



# 2017 Year-End Securities Litigation and Regulatory Enforcement Highlights

**BakerHostetler**

White Collar, Investigations and Securities Enforcement  
and Litigation Practice Team

## Table of Contents

Supreme Court Cases	4
Securities Law Cases	10
Insider Trading Cases	20
Settlements	29
Investment Adviser and Hedge Fund Cases	37
SEC Cooperation and Whistleblower Programs	43
CFTC Cases and Developments	49
Securities Policy and Regulatory Developments	59
BakerHostetler White Collar, Investigations and Securities Enforcement and Litigation Team National Contacts	66

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### Welcome to the 2017 Year-End Report from the BakerHostetler White Collar, Investigations and Securities Enforcement and Litigation Practice Team

The purpose of this report is to provide a periodic survey of matters we believe to be of interest to general counsel, chief compliance officers, compliance departments, legal departments, and members of the securities and commodities industries.

We issue this report at midyear and shortly after year-end. We hope you find the information and commentary useful, and we welcome your comments and suggestions. We encourage you to contact any of the practice team leaders listed at the end of the report.

This report highlights recent, significant developments, including but not limited to the following:

- **Supreme Court Cases**, including a summary of the recent oral argument in *Somers* concerning the scope of Dodd-Frank whistleblower protections, a summary of the recent oral argument in *Cyan* concerning whether state courts have subject matter jurisdiction to adjudicate Securities Act claims, and an update on the *Leidos* litigation that concerned whether Securities and Exchange Commission (“SEC”) regulations create a duty to disclose that can give rise to securities fraud claims.
- **Securities Law Cases**, including *In re Petrobras Securities*, where the Second Circuit added clarity to the extraterritorial application of U.S. securities laws in the class action context; the Ninth Circuit’s view on “mixed statements” in *In re Quality Systems, Inc. Securities Litigation*; and the Second Circuit’s view in *Waggoner v. Barclays PLC* on whether direct evidence of price impact is necessary to demonstrate market efficiency.
- **Insider Trading Cases**, including cases reflecting the SEC’s continued use of data analytics and artificial intelligence to uncover large insider trading rings.
- **Settlements**, including insider trading settlements and settlements involving financial institutions, brokers and pharmaceuticals.
- **Investment Adviser and Hedge Fund Cases**, indicating the SEC’s focus shift from high-profile Wall Street firms to small-time players, where, in nearly every case, the amount customers lost totaled less than \$1 million.
- **SEC Cooperation and Whistleblower Programs**, including the SEC’s increasing number of tips during the 2017 fiscal year, and its continued imposition of reduced civil penalties in recognition of cooperation efforts; awards of large amounts to individual whistleblowers; and *Somers*, where the U.S. Supreme Court heard arguments on whether whistleblowers who fail to report to the SEC are entitled to protection under the Dodd-Frank Act.
- **Commodities and Futures Regulation and Cases**, including innovative technology programs in FinTech, and enforcement cases focusing on cryptocurrency, spoofing, anti-fraud enforcement, and compliance with regulatory requirements.
- **Securities Policy and Regulatory Developments**, including the SEC’s focus on virtual currencies, the creation of the SEC’s Cyber Unit to address cybersecurity concerns and assess the Commission’s internal risk, and ratification of Administrative Law Judges.

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## Supreme Court Cases



### Supreme Court Cases

After issuing two landmark securities-related decisions in the first half of 2017, including *Kokesh v. SEC*, No. 16-529,<sup>1</sup> the Supreme Court authored none in the second half of 2017. However, more landmark securities-related decisions could soon be on their way, since the Supreme Court recently heard oral argument on two appeals that could significantly affect the securities bar.

On Feb. 21, 2018, the Supreme Court decided one of those appeals: *Digital Realty Trust, Inc. v. Somers*, No. 16-1276 (2017). In *Somers*, the respondent, Paul Somers argued that petitioner Digital Realty Trust, Inc. (“Digital Realty”) violated the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (“Dodd-Frank”) when they fired Mr. Somers for blowing the whistle on company misconduct. The issue on appeal was whether Dodd-Frank’s whistleblower protections extended to individuals who reported misconduct to company managers but not to the SEC. The Supreme Court ultimately found that it did not.<sup>2</sup> The Supreme Court also heard oral argument in *Cyan, Inc. v. Beaver County Employees Retirement Fund*, No. 15-1439 (2017), a securities class action litigation that the plaintiff class brought in California state court. The issue on appeal is whether the Securities Litigation Uniform Standards Act of 1998 (“SLUSA”) stripped state courts of jurisdiction to hear covered class actions under the Securities Act of 1933.

On Oct. 17, 2017, the Supreme Court also announced that it was removing *Leidos, Inc. v. Indiana Public Retirement System*, No. 16-581 (2017), from the oral argument calendar after the parties settled the matter outside of court. As a result, the Supreme Court will no longer decide in this term whether Item 303 of Regulation S-K creates a duty to disclose that can give rise to securities fraud claims.

### Supreme Court Limits Dodd-Frank’s Whistleblower Protections

On Nov. 28, 2017, the Supreme Court heard oral argument in *Somers*. At stake in *Somers* was whether individuals who report company misconduct to company managers but *not* to the SEC are still “whistleblowers” under Dodd-Frank and hence subject to the act’s whistleblower protections. Plaintiff Paul Somers argued that they are, pointing to the SEC’s long-standing position to this effect. Digital Realty argued to the contrary, noting that Dodd-Frank’s plain language, which takes precedence over the SEC’s interpretation, suggests that such individuals are not whistleblowers. On Feb. 21, 2018, the Supreme Court agreed with Digital Realty, finding that to sue “under Dodd-Frank’s anti-retaliation provision,” a person must first inform the Commission.<sup>3</sup>

Digital Realty is a real estate investment trust company where Paul Somers worked as vice president of portfolio management. Somers complained to company managers that his supervisor had eliminated internal controls and hid major cost overruns. Shortly thereafter, the company fired Somers. Somers then sued the company under Dodd-Frank, arguing that its anti-retaliation provision legally prevented Digital Realty from firing Somers in retaliation for his whistleblowing on company misconduct. The District Court for the Northern District of California agreed, holding that Somers was a whistleblower under Dodd-Frank and hence subject to its whistleblower protections.<sup>4</sup> The Ninth Circuit Court of Appeals affirmed the lower court’s decision on the

1 See Marc D. Powers, Mark A. Kornfeld and Melissa L. Kosack, et al., *2017 Mid-Year Securities Litigation and Enforcement Highlights: Supreme Court Cases Review*, BakerHostetler, at 5-12 (July 28, 2017), <https://www.bakerlaw.com/webfiles/Litigation/2017/Alerts/2017-Mid-Year-Securities-Litigation-and-Enforcement-Highlights.pdf>

2 *Digital Realty Tr., Inc. v. Somers*, No. 16–1276, 2018 WL 987345, at \*4 (U.S. Feb. 21, 2018).

3 *Id.*

4 *Somers v. Digital Realty Trust, Inc.*, 119 F. Supp. 3d 1088 (N.D. Cal. 2015), *aff’d*, 850 F.3d 1045 (9th Cir. 2017), *rev’d*, No. 16–1276, 2018 WL 987345, at \*4 (U.S. Feb. 21, 2018).

### Supreme Court Cases

same grounds, relying in part on an *amicus curiae* brief from the SEC that supported Somers' interpretation of Dodd-Frank's anti-retaliation provisions.<sup>5</sup>

During oral argument at the Supreme Court, the majority of the justices seemed unconvinced that Somers was indeed a whistleblower entitled to protection under Dodd-Frank. The dissonance stemmed from Dodd-Frank's plain-language definition of a "whistleblower," which provides that a whistleblower is "any individual who provides ... information relating to a violation of the securities laws to *the Commission*."<sup>6</sup> This straightforward language indicates that individuals who, like Somers, fail to report misconduct to the SEC are *not* whistleblowers under Dodd-Frank. As Justice Neil Gorsuch said at oral argument, "[H]ow much clearer could Congress have been to say in this section the following definitions shall apply, and whistleblower is defined as including a report to the Commission[?]"<sup>7</sup>

As he had in the lower courts, Mr. Somers largely relied on the SEC's broad interpretation of Dodd-Frank. Specifically, in 2011, the SEC promulgated a rule that extended Dodd-Frank's whistleblower protections to whistleblowers who reported the misconduct only to company managers.<sup>8</sup> The SEC defended its broad interpretation in an *amicus curiae* brief to the Supreme Court, arguing that broadly interpreting Dodd-Frank's definition of whistleblowers made the most practical sense.

The arguments from Somers and the SEC, however, did not seem to persuade the Court. Justice Gorsuch noted at oral argument that the SEC "provid[ed] no notice to people" and "no reasonable opportunity to comment" on its 2011 rule that took the expansive position that internal whistleblowers were covered under Dodd-Frank.<sup>9</sup> He reasoned that allowing the SEC to extend Congress' definition of whistleblowers "put[s] the whole administrative process on its head."<sup>10</sup> Chief Justice John Roberts agreed and noted that Congress' definitions will always trump the SEC's interpretations except in the rare case where, unlike here, Congress' definition is "absurd or anomalous" to the point where "it really makes a mess" of the statute.<sup>11</sup> Justice Elena Kagan added that while excluding individuals like Somers from Dodd-Frank's whistleblower protections is "peculiar" and "probably not what Congress meant," the law "says what it says."<sup>12</sup> Finally, Justice Stephen Breyer reasoned that adopting a narrower interpretation of the whistleblower definition under Dodd-Frank would not necessarily lead to an inequitable result, since the Sarbanes-Oxley Act of 2002 protects internal whistleblowers from employer retaliation.<sup>13</sup>

As noted above, the Supreme Court ultimately overruled the lower court rulings in *Somers* and held that Dodd-Frank's whistleblower protections do not apply to individuals like Mr. Somers who blew the whistle to company managers but not the SEC. This essentially overrules the

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<sup>5</sup> *Somers v. Digital Realty Trust, Inc.*, 850 F.3d 1045 (9th Cir. 2017), *rev'd*, No. 16-1276, 2018 WL 987345, at \*4 (U.S. Feb. 21, 2018).

<sup>6</sup> 15 U.S.C. § 78u-6(a)(6) (emphasis added).

<sup>7</sup> See Oral Arg. Tr., *Somers v. Digital Realty Trust, Inc.*, No. 16-1276 (U.S. Nov. 28, 2017), at 30:25-31:4, [https://www.supremecourt.gov/oral\\_arguments/argument\\_transcripts/2017/16-1276\\_i426.pdf](https://www.supremecourt.gov/oral_arguments/argument_transcripts/2017/16-1276_i426.pdf).

<sup>8</sup> 17 C.F.R. § 240.21F-2.

<sup>9</sup> See Oral Arg. Tr., *supra* note 7, at 38:15-16.

<sup>10</sup> *Id.* at 38:13-14.

<sup>11</sup> *Id.* at 52:9-23.

<sup>12</sup> *Id.* at 48:15-49:3.

<sup>13</sup> *Id.* at 27:15-28:1.

### Supreme Court Cases

SEC's expansive interpretation of whistleblowers under Dodd-Frank, and will now force internal whistleblowers to seek relief against employers that retaliated against them under the Sarbanes-Oxley Act of 2002.

