, Office of the Whistleblower, 2017 Annual Report to Congress: Whistleblower Program (2017) at 23, *available at* https://www.sec.gov/files/sec-2017-annual-report-whistleblower-program.pdf [hereinafter 2017 Annual Whistleblower Report].

9. 15 U.S.C. § 78u-6(h)(1).

10. *In the Matter of Paradigm Capital Management, Inc. and Candace King Weir*, Adm. Proc. File No. 3-15930 (June 16, 2014).

11. 2017 Annual Whistleblower Report at 23.

12. *Id.* at 27.

13. 15 U.S.C. § 78u-6. Unsurprisingly, given the amount of money potentially involved, the whistleblower program has not been without controversy and its share of litigation. Would-be claimants have litigated their right to awards after having blown the whistle internally, rather than directly to the SEC, where their actions still ultimately resulted in a recovery for the SEC. Until February 2018, there was a circuit split surrounding this issue, but it was resolved with the Supreme Court's unanimous holding in *Digital Realty Trust, Inc. v. Somers* that Dodd-Frank's protections extend only to employees who blow the whistle directly to the SEC. 138 S. Ct. 767 (2018).

14. 2017 Annual Whistleblower Report at 1.

15. Press Release, U.S. Sec. & Exch. Comm'n, SEC Announces Its Largest-Ever Whistleblower Awards (Mar. 19, 2018), *available at* https://www.sec.gov/news/press-release/2018-44.

16. U.S. Sec. & Exch. Comm'n, SEC Office of Compliance Inspections and Examinations, 2018 National Exam Program Examination Priorities at 1, *available at* https://www.sec.gov/about/offices/ocie/national-examination-program-priorities-2018.pdf.

17. U.S. Sec. & Exch. Comm'n, FY 2019 Congressional Budget Justification at 106, *available at* https://www.sec.gov/files/secfy19congbudgjust.pdf.

18. *Id.*

19. *Id.*

20. U.S. Sec. & Exch. Comm'n, SEC Office of Compliance Inspections and Examinations, 2018 National Exam Program Examination Priorities at 3, *available at* https://www.sec.gov/about/offices/ocie/national-examination-program-priorities-2018.pdf.

21. Testimony on "Oversight of the U.S. Securities and Exchange Commission," Chairman Jay Clayton (Sept. 26, 2017), *available at* https://www.sec.gov/news/testimony/testimony-clayton-2017-09-26.

22. Enforcement Manual at § 2.3.4.

23. In February 2017, acting head Michael Piwowar revoked senior officials' subpoena power, limiting that authority to the Director of the Enforcement Division. Dave Michaels, *SEC Chief Scales Back Powers of Enforcement Staff*, Wall St. J. (Feb. 15, 2017), *available at* https://www.wsj.com/articles/sec-chief-scales-back-powers-of-enforcement-staff-1487199642.

24. Enforcement Manual at § 2.3.2 ("The analysis for whether to convert a MUI to an investigation, or open an investigation, differs from the analysis for whether to open a MUI. While a MUI can be opened on the basis of very limited information, an investigation generally should be opened after the assigned staff has done some additional information-gathering and analysis.").

25. For example, MUIs are expected to be either closed or converted to investigations within 60 days. Enforcement Manual at § 2.3.1. In 2016, the SEC did, however, extend the maximum time between the SEC's filing of a case and the administrative trial from four months to 10 months. 17 C.F.R. § 201.360(a)(2).

26. *United States v. Stringer*, 408 F. Supp. 2d 1083 (D. Or. 2006).

27. *United States v. Stringer*, 535 F.3d 929 (9th Cir. 2008).

28. *See, e.g., Baxter v. Palmigiano*, 425 U.S. 308, 320 (1976).

29. *See, e.g., Trustees of the Plumbers and Pipefitters Nat'l Pension Fund v. Transworld Mech., Inc.*, 886 F. Supp. 1134, 1138 (S.D.N.Y. 1995).

