

# SEC Investigations

A Guide for Public Company Directors,  
Officers, and In-House Counsel

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# Introduction

Even public companies with a strong code of conduct, an exemplary tone at the top, robust internal controls, and a culture of compliance may face allegations of misconduct that can lead to an investigation by the Division of Enforcement of the US Securities and Exchange Commission (the SEC or the Commission). For a public company, the initiation of an SEC investigation can be startling to the company's board and senior management.

A company may learn of an SEC investigation from a phone call to in-house counsel from Division of Enforcement staff notifying the company that the SEC has opened an investigation. Alternatively, a document preservation notice, voluntary request, or subpoena may arrive without warning. At other times, a public company may learn about the investigation from a third party, such as its auditors, a vendor, or a customer that receives a subpoena or request for information. Public companies should be prepared to respond to the investigation swiftly and with strategic foresight. The decisions made at the outset are frequently critical, will impact how the investigation unfolds, and can shape the investigation's ultimate outcome. This Guide is a resource for public company executives and in-house counsel facing an investigation by the Division. Competently navigating the investigative process from the beginning is imperative and can help a company to avoid an enforcement action or to otherwise minimize the potential sanctions, while allowing senior management to focus on operating the company's business.

This Guide outlines important initial considerations for public companies contacted by the SEC, including:

- Retaining outside counsel, and protecting the attorney-client privilege and work-product protections
- Determining what conduct the SEC is concerned about, whether that conduct is ongoing, and whether prompt remediation is necessary
- Determining which stakeholders need to know about a possible investigation, including management, the Audit Committee, the Board of Directors, independent auditors, and the public
- Preserving and collecting relevant documents
- Determining how and when to engage with the Enforcement staff
- Determining whether to notify the company's insurance carriers
- Determining whether any individuals will need separate counsel and the company's indemnification obligations
- Assessing whether to publicly disclose the investigation and the need for a public relations strategy
- Considering the likelihood and impact of a parallel criminal investigation, regulatory proceedings, or civil litigation

Competently navigating the investigative process from the beginning is imperative and can help a company to avoid an enforcement action or to otherwise minimize the potential sanctions, while allowing senior management to focus on operating the company's business.

Understanding the investigative process and how the investigation may unfold, including internal best practices and SEC staff processes, is particularly important so that in-house counsel can educate business leaders. Managing expectations is also critical to avoid surprising senior management and boards. Informed in-house counsel can educate the company's management and board effectively about how an investigation could develop, helping to set expectations, and minimizing unhelpful surprises and disappointments over the course of the investigation, which could be lengthy. Indeed, a quick phone call to the Division explaining that their concerns must stem from a fundamental misunderstanding of the business or the facts is almost never the right approach, and there is little chance it will resolve the staff's concerns. Nor will attempting to contact Congress, SEC Commissioners, or other senior SEC officials foreclose an investigation.

Not all investigations will run the full course described in this Guide. However, this Guide identifies important considerations for in-house counsel, company officers and directors when outlining the company's strategy, while keeping in mind the goal of concluding the investigation as quickly as possible with minimal disruption to the company and its officers, directors, and employees.

# Overview of SEC Investigations

The SEC begins investigations for a variety of reasons. The Enforcement Staff regularly monitors the financial markets, the internet, company filings, and news stories for information indicating that a violation of the federal securities laws may have occurred. Public company reporting and disclosure has always been an area of focus for the SEC, but in 2013, the SEC announced the formation of the Financial Reporting and Audit Task Force dedicated specifically to detecting fraudulent or improper financial reporting.<sup>1</sup> As part of that effort, the SEC has made a significant investment in tools and personnel to engage in data analysis to identify potential fraudulent activity. One example of that effort is the Corporate Issuer Risk Assessment Program, also known as CIRA, which purportedly “assists the staff in detecting anomalous patterns in financial statements that may warrant additional inquiry.”<sup>2</sup> The Enforcement Division also obtains referrals from other SEC divisions, such as the Division of Corporation Finance, federal and state government agencies (including criminal law enforcement), the Public Company Accounting Oversight Board (PCAOB), and self-regulatory organizations like the Financial Industry Regulatory Authority (FINRA), which routinely monitors trading, news releases, and M&A activity and which makes inquiries and referrals to the SEC as a matter of course.

Public companies may also self-report potentially improper conduct to the SEC staff. Self-reporting may occur because public disclosure of the underlying conduct is required (as with a financial restatement), because a company believes the SEC staff likely will learn about the conduct through other means, or simply because the company’s board and senior management believe that self-reporting is consistent with good corporate governance. Self-reporting may be required as a consequence of a prior government settlement or plea agreement, deferred or non-prosecution agreement, or similar agreement. Obviously, public companies should make the decision whether to self-report carefully.

Public companies should be alert to the existence of putative whistleblowers. Particularly since the passage of the Dodd-Frank Act — which added strong financial incentives and anti-retaliation protections for putative whistleblowers to the Exchange Act — the staff receives communications from employees, investors, short sellers, and other members of the public.<sup>3</sup>

Section 21F provides for a whistleblower program offering financial incentives for a person to voluntarily provide to the Commission non-public information which results in an enforcement action. Specifically, any resulting enforcement action that results in monetary sanctions in excess of US\$1 million makes the whistleblower eligible for an award of between 10-30% of the aggregate monies any US regulator receives. The SEC maintains extensive information about its whistleblower program at <https://www.sec.gov/whistleblower>.

In addition, Section 21F includes an anti-retaliation provision, which establishes a private cause of action for a whistleblower to sue his or her employer in federal court for any form of harassment the employee’s whistleblowing activity causes.

The Commission can also take legal action against retaliating employers. As of the end of Fiscal Year 2017, the SEC had paid more than US\$160 million to 46 whistleblowers since whistleblower rules went into effect in August 2011, with approximately US\$57 million paid in FY 2016 and approximately US\$50 million paid in FY 2017.<sup>4</sup> In 2016, the Commission also brought charges under Rule 21F-17(a) against multiple public companies for including language in separation agreements that impeded whistleblowers from reporting to the Commission. For example, in *In re BlueLinx Holdings, Inc.*, the SEC asserted that separation agreement clauses requiring employees to waive the right to any monetary recovery in connection with any legal complaint “raised impediments to participation by its employees in the SEC’s whistleblower program.” The company paid US\$265,000 in penalties and was required to modify its separation agreements to avoid restricting whistleblower incentives.<sup>5</sup> Accordingly, public companies should be careful to ensure that separation agreements comply with Dodd-Frank so as not to create potential problems with the SEC.

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Even if they are not formal whistleblowers under the processes created pursuant to Dodd-Frank, these putative whistleblowers may bring tips and complaints to the SEC. The SEC maintains an internal database, known as the TCR System, which includes information received through its website, from more traditional sources like phone calls and letters, and from referrals from other agencies.

Any such information, regardless of its source, can be grounds for an investigation. The Division does not need probable or reasonable cause to launch an investigation, public companies do not have judicial remedies for challenging the Enforcement staff's decision to open an investigation, and Enforcement staff have broad discretion in the conduct of an investigation. Occasionally, particularly if conduct outside the US is involved, the SEC may ask a company to investigate internally and report back before pursuing SEC investigative processes.

SEC investigations are authorized by various federal securities statutes and are governed by the rules provided in 17 C.F.R. § 202.5, *Enforcement Activities*, the Division's *Enforcement Manual*, and other Commission guidance. Investigations may be either formal or informal.<sup>6</sup> In a preliminary inquiry, also known as a Matter Under Inquiry (MUI), or in an informal investigation, the staff does not have the power to subpoena companies or individuals, and relies on the voluntary cooperation of those from whom information is sought.<sup>7</sup> In a formal investigation, the staff obtains a formal order of investigation, authorizing them to issue subpoenas that could require the recipient to produce documents or provide testimony.<sup>8</sup> The formal order is not publicly available, but persons asked to produce documents or testify before the Commission can request it.

The Enforcement staff states consistently that SEC investigations are for the purpose of determining whether securities law violations occurred. In correspondence related to the investigation (e.g., document requests and subpoenas), the staff frequently notes that the fact of the investigation should not be "construed as an indication that the Commission or its staff have a negative view of any entity, individual or security" or words to that effect. The existence of an investigation does not mean that the staff will necessarily recommend an enforcement action to the Commission. Instead, the investigation means that the staff has identified an issue that it believes warrants investigative resources. The staff can and does close investigations without enforcement action at any stage of the investigation.

With limited exceptions, the SEC conducts investigations without publicly disclosing their existence, and generally does not confirm or deny publicly that it is investigating a specific company.<sup>9</sup> That said, the staff may contact other individuals and companies who have relevant information about the matter, and these individuals, like the company itself, do not have a duty to keep the matter confidential. These individuals may discuss the investigation with others, including the press. If an investigation results in an enforcement action, however, the SEC will make the matter public. The SEC will publicly file pleadings and orders related to the enforcement action and, generally, the SEC will publicize the enforcement action with press releases and litigation filings published directly on the SEC's website. These press releases and filings could receive substantial media coverage.

The duration of an SEC investigation can be difficult to predict. Typical investigations related to financial disclosures (to the extent such generalizations can be made) frequently take at least one year, and often take two or more years. Investigations lasting five years or even longer are not unheard of. A company can attempt to expedite this timeline by responding to investigation demands promptly and proactively, as well as by crafting a strategy involving internal fact-gathering and legal argument to respond to the staff's concerns.

## Summary of Potentially Applicable Statutes

Numerous federal statutes may be at issue in an SEC investigation. The principle federal securities statutes likely to be involved in an investigation involving public company accounting and disclosures are discussed below.