### Supreme Court Will Determine Whether State Courts Have Concurrent Jurisdiction to Preside Over Covered Class Actions Under the Securities Act of 1933

On Nov. 28, 2017, the Supreme Court heard oral argument in *Cyan*. The *Cyan* appeal arises from a securities class action filed in California state superior court, which alleges that the defendant, Cyan Inc., violated sections 11, 12(a)(2) and 15 of the Securities Act of 1933 by filing an inaccurate and misleading registration statement and prospectus that failed to disclose revenue deficiencies (which later became public).<sup>14</sup>

The defendant moved to dismiss this litigation on the ground that SLUSA pre-empts it. Specifically, the defendant argues that SLUSA amended the Securities Act of 1933's concurrent jurisdiction provision to ensure that securities plaintiffs could file class actions under the Securities Act of 1933 only in federal court. Accordingly, the defendant argues that the California state superior court lacks subject matter jurisdiction to adjudicate this securities class action. The plaintiff class argues that the California state superior court has jurisdiction to adjudicate this class action because SLUSA's amendments to the concurrent jurisdiction provision under the Securities Act of 1933 merely provide that state courts lack jurisdiction to hear covered class actions brought under state law. If the covered class action is brought under the Securities Act of 1933, however, it falls outside of SLUSA's jurisdictional amendments, and state courts can adjudicate such actions just as they had been doing for decades before SLUSA's enactment.

The California state superior court denied the defendant's motion to dismiss without issuing a written opinion,<sup>15</sup> ruling instead at oral argument that a 2011 California appellate court decision and a 2008 Ninth Circuit Court of Appeals decision tied its hands on this issue.<sup>16</sup> Those decisions generally hold that SLUSA continued state-court jurisdiction over class actions brought under the Securities Act of 1933. In particular, the 2011 California appellate court decision interprets SLUSA's amendments to the concurrent jurisdiction provision under the Securities Act of 1933 as having only stripped state courts of jurisdiction to hear covered class actions brought under state law.<sup>17</sup>

During oral argument, the Supreme Court tried to make sense of the confusion as to how the SLUSA amendments affect the concurrent jurisdiction provisions under the Securities Act of 1933. Justices Sonia Sotomayor and Kagan seemed to agree with the plaintiff class that the SLUSA amendments permit securities class actions to be brought under federal law without regard to venue. They also seemed unpersuaded by the defendant's argument that it made little sense for Congress to prevent state courts from hearing covered class actions under state law but to continue to allow them to hear such class actions under federal law. Both justices, as well as

<sup>14</sup> For more information about the factual and legal battle that led to the petition for certiorari, see Geoffrey H. Coll, Marco Molina, *Supreme Court to Determine whether State Courts Have Jurisdiction to Adjudicate Covered Class Actions under the Securities Act of 1933*, BakerHostetler (July 11, 2017), <https://www.bakerlaw.com/alerts/supreme-court-to-determine-whether-state-courts-have-jurisdiction-to-adjudicate-covered-class-actions-under-the-securities-act-of-1933>.

<sup>15</sup> *Beaver Cty. Employees Ret. Fund v. Cyan, Inc.*, No. CGC14538355 (Cal. Sup. Ct. Oct. 23, 2015) (Order Denying Defendants' Motion for Judgment on the Pleadings).

<sup>16</sup> *Luther v. Countrywide Fin. Corp.*, 195 Cal. App. 4th 789 (Cal. App. 2011); *Luther v. Countrywide Home Loans Serv. LP*, 533 F.3d 1031 (9th Cir. 2008).

<sup>17</sup> *Luther*, 195 Cal. App. 4th at 795-97.

### Supreme Court Cases

Justice Ruth Bader Ginsburg, noted that if Congress truly intended to confer exclusive jurisdiction over covered class actions to federal courts pursuant to the Securities Act of 1933, then it could have done so in a much clearer fashion, as it did under the Securities Exchange Act of 1934.<sup>18</sup>

Other justices were concerned about how to interpret the plain text of the SLUSA amendments. For example, both Justices Samuel Alito and Gorsuch characterized the text as “gibberish,”<sup>19</sup> and Alito commented that “all the readings that everybody has given to all of these provisions are a stretch.”<sup>20</sup> That included the interpretation of the acting solicitor general, who submitted an *amicus curiae* brief arguing that the SLUSA amendments continued state court concurrent jurisdiction of covered class actions under the Securities Act of 1933 but also allowed such class actions to be removed to federal court. Justices Breyer, Ginsburg and Kennedy seemed sympathetic to the acting solicitor general’s interpretation of the text, but several justices registered their view that the removal argument was not ripe because the *Cyan* case had not been removed.<sup>21</sup>

Time will tell how the Supreme Court will untangle the relevant statutory text. Based on the comments at oral argument, it seems possible, if not likely, that the Supreme Court will side with the plaintiff class and hold that the SLUSA amendments to the Securities Act of 1933 did not strip state courts of subject matter jurisdiction to adjudicate covered class actions under the Securities Act of 1933. If so, we should expect a rise in Securities Act of 1933 class actions in state court. A decision in *Cyan* is expected in the first half of 2018.

Douglas Greene, practice leader of BakerHostetler’s Securities and Governance Litigation Team was retained by the Washington Legal Foundation (“WLF”) to file an amicus brief. WLF agrees with petitioners that interpreting SLUSA to permit concurrent jurisdiction over 1933 Act covered class actions would undermine the Private Securities Litigation Reform Act (“Reform Act”), not only as to Securities Act claims, but also as to claims under Section 10(b) of the Exchange Act. WLF believes that SLUSA was designed to prevent plaintiffs from circumventing the Reform Act, which, in turn, was created to discourage the filing of unmeritorious class actions resulting in extortionate settlements. When viewed in this context, WLF argues that SLUSA is meant to establish exclusive federal-court jurisdiction over all securities class actions, thereby maintaining a system in which related claims are consolidated and heard in the same forum, governed by the Reform Act.

### Supreme Court Will No Longer Review Whether SEC Regulations Create a Duty to Disclose That Can Give Rise to Securities Fraud Claims

On Oct. 17, 2017, the Supreme Court removed *Leidos* from the oral argument calendar because the parties in that litigation reached an out-of-court settlement.

The issue in *Leidos* was whether a company’s failure to disclose the information required by Item 303 of the SEC’s Regulation S-K (“Item 303”) is actionable under Section 10(b) of the Securities Exchange Act and SEC Rule 10b-5 thereunder. Item 303 requires covered entities to discuss their financial condition, including “any known trends or uncertainties that have had or that the

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18 See Oral Arg. Tr., *Cyan, Inc. v. Beaver Cty. Employees Ret. Fund*, No. 15-1439 (U.S. Nov. 28, 2017), at 4:16-20 (Justice Ginsburg called defendant’s interpretation “rather obtuse” and an “odd” method of conferring exclusive jurisdiction), [https://www.supremecourt.gov/oral\\_arguments/argument\\_transcripts/2017/15-1439\\_lmg.pdf](https://www.supremecourt.gov/oral_arguments/argument_transcripts/2017/15-1439_lmg.pdf); see also *id.* at 10:5-9, 15:21-16:7 (Justice Kagan); *id.* at 26:10-19 (Justice Sotomayor).

19 *Id.* at 11:11-21 (Justice Alito); *id.* at 47:1-12 (Justice Gorsuch).

20 *Id.* at 41:15-17.

21 See *id.* at 37:1-4 (Justice Ginsburg); *id.* at 45:12-20 (Justice Kennedy).



### Supreme Court Cases

registrant reasonably expects will have a material favorable or unfavorable impact” in SEC filings.<sup>22</sup> The plaintiffs in *Leidos* contended that the defendant company violated this requirement when it failed to disclose its liability in an overbilling scheme as a known trend or uncertainty that could be reasonably expected to have a material impact on its financial condition. The plaintiffs further contended that the defendant’s omission of such information required under Item 303 amounted to securities fraud.

The District Court for the Southern District of New York dismissed plaintiffs’ securities fraud claims in their entirety.<sup>23</sup> The Second Circuit Court of Appeals reversed, holding that Item 303 imposes an affirmative duty to disclose that can serve as the basis for a securities fraud claim.<sup>24</sup> The Second Circuit then vacated the district court’s order and remanded for further proceedings consistent with its decision.<sup>25</sup>

The Second Circuit Court of Appeals’ decision in *Leidos* is in direct conflict with prior decisions by the Third Circuit Court of Appeals and the Ninth Circuit Court of Appeals. In a decision authored by then-Judge Samuel Alito, the Third Circuit Court of Appeals previously held that failure to comply with Item 303 does not automatically give rise to a securities fraud claim because the materiality standard for securities fraud is narrower than that of Item 303.<sup>26</sup> The Ninth Circuit Court of Appeals similarly held that the duty to disclose in Item 303 “is much broader than what is required” for securities fraud.<sup>27</sup>

Because *Leidos* settled, the Supreme Court will not issue a decision in this term that resolves the circuit split on whether Item 303 creates a duty to disclose that can give rise to securities fraud claims. However, it is very likely that this issue will once again surface through an appeal in another litigation and that the Supreme Court will have another opportunity to address the issue and eventually resolve the circuit split.

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<sup>22</sup> 17 C.F.R. § 229.303(a)(1).

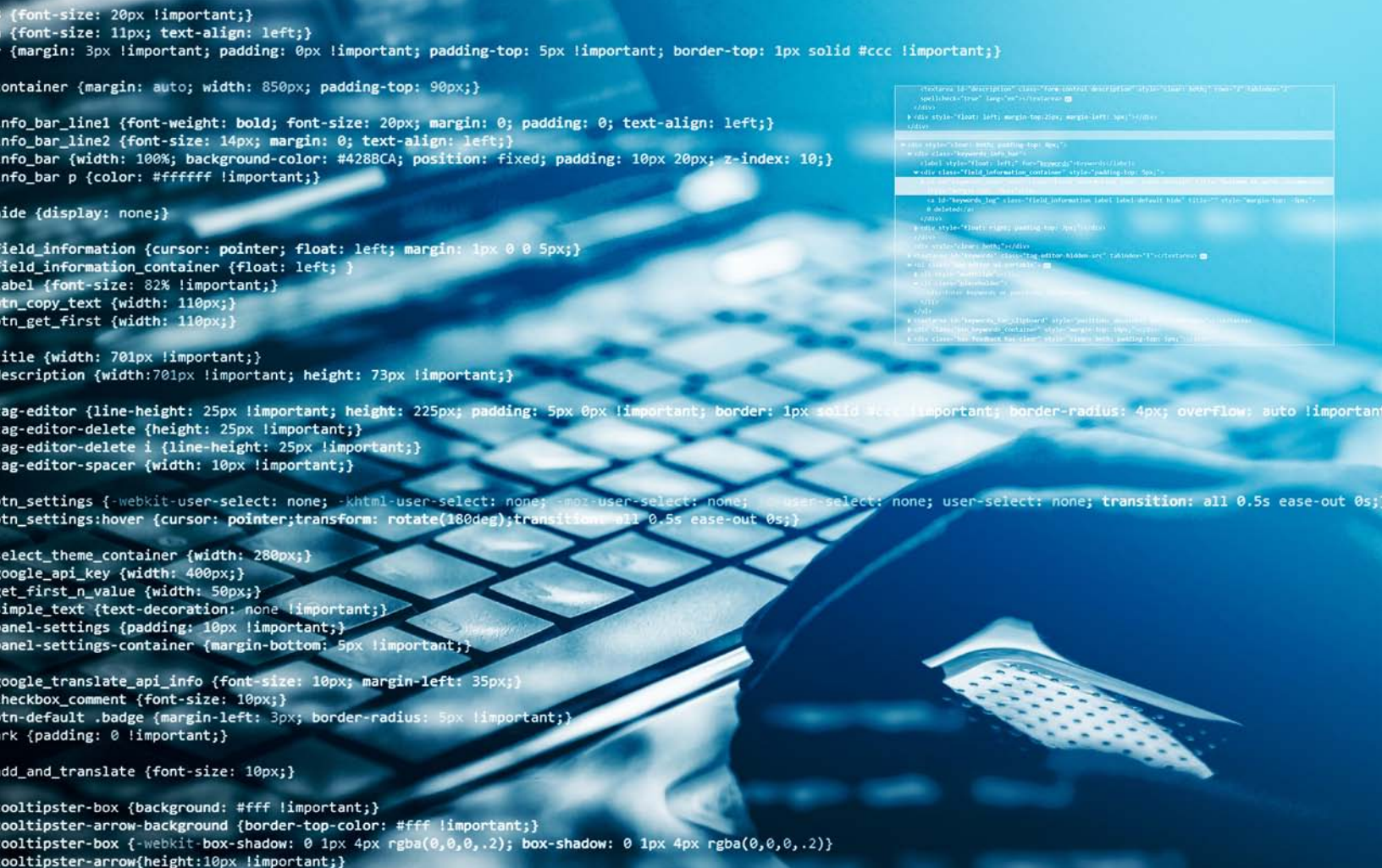
<sup>23</sup> *In re SAIC, Inc. Sec. Litig.*, No. 12 Civ. 1353(DAB), 2013 WL 5462289, at \*11 (S.D.N.Y. Sept. 30, 2013).