30. *See, e.g., SEC v. Oakford Corp.*, 181 F.R.D. 269 (S.D.N.Y. 1998).

31. Enforcement Manual at § 3.2.3.2.

32. The SEC is not required to send targets Wells Notices, but it usually does. The 1972 Wells Committee concluded: "Except where the nature of the case precludes, a prospective defendant or respondent should be notified of the substance of the staff's charges and probable recommendations in advance of the submission of the staff memorandum to the Commission recommending the commencement of an enforcement action and be accorded an opportunity to submit a written statement to the staff to be forwarded to the Commission together with the staff memorandum."

33. The Commission archives all of its votes on its website. *See Commission Votes*, U.S. Sec. & Exch. Comm'n (May 2018), https://www.sec.gov/about/commission-votes.shtml.

34. Jean Eaglesham, *SEC Drops 20 Percent of Probes After 'Wells Notice,'* Wall St. J. (Oct. 9, 2013), *available at* https://www.wsj.com/articles/sec-drops-20-of-probes-after-8216wells-notice8217-1381363343.

35. *Baxter v. Palmigiano*, 425 U.S. 308 (1976).

36. Robert S. Khuzami, Director, SEC Div. of Enforcement, Remarks at News Conference Announcing Enforcement

Cooperation Initiative and New Senior Leaders, at 1 (Jan. 13, 2010), *available at* https://www.sec.gov/news/speech/2009/spch110509rk.htm.

37. U.S. Sec. & Exch. Comm'n, Div. of Enforcement, Division of Enforcement Approach to Forum Selection in Contested Actions (2015); *see also* Andrew Ceresney, Director, SEC Div. of Enforcement, Keynote Speech at New York City Bar 4th Annual White Collar Institute (May 12, 2015).

38. *Id.*

39. Jean Eaglesham, *SEC Wins with In-House Judges*, WALL ST. J. (May 6, 2015), *available at* http://www.wsj.com/articles/sec-wins-with-in-house-judges-1430965803.

40. Andrew Ceresney, Director, SEC Div. of Enforcement, Remarks to the American Bar Association's Business Law Section Fall Meeting (Nov. 32, 2014), http://www.sec.gov/News/Speech/Detail/Speech/1370543515297.

41. Press Release, U.S. Office of Personnel Management, Statement from the U.S. Office of Personnel Management Regarding the 2017 Administrative Law Judge Examination (Aug. 3, 2017), *available at* https://www.opm.gov/news/releases/2017/08/statement-from-the-us-office-of-personnel-management-regarding-the-2017-administrative-law-judge-examination-1 ("By applying for the ALJ examination, applicants are essentially applying to be placed on a register (i.e., a list of eligibles), not for a specific job at a specific agency.").

42. 5 U.S.C. § 3317(a), 3318(a). They may, in the alternative, select ALJs with existing appointments from another agency. 5 C.F.R. 2.2(a).

43. *Tilton et al. v. SEC*, No. 15-cv-2472, 2015 WL 4006165 (S.D.N.Y. June 30, 2015), *aff'd*, 824 F.3d 276 (2d Cir. 2016), *cert. denied*,137 S. Ct. 2187 (2017).

44 *Id.*

45. *Lucia v. SEC*, 138 S. Ct. 2044 (June 21, 2018).

46. The Commission "ratified" its prior appointments of ALJs on Nov. 30, 2017. *In re Pending Administrative Proceedings,* Securities Act Release No. 10,440, Exchange Act Release No. 82178, Investment Advisers Act Release No. 4816, Investment Company Act Release No. 32929 (Nov. 30, 2017). The SEC claimed that by doing so, it had "resolved any concerns that administrative proceedings presided over by its ALJs violate the Appointments Clause." SEC Ratifies Appointment of Administrative Law Judges (Release No. 17-215).