### ***The Anti-Fraud Provisions***

Section 10(b) of the Securities Exchange Act of 1934 (Exchange Act) and Rule 10b-5 thereunder prohibit fraudulent conduct "in connection with the purchase or sale of any security."<sup>10</sup> Section 17(a) of the Securities Act of 1933 (Securities Act) prohibits fraudulent conduct "in the offer or sale of any securities."<sup>11</sup> These are the two catchall anti-fraud provisions that generally apply to misstated financial statements and related false or misleading disclosures by public companies.<sup>12</sup>

Section 17(a)(1) of the Securities Act, Section 10(b) of the Exchange Act, and Rule 10b-5 require a showing of scienter.<sup>13</sup> The scienter requirement is satisfied by a showing of willful misconduct or recklessness.<sup>14</sup>

By contrast, Sections 17(a)(2) and 17(a)(3) of the Securities Act do not require a showing of scienter.<sup>15</sup> Those two provisions make it unlawful, in the offer or sale of any securities using jurisdictional means, “to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading;” or “to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.”<sup>16</sup>

### ***Reporting, Books and Records, and Internal Controls***

Section 13(a)(2) of the Exchange Act and Rules 13a-1 and 13a-13 require every public company to file with the Commission annual and quarterly reports.<sup>17</sup> The SEC and the courts have held that a company violates these provisions if it files annual or quarterly reports that include financial statements that are materially misstated or that contain misstatements or omissions in the disclosure.<sup>18</sup> No showing of scienter is necessary to establish an issuer’s violation of the corporate reporting provisions, Section 13(a) of the Exchange Act and Rule 13a-1.<sup>19</sup> Consequently, an issuer violates the reporting provisions if it files materially false or misleading reports or omits information necessary to render the statements not misleading.<sup>20</sup>

Section 13(b)(2)(A) of the Exchange Act requires a public company to make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of company assets.<sup>21</sup> The Exchange Act defines the term “in reasonable detail” to mean the level of detail that would “satisfy prudent officials in the conduct of their own affairs.”<sup>22</sup> Section 13(b)(2)(B) of the Exchange Act requires a public company to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that:

- (i) transactions are executed in accordance with management’s general or specific authorization;
- (ii) transactions are recorded as necessary (I) to permit preparation of financial statements in conformity with generally accepted accounting principles . . . , and (II) to maintain accountability for assets;
- (iii) access to assets is permitted only in accordance with management’s general or specific authorization; and
- (iv) the recorded accountability for assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to any differences . . . .<sup>23</sup>

Scienter and materiality are not elements of primary violations of either Section 13(b)(2)(A) or Section 13(b)(2)(B).<sup>24</sup>

## **Investigative Process and a Public Company’s Response to an SEC Investigation**

Regardless of whether the investigation is formal or informal, a company under investigation should take the matter seriously from beginning to end. Any investigation can lead to an enforcement action and the consequences can affect both a company’s finances and reputation. The tone with which a company approaches an investigation may also demonstrate to the SEC that the company is earnest in its attempt to determine the relevant facts and remedy any mistakes or wrongdoing — factors that the SEC may consider when determining what charges and sanctions to seek. The key action items and considerations discussed below can aid a company subject to an SEC investigation in crafting that tone from the outset.

### ***Retaining Outside Counsel***

When a company learns of a potential SEC investigation, the company should consider retaining outside counsel with experience in SEC investigations. A company faces a multitude of complex issues and strategic decisions, and outside counsel’s experience in dealing with the Enforcement staff is important. Moreover, counsel will want to be well-versed in the facts, and possibly will conduct an internal investigation, in order to adequately defend a company in an SEC investigation. The staff will be more likely to rely on a thorough review that was conducted by competent outside counsel than one, however robust, conducted by in-house counsel. Using outside counsel to conduct an investigation can minimize delays and free up in-

house counsel to continue with their day-to-day responsibilities. Further, using outside counsel to conduct an investigation can bolster the preservation of attorney-client privilege protections — which can become complicated if in-house counsel provide both legal and business advice. Using experienced and respected counsel can improve the staff's perception of a company, as the staff may make an adverse inference against the company if the staff believes counsel is employing deceptive or dilatory tactics.

### **Public Disclosure of an SEC Investigation**

A company should consider several strategic factors when determining whether and when to disclose publicly an SEC investigation. There is no specific line-item disclosure requirement, meaning a company must assess the materiality of the investigation, underlying conduct, and potential outcomes, before deciding whether disclosure is required. As a result, a company should carefully analyze the facts and circumstances developed during an investigation, determine how those facts affect the company's previous disclosures, and make materiality assessments. If disclosure is advisable or required, a company must decide whether to make immediate disclosure in a current report on Form 8-K or whether to wait until the next periodic filing on Form 10-Q or Form 10-K.

A company should consider several strategic factors when determining whether and when to disclose publicly an SEC investigation.

A company may choose to disclose earlier based on a variety of strategic considerations, including whether earlier disclosure will preserve credibility with investors and analysts (and whether that credibility may be harmed by delayed disclosure), the risk of leaks, and whether the SEC may contact customers or other third parties about the investigation. Taking into account these strategic considerations — particularly if a company fully understands the scope of the potential misconduct — it may choose to disclose the existence of an investigation when the Enforcement staff first notifies the company of the investigation.

Alternatively, a company may choose not to publicly disclose an SEC investigation until disclosure is required pursuant to a specific requirement (such as Regulation S-K), or the company learns that the staff has decided to recommend that the Commission authorize an enforcement action against the company or its officers.<sup>25</sup> In any event, a company under investigation must not falsely deny the existence of an SEC investigation. However, a company may wish to consider a policy of not commenting on the existence of a SEC investigation.

In addition to determining whether to disclose the fact of an investigation, a company should also consider whether the investigation affects any pending disclosure documents or registration statements. Pursuant to Regulation S-K, public companies are required to provide disclosure in periodic and annual reports and registration statements concerning a number of specific items that the discovery of corporate wrongdoing may affect:

- **Item 103, *Legal Proceedings***, requires disclosure of “pending” proceedings as well as proceedings “known to be contemplated by governmental authorities” against a corporation, subject to a materiality threshold.<sup>26</sup>
- **Item 303, *Management's Discussion and Analysis of Financial Condition and Results of Operations*** (“MD&A”), requires public companies to disclose “known trends or uncertainties that have had or that the registrant reasonably expects will have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations.”<sup>27</sup> Item 303 requires disclosure of a pending investigation only if the company “reasonably expects” the investigation to have a materially adverse effect on the company. However, over the course of an investigation management or the board may become aware of conduct, particularly improper or illegal conduct that may increase the risk of a material effect on the company.
- **Item 401(f), *Involvement in Certain Legal Proceedings***, requires disclosure of certain legal proceedings concerning officers, directors, and nominees that are “material to an evaluation of the ability or integrity” of that person.<sup>28</sup> Over the years, there has been some controversy over whether Item 401(f) (as well as Item 103) requires the disclosure of potentially illegal conduct prior to the filing of a complaint or indictment.
- **Item 503(c), *Risk Factors***, requires disclosure of the most significant risk factors that apply to the company in particular.<sup>29</sup>

Disclosure in the footnotes to a company's financial statements may be required if the company or auditors determine that the investigation constitutes a contingency with respect to which a loss is "probable" (*i.e.*, likely to occur) or "reasonably possible" (*i.e.*, the chance of the loss occurring is less than likely but more than remote).<sup>30</sup> If a loss is probable and a company can reasonably estimate the amount of the loss, the applicable accounting literature requires the company to accrue a reserve. If a loss is probable but the amount is not reasonably estimable, a company must disclose the nature of the contingency and state that it cannot estimate the amount of the loss. Similarly, if a company determines that the amount is reasonably possible but not probable, the company must disclose the nature of the contingency and an estimate of the possible loss (or the range of possible loss), or state that such an estimate cannot be made.

Finally, the CEO and CFO (and any other certifying officers) should be aware of relevant information that affects their certifications pursuant to Sections 302 and 906 of the Sarbanes-Oxley Act as to the accuracy of SEC filings, including the financial reports included in those filings.<sup>31</sup>

Of course, the disclosure of an investigation (as well as any evidence of possible misconduct or other negative facts) likely will result in adverse publicity and possible private litigation, such as shareholder class actions or derivative actions. Therefore, a company should instruct all employees who deal with the media about how to respond to questions from the press, analysts, and shareholders about a disclosed investigation. Any communications related to the investigation should take into account public relations considerations; concerns about releasing inaccurate or misleading statements; waivers of privilege; and Regulation Fair Disclosure (Reg FD).<sup>32</sup>

A company and its counsel should also consider whether the company should inform third parties of the investigation, including, for example, insurance carriers, lenders, customers, and other business partners.

### ***Preserving and Producing Documents***

During an investigation, the SEC often gathers information through document requests. At the beginning of any investigation, the company should take proactive steps to preserve relevant documents, which may include paper records, electronic files, and other materials. These steps should include the suspension of document destruction routines or procedures. Improper document destruction or alteration — even if inadvertent — is always a serious matter and can carry significant penalties, including fines and prison sentences.<sup>33</sup>

Document collection, processing, and review can be both time-consuming and expensive. Moreover, SEC document requests and subpoenas are often very broad and have unrealistic deadlines. As a result, the Enforcement staff is usually receptive to negotiating both the scope and timing of document productions. Through these negotiations, counsel may be able to extend the amount of time given for a production, limit the date range or subject matter for document requests, or even eliminate certain requests altogether. The staff may also agree to accept production of documents on a rolling basis. Also, in the event of production delays, counsel should contact the staff immediately with a status update to assure them of a client's continued cooperation.

Cases involving documents in foreign jurisdictions can add a layer of complexity to an SEC investigation. Frequently, in investigations involving large productions of documents located outside the United States, the Enforcement staff will rely on voluntary productions in lieu of subpoena-based requests.<sup>34</sup> However, in matters involving US-based public companies, the SEC can take the position that company documents located outside the US are under the custody and control of the parent. Additionally, if a US-based entity or individual refuses to produce voluntarily documents located outside the United States, the SEC may attempt to use compulsory process to obtain the documents.<sup>35</sup>

If blocking statutes, such as the European Union's General Data Protection Regulation (the GDPR), present a potential legal barrier to compliance with an SEC document request or investigative subpoena for materials located outside the United States — and the Enforcement staff believes that a company is otherwise cooperating in an investigation — the staff can exhibit flexibility in accepting information in some form that will not violate local law. For example, the *Enforcement Manual* states that in some instances, "the company may be able to convey important information to the staff by producing interview memoranda and through reports of findings derived from otherwise restricted sources."<sup>36</sup>



## **SEC Interviews and Investigative Testimony**

Witness interviews and investigative testimony (the latter of which is under oath and transcribed by a court reporter) also play an important role in the staff's fact gathering process. Generally, after document production is complete, the staff may consider whether to request witness interviews or testimony from company employees. The Division will expect that in cooperating with the investigation, a company will use its best efforts to make current employees available for testimony or interviews. However, the staff will not likely be able to compel the appearance for testimony of non-US citizens (unless the staff can properly serve those non-US citizens while they are in the United States).