<sup>24</sup> *Ind. Pub. Ret. Sys. v. SAIC, Inc.*, 818 F.3d 85, 94-96 (2d Cir. 2016).

<sup>25</sup> *Id.* at 98.

<sup>26</sup> *Oran v. Stafford*, 226 F.3d 275, 286 n.6 (3d Cir. 2000).

<sup>27</sup> *In re NVIDIA Corp. Sec. Litig.*, 768 F.3d 1046, 1055 (9th Cir. 2014).



## Securities Law Cases

### Securities Law Cases

The first half of 2017 saw a number of case law developments in the circuit courts that are likely to have a lasting impact on the securities industry, particularly with respect to class action litigation.<sup>28</sup> This trend continued in the second half of the year with cases including *In re Petrobras Securities*, where the Second Circuit analyzed the requirements for certifying Rule 23(b)(3) classes in securities fraud cases involving internationally traded over-the-counter securities; *In re Quality Systems, Inc. Securities Litigation*, where the Ninth Circuit provided its view on “mixed statements”; and *Waggoner v. Barclays PLC*, where the Second Circuit determined that direct evidence of price impact is not always necessary to demonstrate market efficiency.

### Second Circuit’s *Petrobras* Ruling Adds Clarity to the Extraterritorial Application of U.S. Securities Laws

On July 7, 2017, the Second Circuit in *In re Petrobras Securities* added clarity to the extraterritorial application of U.S. securities laws in the class action context.<sup>29</sup> The Second Circuit specifically addressed the requirements for certifying Rule 23(b)(3) classes in securities fraud cases involving internationally traded over-the-counter securities. In *Petrobras*, investors in *Petróleo Brasileiro SA* (“Petrobras”) – a Brazilian oil and gas company majority owned by the Brazilian government – filed putative class actions under the Securities Act of 1933 and the Securities Exchange Act of 1934 against Petrobras and other defendants (altogether, the “Petrobras Defendants”).<sup>30</sup>

On Feb. 2, 2016, the United States District Court for the Southern District of New York granted the plaintiffs’ motion to certify two classes: (1) the Exchange Act class, which included investors who purchased Petrobras securities, including debt securities issued on the New York Stock Exchange (“NYSE”) or pursuant to other domestic transactions, and American Depositary Shares (“ADS”), and (2) the Securities Act class, which included investors who purchased or otherwise acquired notes in domestic transactions.<sup>31</sup> Petrobras had issued multiple debt securities (“Petrobras Notes”) that were traded in over-the-counter transactions because they were not listed on any U.S.-based exchange.<sup>32</sup>

The plaintiffs alleged that the Petrobras Defendants made two types of false and misleading statements under the Exchange Act, namely (1) the production of “financial statements with inflated asset values” and (2) the assurance of Petrobras investors that “the company adhered to ethical management principles and maintained strict financial controls to prevent fraud and corruption.”<sup>33</sup> The plaintiffs also alleged that the defendants made “materially false representations in registration statements and other documents connected with offerings of Petrobras Notes,” thereby establishing liability under the Securities Act.<sup>34</sup>

The Second Circuit found that because certain Petrobras Notes did not trade on a U.S. exchange, noteholders in both classes were entitled to assert claims only “if they can show that they acquired

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28 See 2017 Mid-Year Securities Litigation and Enforcement Highlights: Supreme Court Cases Review, *supra* note 1, at 14-27.

29 *In re Petrobras Secs.*, 862 F.3d 250, 256 (2d Cir. 2017).

30 *Id.* at 258-59.

31 *Id.*

32 *Id.*

33 *Id.*

34 *Id.*

## 2017 YEAR-END SECURITIES LITIGATION AND REGULATORY ENFORCEMENT HIGHLIGHTS

### Securities Law Cases

their Notes in ‘domestic transactions.’”<sup>35</sup> Accordingly, the Second Circuit found that the district court “must assess each class member’s over-the-counter transactions for markers of domesticity under *Morrison v. National Australia Bank Ltd.*, 561 U.S. 247, 130 S.Ct. 2869, 177 L.Ed.2d 535 (2010).”<sup>36</sup>

While emphasizing that the reach of U.S. securities laws is presumptively limited to (1) “transactions in securities listed on domestic exchanges” and (2) “domestic transactions in other securities,” the Second Circuit concluded that a purchase of Petrobras ADS satisfies *Morrison*’s first prong “as long as the transaction occurs on the NYSE.”<sup>37</sup> The Second Circuit also concluded that because the Petrobras Notes did not trade on any domestic exchange, the noteholders would be required to show that their notes “were acquired in a ‘domestic transaction.’”<sup>38</sup>

According to the Second Circuit, the “location or residency of the buyer, seller, or broker will not necessarily establish the situs of the transaction.”<sup>39</sup> Instead, for a transaction to qualify as domestic, plaintiffs would have to produce evidence showing that irrevocable liability was incurred or legal title passed in the United States, including but not limited to “facts concerning the formation of the contracts, the placement of purchase orders ... or the exchange of money.”<sup>40</sup>

In order for a class to be certified, however, the questions of law or fact common to class members must predominate over any questions affecting only individual members.<sup>41</sup> The Second Circuit explained that a proper predominance assessment would involve two predicate questions: whether (1) the “determination of domesticity [is] material to plaintiffs’ class claims” and (2) that determination is “susceptible to generalized class-wide proof” such that it represents a ‘common’ question rather than an ‘individual’ one.”<sup>42</sup> The Second Circuit found that the district court “failed to meaningfully address the second question.”<sup>43</sup>

The Second Circuit also addressed the issue of ascertainability, i.e., whether a class is sufficiently definite, and found that ascertainability does not require “a showing of administrative feasibility at the class certification stage” – a clear departure from the Third Circuit’s “heightened ascertainability test.”<sup>44</sup>

The Second Circuit ultimately remanded *Petrobras*, finding that the district court failed to give “careful scrutiny to the relation between the common and individual questions” central to the case.<sup>45</sup> The Second Circuit determined that on the available record, the question of domesticity was an individual one “requiring putative class members to ‘present evidence that varies from member to member.’”<sup>46</sup> According to the Second Circuit, facts about who sold the relevant securities, how the transactions

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35 *Id.* (citing *Morrison v. Nat’l Australia Bank Ltd.*, 561 U.S. 247, 267 (2010)).

36 *Id.* at 256-57.

37 *In re Petrobras Secs.*, 862 F.3d at 262.

38 *Id.*

39 *Id.*

40 *Id.*

41 *Id.* at 270.

42 *Id.*

43 *In re Petrobras Secs.*, 862 F.3d at 271.

44 *Id.* at 265.

45 *Id.* at 272.

46 *Id.*

### Securities Law Cases

were effectuated and the forms of documentation would be individualized.<sup>47</sup> The Second Circuit made clear that the “predominance analysis must account for such individual questions, particularly when they go to the viability of each class member’s claims.”<sup>48</sup>

### Ninth Circuit Finds That Non-Forward-Looking Portions of Mixed Statements Are Not Eligible for Protection Under the Private Securities Litigation Reform Act

On July 28, 2017, the Ninth Circuit in *In re Quality Systems, Inc. Securities Litigation*, reversed and remanded the United States District Court for the Central District of California’s dismissal of a class action suit against Quality Systems Inc. (“QSI”), a California-based health records software developer, involving violations of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5.<sup>49</sup> QSI develops and markets management software for medical and dental providers.<sup>50</sup> The plaintiffs alleged that the defendants, including QSI and several of its officers, made false or misleading statements to investors about QSI’s current and past sales pipeline and used those statements as the basis for reports on QSI’s projected growth and revenue.<sup>51</sup>

The plaintiffs further alleged that the individual defendants had “real-time” access to QSI’s sales information showing a reduction in sales due to market conditions, and defendants knew that public statements to the contrary were false or misleading.<sup>52</sup> The district court found defendants’ non-forward-looking statements to be “non-actionable puffery,” and that their forward-looking statements concerning projected growth were protected by the Private Securities Litigation Reform Act’s (“The Reform Act”) safe harbor provision.<sup>53</sup> However, the Ninth Circuit disagreed.

The Ninth Circuit acknowledged that “a defendant will not be liable for a false or misleading statement if it is forward-looking and *either* is accompanied by cautionary language *or* is made without actual knowledge that it is false or misleading,” but found that some of defendants’ statements “were ‘mixed statements,’ containing non-forward-looking statements as well as forward-looking statements of projected revenue and earnings.”<sup>54</sup> The Ninth Circuit held that “a defendant may not transform non-forward-looking statements into forward-looking statements that are protected by the safe harbor provisions of the Reform Act by combining non-forward-looking statements about past or current facts with forward-looking statements about projected revenues and earnings.”<sup>55</sup> The Ninth Circuit found many of the defendants’ non-forward-looking statements to be materially false or misleading<sup>56</sup> and certain forward-looking statements to not only be materially false or misleading, but also “made with actual knowledge of their false or misleading nature” and unaccompanied by appropriate cautionary statements.<sup>57</sup>

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47 *Id.*

48 *Id.* at 274.

49 *In re Quality Sys., Inc. Sec. Litig.*, 865 F.3d 1130, 1135 (9th Cir. 2017).

50 *Id.* at 1135.

51 *Id.*

52 *Id.*

53 *Id.* (citation omitted).

54 *In re Quality Sys., Inc.*, 865 F.3d at 1141 (citation omitted) (emphasis in original).