47. *Lucia*, 138 U.S. at 2055 ("[T]he 'appropriate' remedy for an adjudication tainted with an appointments violation is a new 'hearing before a properly appointed' official.") (quoting *Ryder v. United States*, 515 U.S. 177 at 183, 188 (1995)). The Court mandated that Mr. Lucia's case not be heard by the same ALJ, "even if he has by now received (or receives sometime in the future) a constitutional appointment. … To cure the constitutional error, another ALJ (or the Commission itself) must hold the new hearing to which Lucia is entitled." *Id.*

48. *In re Pending Administrative Proceedings*, Admin. Proc. Rulings Release No. 5954 (Aug. 23, 2018).

49. *See Goldberg v. Kelly*, 392 U.S. 254 (1970).

50. Amended by Release No. 34-78319: Adoption of Amendments to the Rules of Practice (July 13, 2016).

51. 17 CFR § 201.230(a)(1).

52. 17 CFR § 201.230(b)(3).

53. *SEC v. Merkin*, 283 F.R.D. 699 (S.D. Fla. 2012).

54. *Id.* at 698.

55. ENFORCEMENT MANUAL at § 4.3.

56. *Id.*

57. *Id.* (citing *Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934 and Commission Statement on the Relationship of Cooperation to Agency Enforcement Decisions*, Securities Exchange Act Rel. No. 44969 n.3 (Oct. 23, 2001) ("Seaboard 21(a) Report").

58. Order on Defendants' Motion to Compel Production from Non-Party Law Firm at 13, *SEC v. Herrera*, No. 17-cv-20301 (S.D. Fla. Dec. 5, 2017).

59. Section 17 of the Securities Act of 1933 contains a general anti-fraud provision and requires only negligence or recklessness. *Aaron v. SEC*, 446 U.S. 680, 696-97 (1980); *SEC v. Monarch Funding Corp.*, 192 F.3d 295, 308 (2d Cir. 1999).

60. *See Administrative Proceedings*, U.S. SEC. & EXCH. COMM'N (May 15, 2018), https://www.sec.gov/litigation/admin.shtml.

61. Between October 2010 and March 2015, the SEC won 69 percent of its cases in federal court. *See* Eaglesham, *SEC Wins with In-House Judges*, *supra* note 39. Federal prosecutors in 2016 obtained guilty pleas or verdicts in almost 94 percent of their cases. *See* DEPARTMENT OF JUSTICE, FISCAL YEAR 2016 UNITED STATES ATTORNEYS' ANNUAL STATISTICAL REPORT (2016) at Table 2A, *available at* https://www.justice.gov/usao/page/file/988896/download.

62. For example, last year Ms. Tilton prevailed before an ALJ, who dismissed all charges after a month-long trial. *In re Lynn Tilton*, Initial Decision Release No. 1182 (Sept. 27, 2017).

63. Office of Administrative Law Judges, U.S. Sec. & Exch. Comm'n (Jan. 26, 2017), https://www.sec.gov/alj.

64. 15 U.S.C. §§ 77h-1(g), 78u-2(b), 80a-9(d), 80b-3(i).

65. 15 U.S.C. § 78u(d)(3)(A).

66. 17 C.F.R. § 201.1004.

67. *See Inflation Adjustments to the Civil Monetary Penalties Administered by the Securities and Exchange Commission*, U.S. SEC. & EXCH. COMM'N (Jan. 15, 2018), https://www.sec.gov/enforce/civil-penalties-inflation-adjustments.htm.

68. 137 S. Ct. 1635.

69. *Id.* at 1642 n.3.

70. 15 U.S.C. § 78u(d)(5).

71. *See, e.g., SEC v. Goble*, 682 F.3d 934 (11th Cir. 2012).

72. *Janus Capital Group, Inc. v. First Derivative Traders*, 564 U.S. 135, 142 (2011).

73. *Lorenzo v. SEC*, 872 F.3d 578 (D.C. Cir. 2017).

74. *Lorenzo*, 872 F.3d at 597.

75. *Id.* at 601. ■

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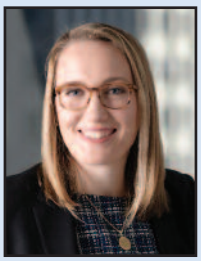

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