Once the staff starts interviewing witnesses or taking investigative testimony, the order of witness testimony can become an important tactical decision. A company may be able to convince the staff that a particular order of testimony is most likely to answer their questions in an efficient manner. This strategy may avoid a situation in which the SEC feels the need to go back to earlier witnesses based on the more expansive testimony of later witnesses.

If the SEC requests or subpoenas witness testimony, counsel will need to prepare witnesses to testify accurately and effectively. Witnesses have a right to be accompanied by counsel during testimony, and only counsel who represent the witness can attend investigative testimony. Witness preparation requires time and an understanding of key documents about which the SEC may ask a witness to testify. Counsel should conduct a thorough review of documents that may be relevant to the investigative issues and understand a witness' recollection of key facts. Counsel should also prepare a witness for questions the Enforcement staff is likely to ask.

Company counsel should consider potential conflicts issues carefully throughout the investigation, including the need for any *Upjohn* warnings to make clear to employees that counsel represents the company and is not the attorney for the individual.<sup>37</sup> In certain circumstances, either due to conflicts or for strategic reasons, a company employee may require individual counsel separate from counsel representing the company. If employees require separate counsel, the company will also need to assess its indemnification obligations under governing documents. SEC staff are particularly sensitive to counsel representing multiple witnesses whom the staff may believe to be adverse interests.<sup>38</sup>

If separate representation is not necessary, joint representation can limit expenses and facilitate the sharing of information. To the extent individuals retain separate counsel, the company should explore the feasibility of common interest agreements, which can facilitate sharing privileged information between parties while maintaining the confidentiality of privileged communications. If entering into an agreement, counsel should consider whether the agreement should be oral or written and the obligations placed on the company. Indeed, common interest agreements are not without risk and can restrict the use of information obtained from another party even when disclosing that information may be advantageous.

The Fifth Amendment privilege against self-incrimination is available to individuals throughout an SEC investigation and civil enforcement action. Whether an individual asserts the privilege will be the decision of the individual with advice from her or his counsel, but this can have significant ramifications for the company in both the SEC investigation and in related civil litigation — particularly if a senior executive makes the assertion. The Commission can draw an adverse inference from an individual's assertion of the right (against the individual and possibly the company) in deciding whether to proceed with an enforcement action, and may move the court to do the same in subsequent enforcement proceedings.<sup>39</sup> In addition, a company may feel substantial pressure to fire any employee who asserts the Fifth Amendment privilege.

## **Cooperation with SEC Staff**

Since 2001, when the SEC released its *Seaboard Report*<sup>40</sup> outlining considerations for the SEC in evaluating whether a public company would receive credit in the form of reduced charges or sanctions for "self-policing, self-reporting, remediation and cooperation," the SEC has emphasized the importance of a public company's cooperation in an SEC investigation. The SEC website highlights the Enforcement Cooperation Program, and the benefits of cooperation.<sup>41</sup> Depending on the level of cooperation, the benefits may be significant. The SEC has been willing to agree to cease-and-desist orders, deferred prosecution agreements, non-prosecution agreements, and even "full passes" if the respondent substantially cooperated with the investigation. In most instances though, to the extent the Commission rewards cooperation, it is through the reduction of charges, penalties, or other sanctions which the staff would otherwise have pursued. Whether—and how—to cooperate is a judgment each company must make.

The *Seaboard Report* set forth a non-exclusive list of criteria for the staff to consider “in determining whether, and how much, to credit self-policing, self-reporting, remediation and cooperation” while maintaining “broad discretion to evaluate every case individually, on its own particular facts and circumstances.”<sup>42</sup> The *Seaboard Report* includes the following questions, among others, relating to these considerations:

- How did the company cooperate with the staff’s investigation?
- What compliance procedures were in place to prevent the misconduct now uncovered?
- How was the misconduct detected and who uncovered it? Did the company report the misconduct to the SEC, or did the SEC know about the problem before hearing from the company?
- What steps did the company take upon learning of the misconduct?
- What assurances are there that the conduct is unlikely to recur?<sup>43</sup>

In January 2010, as part of a broad effort to further encourage cooperation by individuals and companies, the SEC updated the *Enforcement Manual* to address how to measure and reward cooperation by individuals and public companies.<sup>44</sup> In addition to encompassing the principles initially laid out in the *Seaboard Report*, the *Enforcement Manual* now identifies a “non-exclusive” list of tools for “facilitating and rewarding cooperation,” including proffer agreements, cooperation agreements, deferred prosecution agreements, non-prosecution agreements, and immunity requests.<sup>45</sup> These incentives (along with the whistleblower rewards available to individuals) can impact whether and to what degree public companies and individuals cooperate with the SEC.

A company should remember that cooperation does not preclude counsel from negotiating with the staff regarding its requests for documents and testimony or from vigorously advocating for the company. Counsel should approach these negotiations with the goal of maintaining a running dialogue with the Enforcement staff to understand what they are specifically seeking and to determine how counsel — mindful of the burdens of the staff’s request and impact on a company — can provide the staff with the requested information.

A company should remember that cooperation does not preclude counsel from negotiating with the staff regarding its requests for documents and testimony or from vigorously advocating for the company.

At the same time, counsel must approach negotiations carefully and strategically. Counsel’s credibility plays a major factor in the staff’s perception of the client during an investigation, and the staff may make an adverse inference against the client if the staff believes counsel is employing dilatory tactics.

Cooperating earlier during the investigation may pay dividends during the Wells process (discussed below) because the staff will consider it as one factor in determining whether to allow the party access to the staff’s non-privileged investigative files, which in turn can aid counsel in crafting a persuasive and effective Wells submission.<sup>46</sup>

### ***Attorney-Client Privilege and Attorney Work-Product Considerations***

In the *Seaboard Report*, the Commission identified voluntary disclosure of investigative findings as a factor to consider in determining a company’s cooperation credit, but acknowledged that public companies need not waive the attorney-client privilege, work-product protection, or other privileges in order to receive credit. The *Enforcement Manual* codifies the staff’s approach:

*“Voluntary disclosure of information need not include a waiver of privilege to be an effective form of cooperation and a party’s decision to assert a legitimate claim of privilege will not negatively affect their claim to credit for cooperation. However . . . if a party seeks cooperation credit for timely disclosure of relevant facts, the party must disclose all such facts within the party’s knowledge.”<sup>47</sup>*

Deciding to share privileged materials with the SEC is a significant decision with serious potential consequences. Voluntary disclosure to an independent third party that lacks a common legal interest generally waives the attorney-client privilege,

even if the third party agrees not to disclose the communications to anyone else.<sup>48</sup> Most courts have held that a company's disclosure of privileged materials to the SEC waives the attorney-client privilege.<sup>49</sup> And if the attorney-client privilege is waived to the SEC, that waiver would generally include a waiver as to other third parties, including potential civil litigants or the Department of Justice (DOJ). A waiver with respect to specific documents or information would also likely extend to all other communications related to the same subject matter as the disclosed communications.<sup>50</sup>

Similarly, disclosure of materials protected by work-product protections to the SEC likely would also constitute a waiver of that protection.<sup>51</sup> Attorney work-product protections are waived when otherwise protected documents are either made available to an adversary, or to a third party that could serve as a conduit to an adversary.<sup>52</sup> However, if a court found that work-product protections were waived, it would likely limit the waiver to the specific documents disclosed and not a broader waiver of all work-product related to that subject matter.<sup>53</sup>

### ***Keeping a Company's Independent Auditors Informed***

Appropriately informing a company's independent auditors of the investigation, its progress, and key facts is one of the most important action items for a company in an SEC investigation. When the SEC is investigating, keeping the company's independent auditors in the dark is almost never advisable. In an SEC accounting investigation, the independent auditors will be concerned about a number of issues, including the accuracy of the company's financial statements (and whether a restatement may be necessary), whether they can continue to rely on representations received from management, and whether their prior audits may become a subject of the investigation. Indeed, to the extent the SEC's investigation is accounting related, the independent auditors likely will receive a request for documents and possibly investigative testimony. Keeping the auditors informed and up-to-date will help facilitate the investigation and ensure, to the extent practicable, that the company is able to continue to issue audited financial statements.

Working with the auditors, however, raises privilege and work-product questions that require a careful balancing of the need to keep the auditors informed while maintaining a company's privileges. Just as with disclosure to the SEC, courts have typically held that disclosure of attorney-client privileged information by a company to its independent auditors constitutes waiver of the privilege.<sup>54</sup> However, courts have generally held that sharing work-product with auditors does not waive work-product protections because the auditors are neither the company's adversaries nor a conduit to the company's adversaries.<sup>55</sup>

To the extent a company is also conducting an internal investigation, auditors often make substantive suggestions regarding the scope of document collection, search terms, investigative interviews, and fact-finding. In an investigation, independent auditors may also request:

- Details of the document collection and data processing
- Search terms for identifying relevant documents
- Interview lists
- Key documents
- Detailed briefing on facts from the document review and investigative interviews a company has conducted
- In certain cases, to conduct their own interviews

A company can minimize the risk of delay in the investigation by finding a way to provide such information to the company's independent auditors to ensure their comfort with the investigation process, while being mindful of the privilege and work-product risks.

### ***Considering the Impact of Parallel Civil Litigation and Other Government Investigations***

Decisions about sharing privileged information or work-product should take into account the risk of parallel litigation and other regulatory investigations. When disclosure of an investigation, or the conduct that triggered the investigation (e.g., a financial restatement), causes a stock drop, shareholder class action litigation will almost surely follow. Such cases can generate significant potential damages. Less serious, but even more common, are shareholder derivative suits. These suits, purportedly

brought in the name of the corporation, do not require any stock drop. Instead, the plaintiffs' lawyers contend a company should sue its own officers or directors for causing the alleged misconduct that triggered an SEC investigation. In addition, other regulators of the company may also launch investigations into the same conduct.