55 *Id.*

56 *Id.*

57 *Id.*



### Securities Law Cases

According to the Ninth Circuit, a “mixed statement” exists when “a forward-looking statement is accompanied by a non-forward-looking factual statement that supports the forward-looking statement.”<sup>58</sup> The Ninth Circuit concluded that if “the non-forward-looking statement is materially false or misleading, it is likely that no cautionary language – short of an outright admission of the false or misleading nature of the non-forward-looking statement – would be ‘sufficiently meaningful’ to qualify the statement for the safe harbor.”<sup>59</sup>

*In re Quality Systems, Inc. Securities Litigation* is currently the subject of a petition for a writ of certiorari, and BakerHostetler has been retained by the Washington Legal Foundation (“WLF”) to file an amicus brief in support. WLF agrees with petitioners that the Supreme Court should resolve the conflict among the circuits under the Reform Act’s safe harbor for forward-looking statements, and believes the Supreme Court should use this opportunity to harmonize the safe harbor standard with the Court’s securities jurisprudence. The Supreme Court has called for a response to QSI’s petition. WLF’s amicus brief will be filed on March 22, 2018.

### Tenth Circuit Widens Split on Whether Pre-Wells SEC Investigations Should Be Covered by Insurers

On Oct. 17, 2017, the Tenth Circuit affirmed a United States District Court for the District of Colorado decision in *MusclePharm Corp. v. Liberty Insurance Underwriters, Inc.*, finding that an SEC inquiry into company operations pursuant to a formal order of investigation did not constitute a claim under an Executive Advantage insurance policy.<sup>60</sup> At issue was whether insurance companies are required to cover the costs associated with responding to an SEC investigation before potential charges are announced via Wells notices. The *MusclePharm* decision was a departure from similar cases in the Eighth and Eleventh circuits. Given the frequency of formal orders of investigation, *MusclePharm* dictates that companies should review their insurance policies to ensure pre-Wells investigations are covered.

On May 16, 2013, the SEC mailed a letter to MusclePharm Corp. (“MusclePharm”) stating that it was “conducting an inquiry into MusclePharm” and “requesting that MusclePharm voluntarily produce documents.”<sup>61</sup> On July 8, 2013, MusclePharm received a formal order of investigation from the SEC in connection with a probe into whether MusclePharm’s CEO, Brad Pyatt, and other executives failed to report certain benefits and perks.<sup>62</sup> Specifically, the order stated that “the SEC had ‘information that tends to show’ various ‘possible violation[s]’ of the federal securities laws by MusclePharm and/or its officers and directors.”<sup>63</sup> The order also directed that “a private investigation be made to determine whether any persons or entities have engaged in, or are about

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58 *Id.* at 1146.

59 *Id.* at 1146-47.

60 *Musclepharm Corp. v. Liberty Ins. Underwriters, Inc.*, No. 15-cv-00555-REB-KMT, 2016 WL 4179784, at \*6 (D. Colo. Aug. 4, 2016), *reconsideration denied*, 2016 WL 9753780 (D. Colo.), *aff’d*, No. 16-1462, 2017 WL 4675701 (10th Cir. Oct. 17, 2017).

61 *Musclepharm Corp.*, No. 16-1462, 2017 WL 4675701, at \*3.

62 *Musclepharm Corp.*, No. 15-cv-00555-REB-KMT, 2016 WL 4179784, at \*3; *see also* Ryan Boysen, *Liberty Win Widens Split on SEC Probe Costs, 10th Circ. Told*, Law360 (Nov. 2, 2017), <https://www.law360.com/securities/articles/981123/liberty-win-widens-split-on-sec-probe-costs-10th-circ-told>.

63 *Musclepharm Corp.*, No. 15-cv-00555-REB-KMT, 2016 WL 4179784, at \*3

### Securities Law Cases

to engage in, any of the reported acts or practices or any acts or practices of similar purport or object.”<sup>64</sup> Notably, the footer of each page of the July 8, 2013, order included a disclaimer stating that “it should be understood that the Commission has not determined whether any of the persons or companies mentioned in the order have committed any of the acts described or have in any way violated the law.”<sup>65</sup>

MusclePharm eventually settled with the SEC on Sept. 8, 2015, and the SEC issued cease-and-desist orders against MusclePharm and its officers.<sup>66</sup> Nonetheless, MusclePharm claimed to have spent “more than \$3 million responding to the investigation” before the SEC formally alleged wrongdoing via Wells notices dated Feb. 13, 2015.<sup>67</sup> According to MusclePharm, the figure included “more than \$1,319,539.73 for ‘legal and related expenses’ and more than \$1,708,868.29 in indemnification costs.”<sup>68</sup> On June 20, 2013, MusclePharm sought coverage for its costs under a directors and officers policy it held with Liberty Insurance Underwriters Inc. (“Liberty”). When Liberty denied the claim, litigation ensued.<sup>69</sup>

The Liberty policy states that,

[t]he Insurer shall pay on behalf of the **Insured Organization** all Loss which is permitted or required by law to indemnify the **Insured Persons** as a result of a **Claim** first made during the **Policy Period** or **Discovery Period**, if applicable, against the Insured Persons for a **Wrongful Act** which takes place before or during the **Policy Period**.<sup>70</sup>

The policy defined a Claim as,

(a) a written demand for monetary or non-monetary relief against an **Insured Person** or ... against the **Insured Organization**, including a request to toll the statute of limitations; (c) a formal administrative or regulatory proceeding against an **Insured Person**; (d) a formal criminal, administrative, or regulatory investigation against an **Insured Person** when such **Insured Persons**’ [sic] receives a Wells notice or target letter in connection with such investigations.<sup>71</sup>

And a Wrongful Act was defined as

(a) any actual or alleged error, misstatement, misleading statement, act, omission, neglect, or breach of duty, actually or alleged[ly] committed or attempted by the **Insured Persons** in their capacities as such or in an **Outside Position**, or ... by the **Insured Organization**; or (b) any matter claimed against the **Insured Persons** solely by reason of their status as **Insured Persons**.<sup>72</sup>

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64 *Id.*

65 *Musclepharm Corp.*, No. 16-1462, 2017 WL 4675701, at \*2.

66 *Id.* at \*3.

67 *Id.*

68 *Id.*

69 *Id.*

70 *Id.* at \*1 (emphasis in original).

71 *Id.*

72 *Musclepharm Corp.*, No. 16-1462, 2017 WL 4675701, at \*1-2.

### Securities Law Cases

MusclePharm brought suit against Liberty in Colorado state court for breach of contract and statutory and common law bad-faith breach of insurance contract, alleging that the SEC investigation was a “claim” within the meaning of the policy, obligating Liberty to cover all “loss” incurred in connection with the claim.<sup>73</sup> On March 18, 2015, Liberty removed the suit to the United States District Court for the District of Colorado.

The District of Colorado found that the July 8 SEC order did not allege a “wrongful act” within the meaning of the policy and concluded “Liberty did not have a duty to indemnify MusclePharm for costs that it incurred prior to the Wells Notices.”<sup>74</sup>

MusclePharm argued on appeal that the district court misconstrued the policy’s definition of the terms “claim” and “allege” and therefore erred in finding that its expenses incurred in responding to the SEC’s July 8 order were not covered under the Liberty policy.<sup>75</sup> In an Oct. 17, 2017, ruling, the Tenth Circuit disagreed, stating that a claim did not arise until the SEC issued the Wells Notices.<sup>76</sup>

The Tenth Circuit found that the language used by the SEC – namely, that the investigation was “to determine *whether* any persons or entities have engaged in, or are about to engage in, any of the reported acts or practices or any acts or practices of similar purport or object” – made clear that “this was an SEC investigation, not a proceeding, and coverage under the policy for a ‘regulatory investigation’ was conditioned on the issuance of a Wells Notice or a target letter.”<sup>77</sup> The SEC’s formal order of investigation was not a claim, since the SEC was not seeking relief but was only gathering information.

The Sixth Circuit reached a similar decision in *Employers’ Fire Insurance Co. v. ProMedica Health System, Inc.*<sup>78</sup> In that case, the Sixth Circuit found that subpoenas and civil investigative demands issued by the Federal Trade Commission constitute investigations that “do not necessarily amount to ‘allegations.’”<sup>79</sup>

By contrast, the Second and Eighth Circuits have found for the insured in similar cases.<sup>80</sup> For example, in *Polychron v. Crum & Foster Insurance Cos.*, the Eighth Circuit rejected the characterization of such an investigation as mere requests for information, articulating that such a characterization would underestimate the seriousness of the probe.<sup>81</sup> The Eighth Circuit emphasized that under Arkansas law, “provisions contained in a policy of insurance must be construed most strongly against the insurance company which prepared it.”<sup>82</sup>

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73 *Id.* at \*3.

74 *Id.*

75 *Id.* at \*3.

76 *Id.* at \*6.

77 *Id.*

78 *Employers’ Fire Ins. Co. v. ProMedica Health Sys., Inc.*, 524 F. App’x 241 (6th Cir. 2013).

79 *Id.* at 248-52.

80 See, e.g., *Patriarch Partners, LLC v. Axis Ins. Co.*, No. 16-CV-2277 (VEC), 2017 WL 4233078 (S.D.N.Y. Sept. 22, 2017); *Polychron v. Crum & Foster Ins. Cos.*, 916 F.2d 461 (8th Cir. 1990).

81 *Polychron*, 916 F.2d at 463.

82 *Id.* (citation omitted).

### Securities Law Cases

The Eleventh Circuit has also found for insurers, but only in such a case where the policy language expressly bars coverage for any “investigation of an organization.”<sup>83</sup> In *Office Depot, Inc. v. National Union Fire Ins. of Pittsburgh, Pennsylvania*, the Eleventh Circuit found for the insurer because the policy at issue specifically eliminated coverage for claims “in the form of an administrative or regulatory investigation.”<sup>84</sup>

Given the split in the circuits on how these policies and their terms are interpreted, and the investigative costs associated with pre-Wells investigations, it is important to examine current and future insurance policies to ensure pre-Wells SEC investigations and similar requests for information from other government agencies are covered.

### Second Circuit Interprets Fraud-on-the-Market Doctrine and Finds Direct Evidence of Price Impact Is Not Always Necessary to Demonstrate Market Efficiency

On Nov. 6, 2017, the Second Circuit, in *Waggoner v. Barclays PLC*, affirmed a United States District Court for the Southern District of New York decision certifying a class of plaintiffs who purchased Barclays’ American Depository Shares (“Barclays’ ADS”) during the class period.<sup>85</sup> The plaintiffs alleged violations of Rule 10b-5 and the Securities and Exchange Act of 1934.<sup>86</sup>

The plaintiffs specifically alleged that Barclays violated U.S. securities laws in connection with alleged concealment of information and misleading statements made regarding the company’s management of its liquidity profiling and “LX” dark pool.<sup>87</sup> Barclays’ LX dark pool is a private trading platform where investors may trade securities anonymously.<sup>88</sup> The plaintiffs’ class action was filed shortly after the New York attorney general filed a June 25, 2014, complaint alleging that many representations made by Barclays concerning its dark pool and would-be LX protections afforded to its customers were false and misleading.<sup>89</sup> Barclays’ stock fell 7.38 percent as a result of the attorney general’s action.<sup>90</sup>

Among other things, the plaintiffs alleged that when asked about concerns that high-frequency traders were front-running in LX, Barclays officers made materially false and misleading statements concerning safeguards against such practices.<sup>91</sup> According to the plaintiffs, the false statements included representations that Barclays monitored activity in its LX platform and would remove traders who engaged in conduct that disadvantaged LX clients.<sup>92</sup> The plaintiffs alleged that by contrast, however, “‘Barclays did not in fact protect clients from aggressive high frequency trading activity, did not restrict predatory traders’ access to other clients,’ and did not ‘eliminate

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83 *Office Depot, Inc. v. Nat’l Union Fire Ins. Co. of Pittsburgh, PA*, 453 F. App’x 871, 875-76 (11th Cir. 2011).