A company must be aware that waivers of privilege and work-product protections in one context are generally waivers as to all contexts. It is important to make strategic decisions with that risk in mind. What may help in one forum can have serious adverse consequences in another. For example, detailed written presentations or PowerPoint slides provided to the SEC on the facts of a case may win SEC cooperation credit and could shorten the time of the SEC investigation. But the same presentation — if produced in collateral civil litigation — could provide plaintiffs' lawyers with a road map to the worst facts and raise the settlement value of the civil litigation. A company weighing privilege waivers must assess the risks and benefits across the spectrum of actual and potential related matters.

## **Remediation**

When a company learns of potentially problematic conduct, the company should take immediate steps to ensure that no improper or illegal conduct is ongoing and to remedy any mistakes in financial statements. The SEC considers appropriate remediation to be a key element of cooperation, and prompt and meaningful remediation can impact both whether there is an enforcement action and the scope of the sanctions. Any remediation plan should be robust and demonstrate to the SEC the company's desire to fix any problems that occurred.<sup>56</sup>

Remediation can include personnel actions, and often does if there has been some wrongdoing. Remediation may also include management's assessment of any internal control deficiencies, and management's and the board's plans to remedy any deficiencies to prevent the issues from repeating.

In the event of a financial restatement, remediation may also require a company to consider the need to "claw back" certain executive compensation, even if an executive was not involved in misconduct. The SEC may pursue clawbacks under either Section 304 of the Sarbanes-Oxley Act or Section 954 of Dodd-Frank. Section 304 empowers the SEC to recover certain restatement-related compensation and stock profits from CEOs and CFOs of public companies in the event that misconduct caused the restatement. In *SEC v. Jensen*, a unanimous Ninth Circuit panel held that Section 304 allows the SEC to seek a clawback "regardless of whether a restatement was caused by the personal misconduct of an issuer's CEO or CFO or by other issuer misconduct."<sup>57</sup> In other words, the SEC may pursue executive compensation clawback even if the executive had no role in causing the need for a restatement. Section 954 of Dodd-Frank also addresses clawbacks in the event of a restatement. Section 954 applies to all current and former "executive officers" — not just the CEO and CFO — and puts the onus on a company to claw back incentive-based compensation in excess of what an executive officer would have received with accurate financials. In addition, while Section 304 is limited to restatements caused by misconduct, Section 954 contains no such limitation. The SEC has not yet promulgated the rules to implement Section 954 of Dodd-Frank.<sup>58</sup>

# Resolving the Investigation

## **General**

Favorable resolutions come in many forms. Closing an investigation quickly without any charges, and with minimal disruption to a company's business, is the most desirable outcome — and that does occur. Even if an investigation is extended, an SEC staff decision to close the investigation without action is still a good outcome. If, following an investigation and Wells process, the Enforcement staff is determined to move forward with an enforcement recommendation, a company can still negotiate the violations charged and the relief obtained in a way that may be more favorable than a litigated outcome.

## **Timing**

Defending and cooperating with an SEC investigation is costly, and leaving an investigation unresolved prolongs uncertainty in the capital markets, — which is especially costly for a company that issues securities. A lengthy investigation can also cause broader reputational harm. If a company believes that a response to a Wells notice will not be persuasive or that an

enforcement action is inevitable, the company should consider an attempt to resolve the SEC matter as quickly as possible, assuming a reasonable settlement can be reached. Even if a company seeks to settle, the staff might refuse to enter into serious settlement negotiations prior to investigating the conduct of senior officers or potentially implicated board members, because determining the level of individuals' culpability may impact the level of a company's culpability.

### ***The Wells Process and Settlement Negotiations***

The process by which the Enforcement staff ends an investigation is a flexible one. In theory, in a case that lends itself to enforcement action, the staff continues to investigate and analyze the issues until it tentatively concludes that the staff will recommend to the Commission that it take enforcement action against a particular party. At that point, the staff makes a Wells call — formal notice of the staff's intended recommendation — and provides the party with an opportunity to respond in writing.<sup>59</sup> After receiving a Wells call, counsel typically meets with the Enforcement staff to learn the the staff's position and the possible enforcement recommendation. At this point, a company is entitled to make a Wells submission to the SEC, stating its position and presenting arguments why the Commissioners should reject the staff's recommendation for enforcement.<sup>60</sup> Indeed, the Wells submission is generally a company's only opportunity to make a direct approach to the Commission. The Wells notice does not necessarily indicate that charges will be filed; as one court has noted, "[t]he Wells process was implemented so that the Commission would have the opportunity to hear a defendant's arguments before deciding whether to go forward with enforcement proceedings."<sup>61</sup>

Informally, however, a party that thinks the Enforcement staff does not fully appreciate the strength of its position, or a party that believes that a Wells call is inevitable but settlement is possible, need not, and generally should not, wait for a Wells call before contacting the staff to discuss the relative strengths of their positions and about settlement. And in many cases, the staff may make inquiries regarding the possibility of settlement before making a formal Wells call.

If the staff proceeds with recommending an enforcement action after the Wells notice and a company's Wells submission, the staff submits a memorandum to the Commission setting forth its recommendation along with the Wells submission. The Commission then decides whether to institute an enforcement action based on this recommendation.

### ***Settlement vs. Litigation***

Public companies often opt to settle rather than litigate SEC cases involving allegations that the company misstated their financial condition for a number of reasons beyond the costs of litigation, including:

- Adverse findings in litigated proceedings are generally binding in private shareholder litigation.
- The SEC permits parties to settle without admitting the Commission's allegations or findings of wrongdoing (so long as the parties also do not deny the allegations or findings), although, as discussed below, in some instances the SEC may insist on an admission.
- Settling parties can often influence the way the SEC describes the alleged misconduct. In cases of good cooperation and remediation, settling parties can sometimes arrange for positive mention in the Commission's public releases of a company's cooperation with the SEC's investigation and of remedial measures a company has undertaken.

By contrast, individuals tend to have a different calculus and litigate more frequently against the SEC.

### ***Types of Enforcement Actions***

The Commission is authorized to bring two basic types of enforcement actions:

- Civil injunctive actions in federal district court
- Administrative proceedings before the SEC's own administrative law judges

## ***Civil Injunctive Action***

When filing an enforcement action in federal district court, the SEC will generally seek civil monetary penalties, an injunction against future violations of the federal securities laws, and other equitable remedies. A case begins with the SEC filing a complaint, which sets forth the SEC's allegations. In a settled enforcement action, along with a complaint, parties will also file the defendant's consent to the entry of the final judgment (including any sanctions and undertakings), and the final judgment to be approved by a judge. The final judgment will permanently enjoin the defendant from future violations and impose the agreed-upon sanctions. In a settled action, there are no findings of fact or conclusions of law in the final judgment. If a defendant chooses to litigate with the SEC, the defendant will submit an answer to the complaint and the case will proceed in litigation.

## ***Administrative Proceeding***

Instead of filing an action in federal district court, the Commission may decide to bring an administrative proceeding — a decision that is within the SEC's discretion. A settled administrative proceeding is typically resolved by the entry of a cease and desist order— similar to a federal court injunction — requiring a respondent to cease and desist from violations of the federal securities laws. A settled order will also include the Commission's findings of fact, conclusions of law, and sanctions imposed.

The SEC has increasingly turned to its administrative proceedings in litigated matters.<sup>62</sup> These in-house tribunals, which SEC-employed administrative law judges preside over, operate faster and with less discovery than a federal court proceeding. The use of administrative proceedings has garnered both widespread publicity and constitutional challenges.<sup>63</sup> On July 13, 2016, the SEC announced that it had adopted amendments updating its rules of practice governing its administrative proceedings. Among other changes, the updated rules provide for additional opportunities for conducting depositions and add flexibility to the timeline for certain administrative proceedings.<sup>64</sup> These amendments address some, but not all, of the concerns that have been raised and, during the 2017 Term, the Supreme Court of the US will review whether Commission judges were selected in violation of the US Constitution, with a decision expected by the end of June 2018.<sup>65</sup>

## ***Parallel Criminal Investigations***

The SEC does not have the authority to bring criminal actions. However, the SEC can refer a matter to the DOJ for criminal prosecution, and parallel civil and criminal investigations are common — particularly if they implicate the anti-fraud statutes or the US Foreign Corrupt Practices Act. Additionally, information that a company produced to the SEC can (and will) be shared with the DOJ. Therefore, a company should be mindful of that fact and factor the possibility of a criminal investigation into the myriad strategic decisions it must make during an SEC investigation.

## ***Monetary Sanctions***

Over the past 15 years, the SEC has increasingly sought significant monetary sanctions. In 2013, for example, then-Chair Mary Jo White stated that the SEC “must make aggressive use of our existing penalty authority, recognizing that meaningful monetary penalties — whether against companies or individuals — play a very important role in a strong enforcement program.”<sup>66</sup> Although monetary sanctions are often discussed in terms of aggregate amounts, they are composed of three distinct segments: civil penalties, disgorgement, and prejudgment interest. The component parts proposed by the staff will affect counsel's ability to negotiate the aggregate sanction.

### **Civil Penalties**

The SEC has the authority and discretion to tailor remedies to the seriousness of the violations. A three-tier structure of increasing gravity governs the size of civil monetary penalties that a court may impose for non-insider trading violations. The tier structure penalties are as follows:

- First Tier penalties are assigned to any violations
- Second Tier penalties are reserved for violations involving “fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement”

- Third Tier penalties are reserved for violations involving “fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement” and that “directly or indirectly resulted in substantial losses or created a significant risk of substantial losses to other persons or resulted in substantial pecuniary gain” to the violator<sup>67</sup>

Generally, the securities laws set forth two alternative methods for calculating the maximum penalty. The first method, which is applicable in both administrative and civil actions, permits a “per violation” calculation, the amount of which increases by tier based on the seriousness of the violation. The second method, which is applicable only in civil actions, allows for the imposition of a penalty equal to the “gross amount of pecuniary gain” to the defendant as a result of the violation(s). The chart below outlines the maximum penalties under each tier in each type of action, as of January 2018.

<b>Maximum Penalties Under the Securities Act of 1933/Securities Exchange Act of 1934<sup>68</sup> (All values in US\$)</b>			
		<b>Administrative Action</b>	<b>Civil Action</b>
<b>First Tier</b>	<i>Person</i>	\$8,458 per violation	Greater of (i) \$9,239 per violation or (ii) gross amount of pecuniary gain to person
	<i>Entity</i>	\$84,585 per violation	Greater of (i) \$92,383 per violation or (ii) gross amount of pecuniary gain to entity
<b>Second Tier</b>	<i>Person</i>	\$84,585 per violation	Greater of (i) \$92,383 per violation or (ii) gross amount of pecuniary gain to person
	<i>Entity</i>	\$422,925 per violation	Greater of (i) \$461,916 per violation or (ii) gross amount of pecuniary gain to entity
<b>Third Tier</b>	<i>Person</i>	\$169,171 per violation	Greater of (i) \$184,767 per violation or (ii) gross amount of pecuniary gain to person
	<i>Entity</i>	\$817,654 per violation	Greater of (i) \$923,831 per violation or (ii) gross amount of pecuniary gain to entity

The penalty amounts available still permit the SEC significant flexibility in tailoring a sanction. First, the SEC can usually find as many violations as it needs to — for example, the SEC can charge each allegedly misstated entry in the books and records of a company as a separate violation. Second, if there is a sufficiently large pecuniary gain, the per violation amounts become irrelevant in civil actions. The statutes are not particularly limiting in practice, and the SEC is often subject to public clamor and pressure to impose high penalties for violations of federal securities laws.

### **Disgorgement and Prejudgment Interest**

The Commission routinely seeks disgorgement of ill-gotten gains plus prejudgment interest from the date of the violation. The case law on disgorgement generally states that disgorgement need only be a reasonable approximation of a defendant’s ill-gotten gains, and that once the SEC makes a prima facie showing that the proposed amount is such an approximation, a defendant bears the burden of demonstrating that the amount is not appropriate.<sup>69</sup> In cases involving false financial statements or false SEC filings, courts have ordered defendants to disgorge any profits resulting from the inadequacy of disclosures made.<sup>70</sup> Such a measure is necessarily complicated, and rebutting the SEC’s assertion may require the engagement of forensic experts.<sup>71</sup>

Courts may award prejudgment interest on disgorgement on a discretionary basis. The time frame for imposing prejudgment interest usually begins with the date of the unlawful gain and ends at the entry of judgment.<sup>72</sup> Prejudgment interest may significantly increase the amount the SEC recovers, particularly because there may be years between the time that the conduct occurred that gave rise to the alleged violation of the securities laws and the time a court enters a judgment.

## Potential Admissions Required for a Settlement

Historically, in SEC settlements, parties would neither admit nor deny the Commission's allegations, findings, or conclusions. In recent years, however, the SEC has twice amended its longstanding policy permitting a company to settle without admitting or denying the allegations in the complaint.

First, in early 2012, the SEC announced that it would eliminate the "neither admit nor deny" language in cases where there had already been admissions or adjudications of fact in criminal cases.<sup>73</sup> Thus, in cases involving a parallel criminal conviction, or a non-prosecution or deferred-prosecution agreement including admissions or acknowledgement of criminal conduct, the SEC will delete the standard neither admit nor deny language from the settlement documents, and recite the fact and nature of the criminal conviction or non-prosecution or deferred prosecution agreement in the settlement documents. This policy change would not require admissions beyond those already included in the criminal proceedings, and thus should not have independent effect in other litigation.

Second, in late June 2013, then-Chair White announced that the SEC would change its longstanding policy permitting a company to settle without admitting or denying wrongdoing and adopt a new policy requiring admissions that would apply in cases of egregious conduct or widespread investor harm.<sup>74</sup> An internal memo from the co-heads of the Enforcement Division to the staff cited three criteria for determining whether admissions may be necessary:

- "Misconduct that harmed large numbers of investors or placed investors or the market at risk of potentially serious harm"
- "Egregious intentional misconduct"
- "When the defendant engaged in unlawful obstruction of the commission's investigative processes"<sup>75</sup>

The memo acknowledged that "most" cases would continue to be settled without requiring admissions, but advised that in certain cases "heightened accountability or acceptance of responsibility through the defendant's admission of misconduct may be appropriate, even if it does not allow us to achieve a prompt resolution."<sup>76</sup> At this writing, the SEC has since required admissions in more than 20 cases.<sup>77</sup>

## Collateral Consequences of an SEC Settlement

SEC resolutions can trigger a variety of collateral consequences. Each case is unique and the nature and extent of any collateral consequences will depend on the particular facts and resolution. Some of the potential collateral consequences public companies may face are set forth below.

### Impact on Other Litigation

As noted above, historically, public companies settling with the SEC were able to resolve matters without admitting or denying the Commission's allegations, findings, or conclusions. In addition, in a settled enforcement action, there is no adjudication on the merits of the Commission's allegations. Accordingly, SEC settlements without any admission have no preclusive effect — meaning the fact of a settlement does not preclude litigating the underlying facts in another proceeding like a securities class action.<sup>78</sup> Some recent cases, however, have explored whether any part of the settlement is admissible in subsequent litigation.<sup>79</sup> To the extent a company is required to make an admission to settle with the SEC, however, that admission would be admissible and could have preclusive effect in other litigation. This means that the company would be unable to argue a contrary position, thereby impacting the ability to prevail and the settlement value of any other litigation.

SEC resolutions can trigger a variety of collateral consequences. Each case is unique and the nature and extent of any collateral consequences will depend on the particular facts and resolution.



## ***Public Company Disclosure Obligations***

The disclosures a settlement requires will turn in part on the violations charged. The resolution itself is public, but the entry of an injunction or administrative order against a public company may trigger other disclosure obligations within the company's SEC filings, particularly under Regulation S-K. In any event, a company should carefully consider the appropriate and accurate public disclosure of the settlement.

## ***Ineligibility to File Automatic Shelf Registration Statements***

A company that is a Well-Known Seasoned Issuer ("WKSI") has the ability to file shelf registration statements that are automatically and immediately effective without staff review.<sup>80</sup> Under Rule 405 of the Securities Act, a WKSI cannot be an "ineligible issuer." An ineligible issuer includes an issuer who has (or whose subsidiaries have) within the three years prior to the applicable determination date been the subject of a judicial or administrative decree or order (including a settled claim or order) involving allegations or violations of, or prohibiting future violations of, the anti-fraud provisions of the federal securities laws.<sup>81</sup>

An issuer can apply for an exemption from ineligible issuer status by obtaining a waiver "upon a showing of good cause, that it is not necessary under the circumstances that the issuer be considered an ineligible issuer."<sup>82</sup> As with Regulation D waivers, the Commission has delegated authority to grant such waivers to the Division of Corporation Finance.<sup>83</sup> In deciding whether to grant a waiver, which may include conditions or undertakings, the Division of Corporation Finance considers, among other factors, who at the issuer was responsible for the misconduct, the remediation the issuer implemented, and the impact of denying a waiver.<sup>84</sup> The burden of showing good cause is much increased as of late, particularly if the underlying conduct includes a scienter violation.<sup>85</sup>

## ***Disqualification From Certain Offerings***

Rule 506 of Regulation D permits a company to raise an unlimited amount of capital if the company sells the securities only to accredited investors and 35 additional purchasers who qualify as sophisticated investors.<sup>86</sup> Dodd-Frank required the Commission to adopt disqualification regulations applicable to offerings and sales of securities under Rule 506.<sup>87</sup> Under the rule, an issuer cannot rely on Rule 506 if certain individuals or entities (including directors and officers who participate in the offering) have been subject to a disqualifying event such as SEC enforcement orders or court judgments.

A company may apply to obtain an exemption from this disqualification. Regulation D allows issuers to be exempted from the disqualification if the regulatory order giving rise to the disqualification states in writing that the disqualification "should not arise."<sup>88</sup> In other words, a company can attempt to seek a statement from the Commission that the disqualification need never take effect. In addition, issuers may seek a waiver "upon a showing of good cause . . . that it is not necessary under the circumstances that the exemption be denied."<sup>89</sup> A company must make the request by applying to the Division of Corporation Finance.<sup>90</sup> Granting these waivers has been a point of contention both within the SEC and among legislators, and the Commission can make the waivers conditional.<sup>91</sup> The Commission routinely grants waivers to issuers if the Commission determines that denying the exemption is unnecessary.<sup>92</sup>

## ***Loss of Safe Harbor for Forward Looking Statements***

Section 27A of the Securities Act and Section 21E of the Exchange Act provide issuers with safe harbors from private actions alleging that certain forward-looking statements were materially untrue or incomplete.<sup>93</sup> An issuer who — in the three years prior to the forward-looking statement — was "the subject of a judicial or administrative decree or order arising out of a government action that . . . prohibits future violations of the anti-fraud provisions of the securities laws . . . [or] determines that the issuer violated the anti-fraud provisions of the securities laws" cannot take advantage of the safe harbor provisions.<sup>94</sup> However, a disqualified issuer may apply to the Commission for exemption.<sup>95</sup>

# Conclusion

SEC investigations can be complex, costly, and time-consuming. But understanding the process and pitfalls can help public company executives and in-house counsel navigate the process, while avoiding unnecessary distraction from business operations. Understanding the process, risks, and strategic issues a company will face can help avoid missteps and move the investigation toward resolution as quickly as possible with the least disruption to the company, its executives, and employees.