84 *Id.*

85 *Strougo v. Barclays PLC*, 312 F.R.D. 307 (S.D.N.Y. 2016), *aff’d sub nom. Waggoner v. Barclays PLC*, 875 F.3d 79, 84-85 (2d Cir. 2017).

86 *Waggoner*, 875 F.3d at 85.

87 *Id.* at 88.

88 *Id.* at 86.

89 *Id.* at 88.

90 *Id.*

91 *Id.*

92 *Waggoner*, 875 F.3d at 88.

### Securities Law Cases

traders who continued to behave in a predatory manner.”<sup>93</sup> According to the plaintiffs, as a result of Barclays’ false and misleading statements, its stock price maintained an “inflated level” that reflected confidence in Barclays’ integrity until the New York attorney general’s action.<sup>94</sup>

The defendants argued that the district court erred in granting class certification because it wrongly concluded that: (1) the *Affiliated Ute Citizens of Utah v. United States* presumption of reliance applied; (2) the *Basic Inc. v. Levinson* presumption applied, without considering direct evidence of price impact after finding that Barclays’ ADS traded in an efficient market; (3) the defendants were required to rebut the *Basic* presumption by preponderance of the evidence; and (4) the plaintiffs’ suggested method of calculating classwide damages was satisfactory.<sup>95</sup>

The Second Circuit agreed that the district court erred in applying the *Affiliated Ute* presumption but rejected the remainder of defendants’ arguments.<sup>96</sup> In a securities fraud action, a plaintiff is generally required to show reliance on a misrepresentation or omission on the part of the defendant.<sup>97</sup> The *Affiliated Ute* presumption “allows the element of reliance to be presumed in cases involving primarily omissions, rather than affirmative misstatements.”<sup>98</sup> The *Basic* presumption “permits reliance to be presumed in cases based on misrepresentations if the plaintiff satisfies certain requirements,” like showing that Barclay’s stock traded in an efficient market.<sup>99</sup>

Efficient markets are markets where public information about companies impacts the stock price.<sup>100</sup> The Second Circuit emphasized that it has “repeatedly ... declined to adopt a particular test for market efficiency,” but it acknowledged that in proving market efficiency at the class certification stage, courts have generally considered five factors: (1) “the average weekly trading volume of the [stock],” (2) “the number of securities analysts following and reporting on [it],” (3) “the extent to which market makers traded in the [stock],” (4) “the issuer’s eligibility to file an SEC registration Form S-3,” and (5) “the demonstration of a cause and effect relationship between unexpected, material disclosures and changes in the [stock’s] price.”<sup>101</sup>

The Second Circuit acknowledged that most plaintiffs seek to satisfy the fifth factor because it permits plaintiffs to submit direct evidence, through an event study or otherwise, showing the causal relationship between a corporate event or financial release and the immediate resulting effect on the stock price.<sup>102</sup> However, the Second Circuit ultimately concluded that “direct evidence of price impact ... is not always necessary to establish market efficiency and invoke the *Basic* presumption, and that such evidence was not required in this case at the class certification stage.”<sup>103</sup>

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93 *Id.*

94 *Id.*

95 *Id.* at 85, 92.

96 *Id.*

97 *Id.* at 93 (citation omitted).

98 *Id.* at 93-94 (citation omitted).

99 *Id.*

100 *Id.* at 94 (citation omitted).

101 *Id.*

102 *Id.*

103 *Id.* at 96-97.



### Securities Law Cases

The court emphasized that “indirect evidence regarding the efficiency of a market for a company’s stock” under the first four factors outlined above “is particularly valuable in situations where direct evidence does *not* entirely resolve the question’ of market efficiency.”<sup>104</sup>

The *Waggoner* decision lowers the obstacles shareholder plaintiffs must overcome to obtain class certification.

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<sup>104</sup> *Id.* at 97 (citation omitted).



## Insider Trading Cases

## 2017 YEAR-END SECURITIES LITIGATION AND REGULATORY ENFORCEMENT HIGHLIGHTS

### Insider Trading Cases

In its recently released annual report, the SEC heralded fiscal year 2017 as a “successful and impactful year for the Enforcement Division.”<sup>105</sup> The Commission brought 754 enforcement actions, with approximately 9 percent of the stand-alone cases involving insider trading (a 1 percent increase from fiscal year 2016).<sup>106</sup>

Consistent with predictions in the “BakerHostetler Brief: Chair Clayton at the SEC,” the SEC’s insider trading and cybersecurity initiatives continue to overlap.<sup>107</sup> The SEC Market Abuse and Detection Center’s use of data analytics to uncover several large insider trading rings, including those in the *Rivas* case discussed below, will likely be a regular occurrence in 2018.<sup>108</sup> Insider trading and individual accountability will continue to be categorical priorities for the SEC, and the SEC will likely continue to use data analytics to enhance its enforcement efforts.<sup>109</sup>

#### ***Timber Hill LLC v. Pershing Square Capital Management, No. 2:17-cv-04776 (C.D. Cal. June 28, 2017), and Anthony Basile v. Valeant Pharmaceuticals, Inc., No. 8:14-cv-02004 (C.D. Cal. Dec. 16, 2014)***

On Dec. 29, 2017, Pershing Square and Valeant Pharmaceuticals (“Valeant”) reached a \$290 million preliminary settlement agreement in connection with two investor class actions that involved insider trading accusations.<sup>110</sup>

Plaintiffs alleged that “[d]efendants’ illicit insider trading and front running scheme began in February 2014,” and “[i]n exchange for information regarding Valeant’s plans to launch a hostile takeover and tender offer for fellow pharmaceutical company Allergan, [Pershing Square’s CEO William] Ackman, agreed to secretly acquire nearly 10% of Allergan’s stock and commit those shares to support Valeant’s bid.”<sup>111</sup> According to plaintiffs, Pershing Square agreed that if the takeover were unsuccessful, it “would kick back 15% of its insider trading profits to Valeant.”<sup>112</sup> Ultimately, Valeant’s attempts at a hostile takeover proved fruitless when competing bidder Actavis plc. outbid Valeant with a \$66 billion offer.<sup>113</sup> This, however, did not leave the defendants at a loss.<sup>114</sup> Pershing Square reaped \$2.3 billion in profits while Valeant received profits in excess of \$400 million.<sup>115</sup>

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105 Report, U.S. Sec. & Exch. Comm’n, *Annual Report: A Look Back at Fiscal Year 2017*, at \*6 (Nov. 15, 2017), <https://www.sec.gov/files/enforcement-annual-report-2017.pdf>.

106 Press Release, U.S. Sec. & Exch. Comm’n, *SEC Enforcement Division Issues Report on Priorities and FY 2017 Results*, Rel. No. 2017-210 (Nov. 15, 2017), <https://www.sec.gov/news/press-release/2017-210>; Report, U.S. Sec. & Exch. Comm’n, *Annual Report: A Look Back at Fiscal Year 2017*, at \*15 (Nov. 15, 2017), <https://www.sec.gov/files/enforcement-annual-report-2017.pdf>.

107 Marc Powers, *Chair Clayton’s Impact at the SEC*, BakerHostetler, (Dec. 5, 2017), <https://www.bakerlaw.com/alerts/chair-claytons-impact-at-the-sec>.

108 Press Release, U.S. Sec. & Exch. Comm’n, *SEC Uncovers Wide-Reaching Insider Trading Scheme*, Rel. No. 2017-143 (Aug. 16, 2017), <https://www.sec.gov/news/press-release/2017-143>.

109 Report, *supra* note 105, at \*4.

110 Jon Hill, *Pershing, Valeant Agree to \$290M Deal Ending Allergan Suits*, Law360 (Jan. 2, 2018), [https://www.law360.com/articles/997812?utm\\_source=rss&utm\\_medium=rss&utm\\_campaign=entity\\_searchse](https://www.law360.com/articles/997812?utm_source=rss&utm_medium=rss&utm_campaign=entity_searchse).

111 Compl., *Timber Hill LLC v. Pershing Square Capital Mgmt.*, No. 2:17-cv-04776, at \*7:4-10 (C.D. Cal. June 28, 2017), [http://securities.stanford.edu/filings-documents/1062/PSCML00\\_01/2017628\\_f01c\\_17CV04776.pdf](http://securities.stanford.edu/filings-documents/1062/PSCML00_01/2017628_f01c_17CV04776.pdf).

112 *Id.* at 8:3-8.

113 Gretchen Morgenson and David Benoit, *Judge Sides Against Ackman and Valeant in Preliminary Allergan Ruling*, Wall Street Journal (Dec. 22, 2017), <https://www.wsj.com/articles/judge-sides-against-ackman-in-preliminary-allergan-ruling-1513981622>.

114 *Supra* note 110.

115 *Supra* note 114.

### Insider Trading Cases

The two-thirds-to-one-third breakdown of the settlement will require Pershing Square to pay \$193.75 million and Valeant to pay the \$96.25 million remainder.

The settlement is still awaiting court approval but will likely be one of the largest shareholder class action settlements of 2017.<sup>116</sup>

#### **SEC v. Yan, No. 1:17-cv-05257 (S.D.N.Y. July 12, 2017)**

On July 12, 2017, the SEC announced insider trading charges against Fei Yan, a Massachusetts Institute of Technology research scientist alleged to have acquired stocks in Mattress Firm Holding Corp. and options in Stillwater Mining Company prior to the public announcement of each company's acquisition.<sup>117</sup> Yan was alleged to have received the material nonpublic information from his wife, an associate at a large New York City law firm who worked on the corporate deals at the time.<sup>118</sup>

The SEC alleged that Yan and his wife were in constant contact, speaking by phone “nearly every day, and often several times a day,” when he purchased Mattress Firm stock.<sup>119</sup> Yan and his wife also spoke “multiple times each day” before trading Stillwater options.<sup>120</sup> After the acquisitions of each company were publicly announced, Yan sold his stocks and options, earning profits of approximately \$120,000.<sup>121</sup>

The SEC also alleged that Yan tried to find ways to conceal his illicit trading through Google searches for “how sec detect unusual trade” and “insider trading with international account” prior to trading on the confidential information.<sup>122</sup> Yan also traded the securities through a brokerage account opened in his mother's name in an attempt to distance himself from the trading. Yan's mother was named as a relief defendant in the SEC complaint.<sup>123</sup> The U.S. Attorney's Office for the Southern District of New York brought a parallel criminal action against Yan.<sup>124</sup> Yan pled guilty to one count of securities fraud and, pursuant to a plea agreement with the government, agreed to forfeit \$119,428.50 in illegal profits.<sup>125</sup>

#### **SEC v. Rivas, No. 17-cv-6192 (S.D.N.Y. Aug. 16, 2017)**

On Aug. 16, 2017, the SEC announced that it brought insider trading charges against Daniel Rivas and six other individuals on allegations that they traded on confidential information about mergers and acquisitions in three separate trading rings.<sup>126</sup> The SEC Market Abuse and Detection Center first spotted unusual activity and suspicious patterns using data analytics, which allowed the

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116 *Supra* note 110.

117 Press Release, U.S. Sec. & Exch. Comm'n, *SEC Files Insider Trading Charges Against Research Scientist Aiming to Avoid SEC Detection*, Rel. No. 2017-125 (July 12, 2017), <https://www.sec.gov/news/press-release/2017-125>.