## Endnotes

- <sup>1</sup> SEC Press Release, *SEC Announces Enforcement Initiatives to Combat Financial Reporting and Microcap Fraud and Enhance Risk Analysis* (July 2, 2013), <http://www.sec.gov/News/PressRelease/Detail/PressRelease/1365171624975>.
- <sup>2</sup> Andrew Ceresney, Director, Division of Enforcement, US Securities & Exchange Commission, Directors Forum 2016 Keynote Address. <https://www.sec.gov/news/speech/directors-forum-keynote-ceresney.html>.
- <sup>3</sup> Dodd-Frank added two key provisions to the Exchange Act. The new Section 21F of the Exchange Act establishes a whistleblower program that offers financial incentives for a person to voluntarily provide non-public information to the Commission, which results in an enforcement action. Specifically, any resulting enforcement action that results in monetary sanctions in excess of US\$1 million entitles the whistleblower to an award of between 10-30% of the aggregate monies received by any US regulator. In addition, Section 21F establishes an anti-retaliation provision, which establishes a private cause of action for a whistleblower to sue his or her employer in federal court for any form of harassment caused by the employee's whistleblowing activity. The Commission itself can also take legal action against retaliating employers. By the end of Fiscal Year 2016, the SEC had paid more than US\$111 million to 34 whistleblowers since whistleblower rules went into effect in August 2011, with more than US\$57 million paid in FY 2016 alone. See SEC, 2016 Annual Report to Congress on Dodd-Frank Whistleblower Program 10 (2016), <https://www.sec.gov/whistleblower/reportspubs/annual-reports/owb-annual-report-2016.pdf>. In 2016, the Commission also brought charges under Rule 21F-17(a) against multiple companies for including language in confidentiality agreements that impeded whistleblowers from reporting to the Commission. For example, in *BlueLinx Holdings, Inc.*, the SEC asserted that separation agreement clauses that required employees to waive the right to any monetary recovery in connection with any legal complaint "raised impediments to participation by its employees in the SEC's whistleblower program." The company paid US\$265,000 in penalties and was required to modify its separation agreements so as to not restrict whistleblower incentives. See *BlueLinx Holdings, Inc.*, Exchange Act Release No. 78528 (Aug. 10, 2016), <https://www.sec.gov/litigation/admin/2016/34-78528.pdf>. Accordingly, public companies should be careful to ensure that separation agreements comply with Dodd-Frank so as not to create potential problems with the SEC.
- <sup>4</sup> SEC, 2017 Annual Report to Congress on Dodd-Frank Whistleblower Program 1 (2017), <https://www.sec.gov/files/sec-2017-annual-report-whistleblower-program.pdf>; SEC, 2016 Annual Report to Congress on Dodd-Frank Whistleblower Program 10 (2016), <https://www.sec.gov/whistleblower/reportspubs/annual-reports/owb-annual-report-2016.pdf>.
- <sup>5</sup> *BlueLinx Holdings, Inc.*, Exchange Act Release No. 78528 (Aug. 10, 2016), <https://www.sec.gov/litigation/admin/2016/34-78528.pdf>.
- <sup>6</sup> The *Enforcement Manual* is available at <https://www.sec.gov/divisions/enforce/enforcementmanual.pdf>.
- <sup>7</sup> The *Enforcement Manual* states that MUIs should generally be closed or converted into a formal investigation within 60 days. See *Enforcement Manual* § 2.3.1.
- <sup>8</sup> Section 21(b) of the Exchange Act (and similar provisions in other federal securities statutes) authorizes the SEC to conduct investigations of possible violations of the federal securities laws. The Commission issues formal orders of investigation that authorize specific enforcement staff to exercise the Commission's authority to subpoena documents and witnesses. Prior to 2009, a formal order of investigation had to be authorized by the Commission itself. In 2009, the SEC's Rules of Practice were amended to delegate authority to the Director of the Division of Enforcement. See Exchange Act Release No. 60448 (Aug. 11, 2009), <https://www.sec.gov/rules/final/2009/34-60448.pdf>; Exchange Act Release 62690 (Aug. 16, 2010), <https://www.sec.gov/rules/final/2010/34-62690.pdf>.
- <sup>9</sup> For instance, if the recipient of an SEC subpoena refuses to comply, the staff is required to file an action in federal district court to enforce compliance. See Section 21(c) of the Exchange Act. 15 U.S.C. § 78u(c).
- <sup>10</sup> Securities Exchange Act of 1934, Pub. L. 73-291, 48 Stat. 881, 15 U.S.C. § 78a et seq.; SEC Rule 10b-5, 17 C.F.R. § 240.10b-5.
- <sup>11</sup> Securities Act of 1933, 48 Stat. 74, 15 U.S.C. § 77a et seq.
- <sup>12</sup> There are other antifraud provisions in the federal securities laws. See, e.g., 15 U.S.C. § 78o(c) (fraud by registered broker dealers); 15 U.S.C. § 80b-6 (Investment Advisers Act prohibited transactions). However, they are less relevant to public companies and public company financial statements.
- <sup>13</sup> *Aaron v. SEC*, 446 U.S. 680, 691, 695, 697 (1980).
- <sup>14</sup> See, e.g., *SEC v. Platforms Wireless Int'l Corp.*, 617 F.3d 1072, 1092 (9th Cir. 2010); *SEC v. Fife*, 311 F.3d 1, 9-10 (1st Cir. 2002); *SEC v. Infinity Grp. Co.*, 212 F.3d 180, 192 (3d Cir. 2000); *Sundstrand Corp. v. Sun Chem. Corp.*, 553 F.2d 1033, 1044 (7th Cir. 1977). Although the Supreme Court has "previously reserved the question whether reckless behavior is sufficient for civil liability under § 10(b) and Rule

10b-5,” it has noted that “[e]very Court of Appeals that has considered the issue has held that a plaintiff may meet the scienter requirement by showing that the defendant acted intentionally or recklessly, though the Circuits differ on the degree of recklessness required.” *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 319 n.3 (2007).

<sup>15</sup> *Aaron*, 446 U.S. at 697.

<sup>16</sup> 15 U.S.C. § 77q(a).

<sup>17</sup> 15 U.S.C. § 78m(a); 17 C.F.R. §§ 240.13a-1, 240.13a-13.

<sup>18</sup> See, e.g., *McConville v. SEC*, 465 F.3d 780, 787–88 (7th Cir. 2006); *Ponce v. SEC*, 345 F.3d 722, 735–36 (9th Cir. 2003).

<sup>19</sup> *SEC v. McNulty*, 137 F.3d 732, 740–41 (2d Cir. 1998); *SEC v. Wills*, 472 F. Supp. 1250, 1268 (D.D.C. 1978).

<sup>20</sup> See, e.g., *Ponce*, 354 F.3d at 734–37; *SEC v. Koenig*, 469 F.2d 198, 200 (2d Cir. 1972).

<sup>21</sup> 15 U.S.C. § 78m(b)(2)(A).

<sup>22</sup> 15 U.S.C. § 78m(b)(7).

<sup>23</sup> 15 U.S.C. § 78m(b)(2)(B).

<sup>24</sup> See *McNulty*, 137 F.3d at 740–41; *SEC v. World-Wide Coin Invs., Ltd.*, 567 F. Supp. 724, 749 (N.D. Ga. 1983).

<sup>25</sup> In 2016, a federal district court in the Southern District of New York dismissed a shareholder suit alleging that defendants had violated securities laws by failing to disclose receipt of a Wells notice. *In re Lions Gate Entm’t Corp. Sec. Litig.*, 165 F. Supp. 3d 1 (S.D.N.Y. 2016). Among other conclusions, the court held that that receipt of a Wells notice, without additional factors, does not trigger a duty to disclose under Section 10(b) of the Exchange Act and Rule 10b-5 because the Commission may ultimately choose not to initiate an action against the investigation target and so the Wells notice itself is not an indication that material litigation is substantially likely to occur. *Id.* at 12–13. The court found further that the fact of the investigation was not *per se* material and that the plaintiffs had failed to allege how knowledge of a preliminary SEC investigation for which there was no settlement in place at the time of the Class Period would have significantly altered the total mix of information available to an investor. *Id.* at 14.

<sup>26</sup> 17 C.F.R. § 229.103.

<sup>27</sup> 17 C.F.R. § 229.303.

<sup>28</sup> 17 C.F.R. § 229.401(f).

<sup>29</sup> 17 C.F.R. § 229.503(c).

<sup>30</sup> See Accounting Standards Codification Topic 450, *Contingencies* (ASC 450) (originally Statement of Financial Accounting Standards No. 5, *Accounting for Contingencies* (FAS No. 5)).

<sup>31</sup> See 18 U.S.C. § 1350; 17 C.F.R. §§ 240.13a-14, 15d-14.

<sup>32</sup> Regulation FD sets forth the SEC rules governing selective disclosure by companies of material nonpublic information. The SEC adopted Regulation FD to prevent material nonpublic information from being given selectively to market professionals such as broker-dealers, investment advisers and managers, and investment companies, who could use such information to their own or their clients’ advantage. Regulation FD applies to communications on behalf of the issuer with market professionals and with security holders who may foreseeably trade on the basis of the disclosed information. See 17 C.F.R. pt. 243.

<sup>33</sup> See 18 U.S.C. § 1519, *Destruction, alteration, or falsification of records in Federal investigations and bankruptcy*; 18 U.S.C. § 1520, *Destruction of corporate audit records*.

<sup>34</sup> See *Enforcement Manual* § 3.2.3.

<sup>35</sup> Courts have upheld the SEC’s authority, as well as the authority of other agencies operating under similar statutes, to seek documents located abroad through administrative subpoenas that are served in the United States. See, e.g., *Civil Aero. Bd. v. Deutsche Lufthansa Aktiengesellschaft*, 591 F.2d 951, 952–53 (D.C. Cir. 1979); *SEC v. Minas de Artemisa, S.A.*, 150 F.2d 215, 218 (9th Cir. 1945).

<sup>36</sup> *Enforcement Manual* § 4.3.1.

<sup>37</sup> See *Upjohn Co. v. United States*, 449 U.S. 383 (1981). An *Upjohn* instruction should make clear to the witness that counsel represents the company and not the employee individually; conversations with the employee may be protected by the attorney-client privilege if counsel seeks information to provide legal advice to the company; the privilege, however, belongs to the company exclusively; and the company may decide to waive the privilege and disclose the communications with the employee to third parties, including the government.

<sup>38</sup> See, e.g., Robert S. Khuzami, Director, Division of Enforcement, Remarks to Criminal Law Group of the UJA-Federation of New York, (June 1, 2011), <https://www.sec.gov/news/speech/2011/spch060111rk.htm>.

<sup>39</sup> *Enforcement Manual* § 4.1.3.

<sup>40</sup> *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*, Exchange Act Release No. 44969, (Oct. 23, 2001) <http://www.sec.gov/litigation/investreport/34-44969.htm> (hereinafter *Seaboard Report*).

<sup>41</sup> <https://www.sec.gov/spotlight/enforcement-cooperation-initiative.shtml>.

<sup>42</sup> *Seaboard Report*.

<sup>43</sup> *Id.*

- <sup>44</sup> The Commission's statement announcing the initiative identified four general considerations to use in assessing cooperation by individuals: (i) the assistance provided by the cooperator; (ii) the importance of the underlying matter; (iii) societal interest in holding the individual accountable for his or her misconduct; and (iv) the appropriateness of cooperation based on the risk profile of the individual. See SEC Press Release, *SEC Announces Initiative to Encourage Individuals and Companies to Cooperate and Assist in Investigations* (Jan. 13, 2010), <https://www.sec.gov/news/press/2010/2010-6.htm>; see also Robert S. Khuzami, Director, Division of Enforcement, Remarks Before the New York City Bar: My First 100 Days as Director of Enforcement (Aug. 5, 2009), <https://www.sec.gov/news/speech/2009/spch080509rk.htm>.
- <sup>45</sup> *Enforcement Manual* § 6.2.
- <sup>46</sup> *Enforcement Manual* § 2.4. The other two factors for the staff to consider are "whether access to portions of the file would be a productive way for both the staff and the recipient of the Wells notice to assess the strength of the evidence that forms the basis for the staff's recommendations" and "the stage of the investigation with regard to other persons or witnesses, including whether certain witnesses have yet to provide testimony."
- <sup>47</sup> *Enforcement Manual* § 4.3.
- <sup>48</sup> *Westinghouse Elec. Corp. v. Republic of Phil.*, 951 F.2d 1414, 1427 (3d Cir. 1991).
- <sup>49</sup> Although recognized by the Eighth Circuit, the First, Third, Fourth, Sixth, Ninth, Tenth, D.C., and Federal Circuits have rejected the selective waiver doctrine. See *In re Pac. Pictures Corp.*, 679 F.3d 1121, 1129 (9th Cir. 2012); *In re Qwest Commc'ns Int'l, Inc.*, 450 F.3d 1179, 1197 (10th Cir. 2006); *Burden-Meeks v. Welch*, 319 F.3d 897, 899 (7th Cir. 2003); *In re Columbia/HCA Healthcare Corp. Billing Practices Litig.*, 293 F.3d 289, 295 (6th Cir. 2002); *United States v. Mass. Inst. of Tech.*, 129 F.3d 681, 686 (1st Cir. 1997); *Genentech, Inc. v. United States Int'l Trade Comm'n*, 122 F.3d 1409, 1416–18 (Fed. Cir. 1997); *Westinghouse Elec. Corp.*, 951 F.2d at 1425; *In re Martin Marietta Corp.*, 856 F.2d 619, 623–24 (4th Cir. 1988); *Permian Corp. v. United States*, 665 F.2d 1214, 1221 (D.C. Cir. 1981); *Diversified Indus., Inc. v. Meredith*, 572 F.2d 596 (8th Cir. 1978) (en banc). The Second Circuit does not have a *per se* rule rejecting selective waiver, but has recognized it only in limited cases. See *In re Steinhardt Partners, L.P.*, 9 F.3d 230, 235–36 (2d Cir. 1993).
- <sup>50</sup> See, e.g., *SEC v. Microtune, Inc.*, 258 F.R.D. 310, 317 (N.D. Tex. 2009) ("When a party waives the attorney-client privilege, it waives the privilege as to all communications that pertain to the same subject matter of the waived communication."); see also *Nguyen v. Excel Corp.*, 197 F.3d 200, 208 (5th Cir. 1999) ("[D]isclosure of any significant portion of a confidential communication waives the privilege as to the whole.").
- <sup>51</sup> See, e.g., *In re Initial Pub. Offering Sec. Litig.*, 249 F.R.D. 457, 466 (S.D.N.Y. 2008) (finding work-product protection was waived when defendant provided materials to the SEC in response to an SEC inquiry); *SEC v. Brady*, 238 F.R.D. 429, 444 (N.D. Tex. 2006) (finding waiver of work-product protections where defendant disclosed privileged information and documents to the SEC, under a confidentiality agreement, in response to an informal SEC investigation).
- <sup>52</sup> Disclosure of materials protected by work-product does not automatically waive work-product protections. Instead, waiver occurs when the documents are either made available to an adversary or to a third party that could serve as a conduit to an adversary. Put differently, waiver results if the work-product is treated in a manner that substantially increases the likelihood that an adversary will come into possession of the material. See *Mass. Inst. of Tech.*, 129 F.3d at 687 (stating that "work product protection is provided against 'adversaries,' so only disclosing material in a way inconsistent with keeping it from an adversary waives work product protection").
- <sup>53</sup> See, e.g., *Brady*, 238 F.R.D. at 444–45 (finding that the disclosure of work-product to the SEC did "not amount to full subject matter waiver").
- <sup>54</sup> See, e.g., *United States v. Deloitte LLP*, 610 F.3d 129, 139–40 (D.C. Cir. 2010) (although voluntary disclosure to auditors waives attorney-client privilege, it does not necessarily waive work-product protection); *Microtune*, 258 F.R.D. at 317 (disclosure to outside auditors waives attorney-client privilege); *Brady*, 238 F.R.D. at 439–40 ("disclosure of privileged information directly to a client's independent auditor . . . destroys confidentiality" and therefore constitutes a waiver).
- <sup>55</sup> See, e.g., *Deloitte LLP*, 610 F.3d at 139–40 (holding disclosure of work-product protected documents to independent auditors did not waive privilege and noting "[t]o the best of our knowledge, no circuit has addressed whether disclosing work-product to an independent auditor constitutes waiver. Among the district courts that have addressed this issue, most have found no waiver"); *Lawrence E. Jaffe Pension Plan v. Household Int'l, Inc.*, 237 F.R.D. 176, 183 (N.D. Ill. 2006) (disclosure of protected materials to auditors did not constitute waiver as "[d]isclosing documents to an auditor does not substantially increase the opportunity for potential adversaries to obtain the information"). But see *Medinol v. Bos. Sci. Corp.*, 214 F.R.D. 113, 116–17 (S.D.N.Y. 2002) (work-product protection waived by disclosure to independent auditor as auditor and company "did not share 'common interests' in litigation").
- <sup>56</sup> Taking steps to bolster controls and remedy any problems that occurred should not be viewed as an admission of liability. Although unlike the Federal Rules of Evidence, in the context of SEC investigations, there is no rule that prohibits the staff from considering the remediation when assessing whether there was misconduct, where mistakes or misconduct has occurred, it is almost always preferable to remediate promptly and comprehensively.
- <sup>57</sup> *SEC v. Jensen*, 835 F.3d 1100, 1104 (9th Cir. 2016).
- <sup>58</sup> The SEC promulgated proposed rules in July 2015. Listing Standards for Recovery of Erroneously Awarded Compensation, 80 Fed. Reg. 41,143 (July 14, 2015) (to be codified at 17 C.F.R. pts. 229, 240, 249, and 274).
- <sup>59</sup> See Procedures Relating to the Commencement of Enforcement Proceedings and Termination of Staff Investigations, Securities Act Release No. 5310, Exchange Act Release No. 9796, Investment Company Act Release No. 7390 (Sept. 27, 1972).

<sup>60</sup> See 17 C.F.R. § 202.5(c). The Rules state further that:

*Submissions by interested persons should be forwarded to the appropriate Division Director or Regional Director with a copy to the staff members conducting the investigation and should be clearly referenced to the specific investigation to which they relate. In the event a recommendation for the commencement of an enforcement proceeding is presented by the staff, any submissions by interested persons will be forwarded to the Commission in conjunction with the staff memorandum.*

*Id.*

<sup>61</sup> See *Richman v. Goldman Sachs Grp., Inc.*, 868 F. Supp. 2d 261, 272 (S.D.N.Y. 2012) (citations omitted). One interesting data point on this front is from a 2013 study of SEC data conducted by the Wall Street Journal, which found that of the 797 individuals who received Wells notices from 2010 through 2012, 159 (or nearly 20%) were not ultimately charged. Jean Eaglesham, *SEC Drops 20% of Probes after "Wells Notice,"* Wall St. J., Oct. 9, 2013.

<sup>62</sup> See Andrew Ceresney, Director, SEC Division of Enforcement, Keynote Speech at New York City Bar 4th Annual White Collar Institute (May 12, 2015), <http://www.sec.gov/news/speech/ceresney-nyc-bar-4th-white-collar-key-note.html>. In 2015, the SEC issued guidance setting forth the considerations it purports to consider in making its forum selection. The four broad factors outlined in the written guidance do not meaningfully constrain the SEC's discretion, however. See SEC Enforcement Div., *Division of Enforcement Approach to Forum Selection in Contested Actions* (May 15, 2015), <https://www.lw.com/thoughtLeadership/lw-sec-guidance-choice-of-venue>.

<sup>63</sup> See, e.g., *Chau v. SEC*, 72 F. Supp. 3d 417, 431–36 (S.D.N.Y. 2014) (addressing constitutional challenges to SEC administrative proceedings, and concluding that, despite "legitimate" concerns about "the growth of administrative adjudication," the choice between the "two tracks on which [the SEC] may litigate certain cases . . . is a matter of enforcement policy squarely within the SEC's province"); Thaya Brook Knight, *ALJs and the Home Court Advantage*, Cato Institute (May 12, 2015), <https://www.cato.org/blog/aljs-home-court-advantage>; Hon. Jed S. Rakoff, U.S. District Court for the Southern District of New York, Keynote Address at the PLI Securities Regulation Institute: *Is the SEC Becoming a Law Unto Itself?* (Nov. 5, 2014), <http://assets.law360news.com/0593000/593644/Sec.Reg.Inst.final.pdf> (observing that, with respect to administrative proceedings, "the law in such cases would effectively be made, not by neutral federal courts, but by SEC administrative judges").