118 *Id.*

119 Compl., *SEC v. Yan*, No. 1:17-cv-05257, at \*6, ¶ 24 (S.D.N.Y. July 12, 2017), <https://www.sec.gov/litigation/complaints/2017/comp-pr2017-125.pdf>.

120 *Id.* at 8, ¶ 37.

121 *Supra* note 118.

122 Compl., *SEC v. Yan*, *supra* note 120, at \*10, ¶¶ 46-47.

123 *Id.* at \*5, ¶ 16.

124 *USA v. Yan*, No. 17-mag-5156 (S.D.N.Y. July 11, 2017).

125 Press Release, U.S. Dep't of Justice, *Cambridge, Massachusetts, Man Pleads Guilty in Manhattan Federal Court to Insider Trading*, Rel. No. 17-349 (Oct. 30, 2017), <https://www.justice.gov/usao-sdny/pr/cambridge-massachusetts-man-pleads-guilty-manchattan-federal-court-insider-trading>.

126 Press Release, U.S. Sec. & Exch. Comm'n, *SEC Uncovers Wide-Reaching Insider Trading Scheme*, Rel. No. 2017-143 (Aug. 16, 2017), <https://www.sec.gov/news/press-release/2017-143>.

### Insider Trading Cases

enforcement division to gather sufficient information to file a complaint against the individuals.<sup>127</sup> In its complaint, the SEC alleged that over the course of three years, Rivas, a former IT employee at a large bank, misused his access to the bank's system by tipping off four individuals who traded on market-moving information relating to 30 impending corporate deals.<sup>128</sup>

The first ring involved Rivas' frequent tips to his girlfriend's father, James Moodhe, who in turn traded on the information and tipped off friend Michael Siva, a financial adviser at a brokerage firm.<sup>129</sup> From there, Siva used the information to make trades for his clients, earning commissions for himself, and to make trades for himself and his wife.

Separately, a second trading ring involved two of Rivas' friends in Florida, Roberto Rodriguez and Rodolfo Sablon, who passed along tips to execute illegal trades using a self-destructing, encrypted smartphone messaging application, code words, and several shell companies, generating over \$2 million in profits in just over a year.<sup>130</sup>

The SEC alleged a third trading ring involving Jhonatan Zoquier, who also profited on inside information communicated through the messaging application and passed information to Jeffrey Rogiers.<sup>131</sup> The SEC alleged that Rogiers then placed illegal trades for himself and tipped off others to trade.<sup>132</sup>

In the pending case, the SEC requested permanent injunctions, disgorgement, penalties and interest.<sup>133</sup> The U.S. Attorney's Office for the Southern District of New York also brought criminal charges against the same seven individuals.<sup>134</sup>

### ***In re Deerfield Management Co., L.P., No. 3-18120 (Aug. 21, 2017)***

On Aug. 21, 2017, the SEC announced that Deerfield Management Co. L.P., a hedge fund advisory firm, agreed to pay in excess of \$4.6 million to settle charges that it failed to maintain, establish and enforce policies and procedures reasonably designed to prevent the misuse of inside information concerning confidential government decisions.<sup>135</sup> As reported in the "2017 Mid-Year Securities Litigation & Enforcement Highlights Report," the case relates to charges brought against current and former Deerfield analysts, a political intelligence analyst who passed them information, and an employee at the Centers for Medicare & Medicaid Services.<sup>136</sup>

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127 *Id.*

128 Compl., *SEC v. Rivas*, No. 17-cv-6192, at \*2, ¶¶ 1-4 (S.D.N.Y. Aug. 16, 2017), <https://www.sec.gov/litigation/complaints/2017/comp-pr2017-143.pdf>.

129 *Supra* note 126.

130 Compl., *SEC v. Rivas*, No. 17-cv-6192, at \*2-3, ¶¶ 5-7 (S.D.N.Y. Aug. 16, 2017), <https://www.sec.gov/litigation/complaints/2017/comp-pr2017-143.pdf>.

131 *Id.*

132 *Id.*

133 *Id.*, at \*4, ¶ 10.

134 Press Release, U.S. Dep't of Justice, *Five Individuals Charged with Participating in Three Insider Trading Schemes Generating More than \$5 Million in Profits on Inside Information Misappropriated from an Investment Bank*, Rel. No. 17-262 (Aug. 16, 2017), <https://www.justice.gov/usao-sdny/pr/five-individuals-charged-participating-three-insider-trading-schemes-generating-more-5>.

135 Press Release, U.S. Sec. & Exch. Comm'n, *Hedge Fund Adviser Charged for Inadequate Controls to Prevent Insider Trading*, Rel. No. 2017-146 (Aug. 21, 2017), <https://www.sec.gov/news/press-release/2017-146>.

136 See *2017 Mid-Year Securities Litigation and Enforcement Highlights: Supreme Court Cases Review*, *supra* note 1, at 31.



### Insider Trading Cases

The SEC noted that Deerfield used the extensive research it conducted to inform its investment decisions. Deerfield did not maintain sufficient policies and procedures to detect and prevent the research firms it engaged from providing material nonpublic information that was used to inform trading decisions. Deerfield placed the burden on its own employees to police themselves. In doing so, the SEC found that Deerfield “created a risk that it would receive and trade on illegal inside information, [and] as it turns out, that’s exactly what happened.”<sup>137</sup>

In the settled order, the SEC found that Deerfield was on notice that the political intelligence analyst was conveying material nonpublic information and that Deerfield had generated more than \$3.9 million in trading profits from material nonpublic information from the same political intelligence analyst and received over \$700,000 through its management agreements with hedge funds due to the same trades.<sup>138</sup>

Deerfield consented to the SEC order, which found that it had violated Section 204A of the Investment Advisers Act of 1940. Deerfield was censured and ordered to pay a total of \$4,757,962 in disgorgement, interest and penalties.

#### **SEC v. Chang, No. 5:17-cv-05438 (N.D. Cal. Sept. 20, 2017)**

On Sept. 20, 2017, the SEC charged Peter C. Chang with insider trading in connection with Alliance Fiber Optic Products Inc.’s stock.<sup>139</sup> According to the SEC, Chang used nonpublic information obtained in the context of his positions as Alliance’s chairman of the board, CEO and president to create secret brokerage accounts nominally held by his wife and brother.<sup>140</sup> The SEC alleged that the Changs’ and his brother’s scheme generated more than \$2 million in illegal profits.<sup>141</sup>

The SEC alleged that Chang secretly traded shares in the accounts held in his wife’s and brother’s names prior to two earnings announcements and an announcement about Corning’s acquisition of Alliance.<sup>142</sup> The SEC also alleged that Chang tipped off his brother in Taiwan with the same nonpublic information, which resulted in his brother’s decision to also trade Alliance shares ahead of the three announcements.<sup>143</sup> Chang was charged criminally in a separate action by the U.S. Attorney’s Office for the Northern District of California.<sup>144</sup>

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137 *Supra* note 135.

138 Order Instituting Administrative and Cease-and-Desist Proceedings at 2, *Matter of Deerfield Mgmt. Co., L.P.*, No. 3-18120 (Aug. 21, 2017), <https://www.sec.gov/litigation/admin/2017/ia-4749.pdf>.

139 Press Release, U.S. Sec. & Exch. Comm’n, *CEO Charged with Using Secret Accounts for Insider Trading in Company Stock*, Rel. No. 2017-168 (Sept. 20, 2017), <https://www.sec.gov/news/press-release/2017-168>.

140 *Id.*

141 *Id.*

142 *Id.*

143 *Id.*

144 *Id.*

### Insider Trading Cases

#### **SEC v. Lollar, No. 5:17-cv-01109 (W.D. Tex. Nov. 1, 2017)**

On Nov. 1, 2017, former Apache Corp. petroleum engineer Christopher J. Lollar settled insider trading charges with the SEC.<sup>145</sup> The SEC alleged that Lollar traded on confidential information prior to Apache's public announcement that it had discovered a new oil source.<sup>146</sup>

Apache's San Antonio office personnel worked to develop a new resource play, called Alpine High, and also prepared a presentation for Apache's board of directors and other senior executives.<sup>147</sup> Lollar worked in the San Antonio office at that time, and according to the SEC's complaint, Lollar had "regular contact with, and access to, many of the engineers and geologists that assisted in preparing the Board Presentation" and access to "high level information about the development of the Alpine High through staff meetings and daily email reports."<sup>148</sup>

The SEC alleged that Lollar "conducted trades in Apache shares and call options in the days and weeks leading up to the company's Alpine High announcement."<sup>149</sup> When Apache made its public announcement about Alpine High, Lollar allegedly sold the Apache stocks and options he had purchased and reaped a total of \$214,295.07 in illegal profits.<sup>150</sup> Lollar agreed to pay a total of \$425,809.50, inclusive of disgorgement payments, interest and a penalty.<sup>151</sup>

#### **SEC v. Leonard, No. 8:17-cv-02926 (M.D. Fla. Dec. 6, 2017)**

On Dec. 6, 2017, the SEC filed insider trading charges against Stephen Leonard, a Florida native who made illegal profits based on inside information misappropriated from his brother.<sup>152</sup>

The SEC alleged that Leonard traded in the stock of Puma Biotechnology Inc. ("Puma"), a biotechnology company where his brother held a senior position.<sup>153</sup> Leonard's brother confided in Leonard about material nonpublic information regarding Puma's clinical trial for its new cancer drug, neratinib.<sup>154</sup> Leonard and his brother had four conversations from May 11 through July 18, 2014, and after each of those conversations, "Leonard misappropriated [the confidential] information, in breach of the duty owed to his sibling, and used the information to purchase Puma stock."<sup>155</sup> After Puma publicly announced positive clinical trial results, Leonard sold shares of his Puma stock and ultimately made approximately \$107,000 in illegal profits.<sup>156</sup>

Leonard consented to a final judgment providing permanent injunctive relief, disgorgement of profits and interests made from his illegal trades, and an additional civil penalty, all totaling \$225,996.86.<sup>157</sup>

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145 Press Release, U.S. Sec. & Exch. Comm'n, *Petroleum Engineer Settles Charges of Insider Trading Ahead of Oil Discovery Announcement*, Rel. No. 2017-204 (Nov. 1, 2017), <https://www.sec.gov/news/press-release/2017-204>.

146 *Id.*

147 Compl., *SEC v. Lollar*, No. 5:17-cv-01109, at \*4, ¶ 15 (W.D. Tex. Nov. 1, 2017), <https://www.sec.gov/litigation/complaints/2017/comp-pr2017-204.pdf>.

148 *Id.* at \*9, ¶ 30.

149 *Supra* note 145.

150 *Id.*

151 *Id.*

152 Litigation Release, U.S. Sec. & Exch. Comm'n, *SEC Charges Florida Man with Insider Trading Based on Drug Trial Information*, Rel. No. 24005, (Dec. 7, 2017), <https://www.sec.gov/litigation/litreleases/2017/lr24005.htm>.

153 *Id.*

154 Compl., *SEC v. Leonard*, No. 8:17-cv-02926, at \*1, ¶ 3 (M.D. Fla. Dec. 6, 2017), <https://www.sec.gov/litigation/complaints/2017/comp24005.pdf>.

155 *Id.*

156 *Id.* at 2, ¶ 7.

157 *Supra* note 152.