<sup>64</sup> SEC Press Release, *SEC Adopts Amendments to Rules of Practice for Administrative Proceedings* (July 13, 2016), <https://www.sec.gov/news/pressrelease/2016-142.html>.

<sup>65</sup> See *Lucia v. SEC*, 868 F.3d 1021 (D.C. Cir. 2017), cert. granted, 86 U.S.L.W. 3356 (U.S. Jan. 12, 2018) (No. 17-130).

<sup>66</sup> Mary Jo White, Chair, SEC, Remarks at the Council of Institutional Investors Fall Conference in Chicago, IL: *Deploying the Full Enforcement Arsenal* (Sept. 26, 2013), <http://www.sec.gov/News/Speech/Detail/Speech/1370539841202> [hereinafter "Deploying the Full Enforcement Arsenal"]. For example, in 2002, the SEC publicized a US\$10 million civil penalty as "the largest ever levied in a Commission action against a public company for financial fraud"; today, the SEC regularly seeks monetary sanctions totaling US\$100 million or more. Compare SEC Press Release, *Xerox Settles SEC Enforcement Action Charging Company With Fraud* (Apr. 11, 2002), <https://www.sec.gov/news/headlines/xeroxsettles.htm> with NYU Pollack Center for Law & Business & Cornerstone Research, *SEC Enforcement Activity Against Public Company Defendants: Fiscal Year 2016 Update 8*, <https://www.cornerstone.com/Publications/Reports/SEC-Enforcement-Activity-Against-Public-Company-Defendants-2016.pdf>.

<sup>67</sup> 15 U.S.C. §§ 77h-1(g), 77t(d), 78u-2(b).

<sup>68</sup> See SEC, *Inflation Adjustments to the Civil Monetary Penalties Administered by the Securities and Exchange Commission* (as of January 18, 2017), <https://www.sec.gov/enforce/civil-penalties-inflation-adjustments.htm>; *Adjustments to Civil Monetary Penalty Amounts* (17 C.F.R. pt. 201), Release Nos. 33-10276; 34-79749; IA-4599; IC-32414, (Jan. 6, 2017), <https://www.sec.gov/rules/final/2017/33-10276.pdf>. By law, the maximum amount of civil monetary penalties under the Securities Act of 1933, the Securities Exchange Act of 1934, the Investment Company Act of 1940, the Investment Advisers Act of 1940, and certain penalties under the Sarbanes-Oxley Act of 2002 are periodically adjusted for inflation. The new adjustments apply to violations occurring after November 2, 2015. Violations occurring on or before November 2, 2015, would be subject to different, slightly lower penalty rates. See *Adjustments to Civil Monetary Penalty Amounts* (17 C.F.R. pt. 201), Release Nos. 33-10104; 34-78156; IA-4437; IC-32162; File No. S7-11-16, (June 27, 2016), <https://www.sec.gov/rules/interim/2016/33-10104.pdf>.

<sup>69</sup> See *SEC v. Razmilovic*, 738 F.3d 14, 31–32 (2d Cir. 2013); *SEC v. Platforms Wireless Int'l Corp.*, 617 F.3d 1072, 1096 (9th Cir. 2010); *SEC v. First City Fin. Corp.*, 890 F.2d 1215, 1230–32 (D.C. Cir. 1989).

<sup>70</sup> See, e.g., *SEC v. Sierra Brokerage Servs. Inc.*, 608 F. Supp. 2d 923, 969–70 (S.D. Ohio 2009); *SEC v. Bilzerian*, 814 F. Supp. 116, 123 (D.D.C. 1993).

<sup>71</sup> The SEC historically took the position that disgorgement was an equitable remedy not subject to the five-year statute of limitations. However, in *Kokesh v. SEC*, 137 S. Ct. 1635 (2017), the Supreme Court held that disgorgement is a "penalty" and is subject to the five-year statute of limitations in 28 U.S.C. § 2462.

<sup>72</sup> *SEC v. First Jersey Sec., Inc.*, 101 F.3d 1450, 1477 (2d Cir. 1996).

<sup>73</sup> Public Statement, Robert Khuzami, Director, SEC Division of Enforcement, *Public Statement by SEC Staff: Recent Policy Change* (Jan. 7, 2012), <http://www.sec.gov/News/PublicStmnt/Detail/PublicStmnt/1365171489600>.

<sup>74</sup> White, *Deploying the Full Enforcement Arsenal*, *supra* note 66.

- <sup>75</sup> See Kara Scannell, *SEC Considers Policy Shift on Admissions of Wrongdoing*, Fin. Times, June 18, 2013, <http://www.ft.com/content/7a93d5dc-d882-11e2-b4a4-00144feab7de.htm>.
- <sup>76</sup> Alison Frankel, *Should Defendants Fear New SEC Policy on Admissions in Settlements?*, Reuters, June 19, 2013, <http://blogs.reuters.com/alison-frankel/2013/06/19/should-defendants-fear-new-sec-policy-on-admissions-in-settlements/>.
- <sup>77</sup> See, e.g., *Credit Suisse AG*, Securities Act Release No. 10229, Exchange Act Release No. 79044 (Oct. 5, 2016); *Citigroup Glob. Mkts., Inc.*, Exchange Act Release No. 78291 (July 12, 2016); *Merrill Lynch, Pierce, Fenner & Smith Inc.*, Exchange Act Release No. 78141 (June 23, 2016); *In re BDO USA, LLP*, Exchange Act Release No. 75862 (Sept. 9, 2015); *OZ Mgmt., LP*, Exchange Act Release No. 75445 (July 14, 2015); *Wedbush Sec. Inc.*, Exchange Act Release No. 73652 (Nov. 20, 2014); *Lions Gate Entm't Corp.*, Exchange Act Release No. 71717 (Mar. 13, 2014); *JPMorgan Chase & Co.*, Exchange Act Release No. 70458 (Sept. 19, 2013).
- <sup>78</sup> See, e.g., *United States v. Brekke*, 97 F.3d 1043, 1049 (8th Cir. 1996); *Lipsky v. Commonwealth United Corp.*, 551 F.2d 887, 893–94 (2d Cir. 1976); *In re Cenco, Inc. Sec. Litig.*, 529 F. Supp. 411, 415–16 (N.D. Ill. 1982).
- <sup>79</sup> The analysis is contingent on various factors, including the type of settlement and how a party might attempt to make use of the settlement, or certain aspects thereof, in a subsequent proceeding. Two competing federal rules of evidence are in play: Rule 408, which generally prohibits the admission of settlement information for purposes of establishing liability; and Rule 803(8)(C), which allows the admission of public records of public agencies setting forth factual findings resulting from a lawful investigation. *Compare Option Res. Grp. v. Chambers Dev. Co.*, 967 F. Supp. 846, 849 (W.D. Pa. 1996) (finding that the Commission's factual findings, including its opinions and conclusions, contained in the settled administrative orders were admissible under Rule 803(8)(C)), *with Carpenters Health & Welfare Fund v. Coca-Cola Co.*, No. 1:00-CV-2838-WBH, 2008 U.S. Dist. LEXIS 112503, at \*19–20 (N.D. Ga. Apr. 23, 2008) (finding that SEC cease and desist order against the defendant was not admissible under Rules 408 and 803(c)), *and SEC v. Pentagon Capital Mgmt. PLC*, No. 08 Civ. 3324, 2010 U.S. Dist. LEXIS 25092, at \*2–4 (S.D.N.Y. Mar. 11, 2010) (finding that factual findings contained in SEC settled orders relating to third-parties were admissible under Rule 803(c)).
- <sup>80</sup> 17 C.F.R. § 230.405.
- <sup>81</sup> *Id.*
- <sup>82</sup> *Id.*
- <sup>83</sup> See SEC, Div. of Corp. Fin., *Revised Statement on Well-Known Seasoned Issuer Waivers* (Apr. 24, 2014), <https://www.sec.gov/divisions/corpfin/guidance/wksi-waivers-interp-031214.htm>.
- <sup>84</sup> *Id.*
- <sup>85</sup> *Id.*
- <sup>86</sup> See 17 C.F.R. § 230.506(b).
- <sup>87</sup> See Disqualification of Felons and Other “Bad Actors” From Rule 506 Offerings, 78 Fed. Reg. 44,730, (July 24, 2013); 17 C.F.R. § 230.506.
- <sup>88</sup> See 17 C.F.R. § 230.262; 17 C.F.R. § 230.506. In addition, Rule 602 of Regulation E also allows public companies to seek a waiver upon a showing of good cause that waiver is not necessary; however, the Commission has not delegated this authority, requiring public companies to appeal directly to the Commission for a Regulation E waiver. 17 C.F.R. § 230.602.
- <sup>89</sup> See 17 C.F.R. § 230.262; 17 C.F.R. §§ 230.505, 230.506.
- <sup>90</sup> *Id.*; SEC, Div. of Corp. Fin., *Process for Requesting Waivers of “Bad Actor” Disqualification Under Rule 262 of Regulation A and Rules 505 and 506 of Regulation D*, <http://www.sec.gov/divisions/corpfin/guidance/262-505-waiver.htm> (last modified Mar. 13, 2015).
- <sup>91</sup> See, e.g., Public Statement, Kara M. Stein, SEC Commissioner, *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), <https://www.sec.gov/news/statement/statement-on-jpmorgan-chase-bank-12-18-2015.html> (“During my tenure, I have been repeatedly concerned about the binary nature of granting or denying waivers.”).
- <sup>92</sup> See also SEC, *Waivers of Disqualification under Regulation A and Rules 505 and 506 of Regulation D*, <https://www.sec.gov/divisions/corpfin/guidance/disqualification-waivers.shtml>.
- <sup>93</sup> 15 U.S.C. §§ 77z-2, 78u-5.
- <sup>94</sup> See 15 U.S.C. §§ 77z-2(b)(1)(A)(ii), 78u-5(b)(1)(A)(ii).
- <sup>95</sup> 15 U.S.C. §§ 77z-2(g), 78u-5(g).





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