### Insider Trading Cases

#### **SEC v. Spera, No. 3:17-cv-12875 (D.N.J. Dec. 11, 2017)**

On Dec. 11, 2017, the SEC charged former day trader Joseph Spera with insider trading.<sup>158</sup> As part of an insider trading ring with former colleagues, Spera allegedly stole confidential information from investment banks and clients, allowing him to trade ahead of secondary stock offerings.<sup>159</sup>

The SEC alleged that Spera and other insiders posed as portfolio managers in order to receive confidential details from investment bankers, including information relating to the bankers' marketing of secondary stock offerings by publicly traded issuers.<sup>160</sup> According to the SEC, the insiders used the confidential information to trade ahead of public announcements, ultimately generating a total of approximately \$5.5 million in illicit profits.<sup>161</sup>

Spera was charged criminally in a parallel criminal action by the U.S. Attorney's Office for the District of New Jersey. The SEC and U.S. Attorney's Office for the District of New Jersey also filed actions against Spera's co-conspirators and their alleged ringleader, Steven Fishoff.<sup>162</sup>

#### **SEC v. Brown, No. 2:17-cv-04630 (D. Ariz. Dec. 14, 2017)**

On Dec. 14, 2017, the SEC announced insider charges against Larry Brown, a former International Rectifier Corp. ("IRC") employee.<sup>163</sup> Brown allegedly learned that Infineon Technologies AG intended to acquire IRC, and he tipped off his friend Sean Fox.<sup>164</sup> Brown and Fox allegedly purchased IRC call options using Fox's brokerage account and combined deposits of \$12,000 in an alleged attempt to hide Brown's involvement.

The SEC alleged that when Fox closed out the option positions following the acquisition, the two made almost \$370,000 in illicit profit.<sup>165</sup> From there, Fox allegedly paid several of Brown's personal expenses and wrote checks to Brown's children and stepchildren, checks Brown's wife endorsed and cashed.<sup>166</sup>

Brown and Fox consented to entry of a final judgment ordering them to pay \$412,867.79 in disgorgement and interest, with a credit for the monetary amount they agreed to pay in their criminal case, which is pending in the District of Arizona for the same underlying conduct.<sup>167</sup>

#### **SEC v. Peer, No. 2:17-cv-01865 (W.D. Wash. Dec. 14, 2017)**

On Dec. 14, 2017, therapist Kenneth Peer settled insider trading charges with the SEC.<sup>168</sup> The SEC alleged that Peer traded in Zulily Inc. ("Zulily") stock based on inside information he learned from a Zulily employee during his counseling sessions.<sup>169</sup>

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158 Press Release, U.S. Sec. & Exch. Comm'n, *Stock Trader Charged in Insider Trading Ring*, Rel. No. 2017-228 (Dec. 11, 2017), <https://www.sec.gov/news/press-release/2017-228>.

159 *Id.*

160 Compl., *SEC v. Spera*, No. 3:17-cv-12875, at \*1-2 (D.N.J. Dec. 11, 2017), <https://www.sec.gov/litigation/complaints/2017/comp-pr2017-228.pdf>.

161 *Supra* note 158.

162 *Id.*

163 Litigation Release, U.S. Sec. & Exch. Comm'n, *SEC Charges Former Employee and Friend with Insider Trading in Securities of International Rectifier Corp.*, Rel. No. 24015 (Dec. 14, 2017), <https://www.sec.gov/litigation/litreleases/2017/lr24015.htm>.

164 *Id.*

165 *Id.*

166 *Id.*

167 *Id.*

168 Litigation Release, U.S. Sec. & Exch. Comm'n, *Therapist Settles Charges of Insider Trading Ahead of Acquisition Announcement*, Rel. No. 24012 (Dec. 14, 2017), <https://www.sec.gov/litigation/litreleases/2017/lr24012.htm>.

169 *Id.*

### Insider Trading Cases

Specifically, Peer “misappropriated nonpublic information disclosed in confidence by his patient, a Zulily employee, relating to Zulily’s impending acquisition by Liberty Interactive Corp.”<sup>170</sup> Following three counseling sessions with his client between July 2015 and Aug. 2015, Peer illegally traded in Zulily securities.<sup>171</sup> When Zulily publicly announced that it would be acquired by Liberty Interactive, Peer sold his securities for \$10,228 in illicit profits.<sup>172</sup>

As part of Peer’s settlement, Peer agreed to pay \$21,267.26 in disgorgement, interest and penalties.<sup>173</sup> Peer is also enjoined from any further securities violations.<sup>174</sup>

### ***Veleron Holding, B.V. v. Morgan Stanley*, --- S. Ct. ---, 2018 WL 311337, No. 17-363 (Jan. 8, 2018)**

On Jan. 8, 2018, the U.S. Supreme Court denied Veleron Holding BV’s petition for a writ of certiorari to review the lower courts’ decisions granting dismissal of an insider trading suit against Morgan Stanley.<sup>175</sup> Veleron, a special-purpose investment vehicle that was formed to make a \$1.5 billion investment in parts manufacturer Magna International Inc., borrowed \$1.229 billion from BNP to finance the investment.<sup>176</sup> Veleron pledged to BNP 20 million shares of Magna that it purchased as collateral for the loan, such that in the event of default, BNP had no recourse but to liquidate the pledged collateral and seek any outstanding deficiency from Veleron.<sup>177</sup> BNP entered into agreements with Morgan Stanley under which Morgan Stanley would liquidate the collateral as the need arose and would be responsible for 8.1 percent of any loss to BNP if there were a default and Veleron fell short.<sup>178</sup>

Under the agreements, BNP could demand immediate payment from Veleron if the price of Magna fell below a specified margin, and when the value of Magna stock sharply fell in Sept. 2008, BNP made a \$92.5 million margin call.<sup>179</sup> Morgan Stanley shorted Magna stock on Sept. 30 and Oct. 1, 2008, in an attempt to cover its own exposure to further declines in the price.<sup>180</sup> On Oct. 2, 2008, BNP sent Veleron an acceleration notice, and when Veleron did not pay, BNP directed Morgan Stanley to liquidate the pledged collateral.<sup>181</sup> Veleron alleged that Morgan Stanley breached its agreement with BNP by liquidating the stock in an unreasonable or negligent way and that by taking a short position on the stock, Morgan Stanley traded on material nonpublic information in violation of its agreement with Veleron, reducing the liquidation proceeds by as much as \$12.6 billion.<sup>182</sup>

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170 Compl., *SEC v. Peer*, No. 2:17-cv-01865, at \*1, ¶ 1 (W.D. Wash. Dec. 14, 2017), <https://www.sec.gov/litigation/complaints/2017/comp24012.pdf>.

171 *Supra* note 168.

172 Compl., *SEC v. Peer*, *supra* note 170, at \*2, ¶ 2.

173 *Supra* note 168.

174 *Id.*

175 *Veleron Holding, B.V. v. Morgan Stanley*, --- S. Ct. ---, 2018 WL 311337 (U.S. Jan. 8, 2018).

176 *Veleron Holding, B.V. v. Morgan Stanley*, 694 Fed. Appx. 858, 859-860 (2d Cir. 2017).

177 *Id.* at 860.

178 *Id.*

179 *Id.*

180 *Id.*

181 *Id.*

182 *Id.*

### Insider Trading Cases

After a trial, a jury in the Southern District of New York found that Morgan Stanley lacked fraudulent intent, and the court subsequently dismissed Veleron's breach-of-contract claim.<sup>183</sup> Though Veleron argued that it was a third-party beneficiary of the collateral liquidation agreement between Morgan Stanley and BNP, the district court disagreed and dismissed Veleron's breach claim for failure to state a claim upon which relief can be granted.<sup>184</sup> The Second Circuit affirmed the district court's decision, specifically noting that the text of the agreement did not account for any duty owed to Veleron and also lacked evidence of Morgan Stanley and BNP's intent to create a third-party beneficiary.

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<sup>183</sup> Clerk's judgment, *Veleron Holding, B.V. v. Morgan Stanley*, No. 1:12-cv-05966-CM-RLE (S.D.N.Y. Nov. 19, 2015), ECF No. 366.

<sup>184</sup> *Veleron Holding, B.V. v. Morgan Stanley*, 694 Fed. Appx. 858 (2d Cir. 2017).





## Settlements

### Settlements

### Insider Trading Settlements

#### ***In re John F. Stimpson, Administrative Pro. File No. 3-18067***

On July 18, 2017, the SEC entered an order instituting cease-and-desist proceedings, pursuant to Section 21C of the Securities Exchange Act of 1934, against John F. Stimpson, a former AuthenTec Inc. IT administrator.<sup>185</sup> Through his job as a senior network administrator at AuthenTec, Stimpson learned of Apple Inc.'s then-pending acquisition of the company.<sup>186</sup> Additionally, he "learned of unusual activity in AuthenTec's human resources department, including preparations for file transfers relating to the merger negotiations."<sup>187</sup> With that knowledge, Stimpson purchased call options on AuthenTec.<sup>188</sup> After the news of the acquisition was public knowledge, the stock price rose by 70 percent.<sup>189</sup> Over the next three months, Stimpson exercised his call options, earning himself \$135,570 in profits.<sup>190</sup> After negotiations, the SEC settled its claims against Stimpson for nearly \$280,000 in disgorgement, penalties and interest.

#### ***SEC v. Damon Hovannisian, No. 1:17-at-00617 (E.D. Cal. filed Aug. 10, 2017)***

On Aug. 10, 2017, in the Eastern District of California, the SEC charged Damon Hovannisian ("Damon"), Vernon Hovannisian, Vincent Hovannisian and Eddie Arakelian with insider trading. The SEC alleged that Damon, the husband of a high-level employee at International Rectifier Corp., a semiconductor company, noticed his wife was working "very long hours" and tipped off his friend and family that "something big" was going to happen at the company.<sup>191</sup> The complaint alleged that Damon "obtained access to the information about the pending acquisition" because his spouse was working on the acquisition of the company by a German chipmaker when she was both home and on vacation.<sup>192</sup>

The SEC alleged that Damon asked his friend to help him purchase the stock through the friend's account prior to the announcement and then to sell the shares two days after the acquisition was announced.<sup>193</sup> It also alleged that Damon tipped off his father and brother, both of whom also traded on the insider information. According to the SEC, collectively the defendants made approximately \$155,000 in illicit profits.<sup>194</sup>

The SEC filed charges pursuant to Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5.<sup>195</sup> Rather than litigating, the group, without admitting or denying the allegations, settled the claims and consented to pay civil penalties, disgorgement and prejudgment interest of approximately \$480,000.<sup>196</sup>

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185 *In re John F. Stimpson*, Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order, Sec. Exch. Act Rel. No. 81160, \*1-3, ¶¶ 1-15 (July 18, 2017), <https://www.sec.gov/litigation/admin/2017/34-81160.pdf>.

186 *Id.*

187 *Id.* at \*3, ¶ 9.

188 *Id.* at \*3, ¶¶ 10-11.

189 *Id.* at \*3, ¶ 13.

190 *Id.* at \*3, ¶ 14.

191 Compl., *SEC v. Damon V. Hovannisian*, No. 17-at-00167, at \*5, ¶¶ 21-25 (E.D. Cal. Aug. 10, 2017), <https://www.sec.gov/litigation/complaints/2017/comp23901.pdf>.

192 *Id.* at \*5, ¶ 21; Litigation Release, U.S. Sec. & Exch. Comm'n, *SEC Charges Four Individuals with Insider Trading in Stock of International Rectifier Corporation*, Rel. No. 23901 (Aug. 11, 2017), <https://www.sec.gov/litigation/litreleases/2017/lr23901.htm>.

193 Litigation Release, *SEC Charges Four Individuals with Insider Trading in Stock of International Rectifier Corporation*, *supra* note 192.

194 *Id.*

195 *Id.*

196 *Id.*

### Settlements

#### ***SEC v. Mayank Gupta, No. 1:17-civ-05274-SVK (N.D. Cal. filed Sept. 12, 2017)***

On Sept. 14, 2017, the SEC announced settled insider trading charges (Sections 10(b) and 14(e) of the Securities Exchange Act of 1934 and Rules 10b-5 and 14e-3) against Mayank Gupta, a former PricewaterhouseCoopers auditor.<sup>197</sup> The SEC alleged that during the course of his audit work, Gupta learned that Cavium Inc., one of his clients, was making plans to acquire QLogic Corp., a company traded on the Nasdaq stock exchange.<sup>198</sup> Before the deal was announced, Gupta allegedly informed his cousin, Pushpendra Agrawal, of the upcoming merger, resulting in Agrawal purchasing 250 QLogic call options.<sup>199</sup> After the news of the merger went public, QLogic's stock increased by over 9 percent, and Agrawal's profits were approximately \$23,785.<sup>200</sup>

Without admitting or denying the SEC's allegations, Gupta agreed to pay a civil penalty of \$23,785, and Agrawal agreed to pay \$23,785 in disgorgement, \$964 in interest and \$11,892 in penalties.<sup>201</sup>

### Civil Settlements

#### ***MGM Resorts International***

On Sept. 13, 2017, the Ninth Circuit upheld a \$75 million settlement of a shareholder securities fraud class action suit brought against MGM Resorts International ("MGM").<sup>202</sup> The lawsuit arose out of MGM's alleged failure to disclose to its investors that its Las Vegas Strip project suffered rising costs and construction defects and that MGM was having difficulty obtaining additional financing.<sup>203</sup>

MGM attempted to dismiss the case, but its efforts were denied.<sup>204</sup> The parties entered mediation, and after "extensive negotiations," the matter was settled, which was approved by the district court.<sup>205</sup> A party in interest objected to the settlement, resulting in additional motion practice.<sup>206</sup> The Ninth Circuit said that the district court properly relied on the mediator's statement that "the settlement "represent[ed] a well-reasoned and sound resolution of highly uncertain litigation" and was "the product of vigorous and independent advocacy and arms-length negotiation conducted in good faith."<sup>207</sup> As such, the district court's decision approving the settlement was affirmed.

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197 Litigation Release, U.S. Sec. & Exch. Comm'n, *Former PricewaterhouseCoopers Auditor and Relative Charged with Insider Trading*, Rel. No. 23934 (Sept. 13, 2017), <https://www.sec.gov/litigation/litreleases/2017/lr23934.htm>.

198 *Id.*

199 *Id.*

200 *Id.*

201 *Id.*

202 See *Luzerne Cty. Ret. Sys. v. MGM Mirage a/k/a MGM Resorts Int'l*, No. 09-cv-01558 (9th Cir. Sept. 13, 2017).

203 Compl., *Luzerne Cty. Ret. Sys. v. MGM Mirage a/k/a MGM Resorts Int'l*, No. 09-cv-01558 (D. Nev. Aug. 17, 2009).

204 Order, *Luzerne Cty. Ret. Sys. v. MGM Mirage a/k/a MGM Resorts Int'l*, No. 09-cv-01558 (D. Nev. Sept. 26, 2013).

205 *Luzerne Cty. Ret. Sys.*, No. 09-cv-01558.

206 *Id.*

207 *Id.*

### Settlements

#### *In re Telia Co. AB*

On Sept. 21, 2017, Swedish telecommunications company Telia Co. consented to the entry of an order of disgorgement in the sum of \$458 million, settling charges that its subsidiary, Coscom LLC, violated the anti-bribery and internal accounting controls provisions of the Foreign Corrupt Practices Act.<sup>208</sup> The company was registered as a U.S. issuer at the time of the bribery.<sup>209</sup>

The charges stemmed from the company's actions in paying at least \$330 million in bribes to government officials in Uzbekistan from 2007 through 2010, generating more than \$2.5 billion in revenue for the company.<sup>210</sup> This in turn allegedly violated (i) Section 30A of the Exchange Act because Telia agreed "to make corrupt payments to government officials in Uzbekistan to obtain business" and (ii) Section 13(b)(2)(B) of the Exchange Act because the company did not "devise and maintain a reasonable system of internal accounting controls."<sup>211</sup>

In addition to its settlement with the SEC, Telia agreed to both a U.S. criminal penalty of approximately \$274 million and a penalty from the Public Prosecution Service of the Netherlands for another \$274 million, resulting in an aggregate financial total of nearly \$1 billion as a result of its actions.<sup>212</sup>

### Regulatory Actions

#### *In re Halliburton Co. & Jeannot Lorenz*

On July 27, 2017, Halliburton Co. ("Halliburton") agreed to a settlement with the SEC for \$29.2 million, resolving the SEC's claims that Halliburton violated the books, records and internal accounting controls provisions of the Foreign Corrupt Practices Act.<sup>213</sup> The SEC found that in 2008, Halliburton's management team was informed by Sonangol officials that Sonangol was going to veto further work with Halliburton in Angola because Halliburton did not work with enough local businesses in Angola.<sup>214</sup> Former Halliburton Vice President Jeannot Lorenz was asked to assist with finding local firms to work with Halliburton that would satisfy Sonangol, which Lorenz did.<sup>215</sup>

In reviewing the transactions, the SEC found that the contracts between Halliburton and the local company "were intended to meet local content requirements rather than the stated scope of work."<sup>216</sup> Further, Lorenz looked for services that the company in question could provide, did not conduct a competitive bidding process for services and took steps to avoid an internal accounting control to review contracts larger than \$10,000 for corruption risks.<sup>217</sup> As a result, between 2010 and 2011,

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208 *In re Telia Co. AB*, Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order, Sec. Exch. Act Rel. No. 81669 (Sept. 21, 2017), <https://www.sec.gov/litigation/admin/2017/34-81669.pdf>.

209 *Id.* at \*2, ¶¶ 1-5.

210 *Id.*

211 *Id.* at \*2, ¶ 4.

212 See William Gorta, *Swedish Telecom Telia to Pay \$1B in FCPA Settlement*, Law360 (Sept. 17, 2017), <https://www.law360.com/articles/966541/swedish-telecom-telia-to-pay-1b-in-fcpa-settlement>.

213 Press Release, U.S. Sec. & Exch. Comm'n, *Halliburton Paying \$29.2 Million to Settle FCPA Violations*, Rel. No. 2017-133 (July 27, 2017), <https://www.sec.gov/news/press-release/2017-133>.

214 *In re Halliburton Co. & Jeannot Lorenz*, Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order, Sec. Exch. Act Rel. No. 81222, at \*2, ¶¶ 1-4 (July 27, 2017), <https://www.sec.gov/litigation/admin/2017/34-81222.pdf>.

215 *Id.*

216 *Supra* note 213.

217 *Id.*

### Settlements

Halliburton paid \$3.7 million to the local Angolan company.<sup>218</sup> During this time, Sonangol awarded Halliburton several lucrative contracts, resulting in an approximately \$14 million profit for Halliburton.<sup>219</sup> The SEC determined that Halliburton awarded the contracts just to pay a local company, thereby satisfying the “local content requirements” for Angola, “not for the stated scope of work set forth in each contract.”<sup>220</sup> Additionally, in awarding the contracts, the SEC determined that Halliburton did not follow any of its internal accounting controls regarding the awarding of contracts.<sup>221</sup>

Halliburton, while not admitting or denying the findings, consented to pay \$14 million in disgorgement, \$1.2 million in prejudgment interest and \$14 million in penalties, and “former vice president Jeannot Lorenz ... agreed to pay a \$75,000 penalty for causing the company’s violations, circumventing internal accounting controls, and falsifying books and records.”<sup>222</sup> Additionally, the company will retain an independent compliance consultant for a period of 18 months to review its anti-corruption policies and procedures.<sup>223</sup>

### In re Banca IMI Securities Corp.

In Aug. 2017, the SEC and Banca IMI Securities (“BISC”) agreed to settle charges the SEC brought against BISC relating to American Depositary Receipts (“ADRs”).<sup>224</sup> ADRs are U.S. securities that permit “U.S. investors to invest in foreign companies without having to purchase the shares in the foreign markets, and allow foreign companies to get increased exposure to U.S. markets” without owning the underlying securities.<sup>225</sup> Brokers like BISC with certain “pre-release agreements,” can obtain ADRs without depositing corresponding foreign shares “provided the broker owns or takes reasonable steps to determine that the customer owns the number of foreign shares that corresponds to the number of shares the ADR represents.”<sup>226</sup>

Over a four-year period, from 2011 through 2015, BISC obtained prereleased ADRs but did not follow the proper procedures, namely, “taking reasonable steps to determine whether the requisite number of ordinary shares was owned and custodied by the person on whose behalf the pre-released ADRs were being obtained.”<sup>227</sup> This resulted in many instances where the ADRs were issued but not “backed by ordinary shares,” inappropriate short selling and inappropriate profiting around the dividend record sale.<sup>228</sup> “U.S. investors who invest in foreign companies through ADRs have a right to expect market professionals to create new ADRs only when they are backed by foreign shares so that the new ADRs are not used to game the system,” said

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218 *Id.*

219 *In re Halliburton Co. & Jeannot Lorenz*, *supra* note 214, at \*7, ¶ 22.

220 *Id.* at \*2, ¶ 3.

221 *Id.*

222 *Supra* note 213.

223 *Id.*

224 Press Release, U.S. Sec. & Exch. Comm’n, *Banca IMI Securities to Pay \$35 Million for Improper Handling of ADRs in Continuing SEC Crackdown*, Rel. No. 2017-144 (Aug. 18, 2017), <https://www.sec.gov/news/press-release/2017-144>.

225 *In re Banca IMI Securities Corp.*, Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933, and Section 15(b) of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order, Sec. Exch. Act Rel. No. 81427, at \*2, ¶ 1 (Aug. 18, 2017), <https://www.sec.gov/litigation/admin/2017/33-10401.pdf>.

226 *Supra* note 224.

227 *Supra* note 225, at \*2, ¶ 4.

228 *Id.*

## 2017 YEAR-END SECURITIES LITIGATION AND REGULATORY ENFORCEMENT HIGHLIGHTS

### Settlements

Sanjay Wadhwa, Senior Associate Director of the SEC's New York regional office.<sup>229</sup> According to Wadhwa, "BISC's actions left the ADR markets ripe for potential abuse."<sup>230</sup>

In connection with the settlement, BISC agreed to pay \$35 million, consisting of \$18 million in disgorgement, \$2.3 million in interest and a \$15 million penalty.<sup>231</sup>

#### ***In re State Street Global Markets LLC, State Street Global Advisors Funds Distributors LLC & State Street Bank & Trust Co.***

On Sept. 7, 2017, the SEC announced that two State Street entities consented to the payment of \$35 million to settle charges in connection with two separate orders.<sup>232</sup>

The first order was between the SEC and State Street Global Markets LLC ("State Street Global"). State Street agreed to settle allegations that it charged customers "hidden and unauthorized mark-ups and commissions beyond the fees, mark-ups, or commissions that the customers had agreed to pay."<sup>233</sup> State Street Global's actions resulted in \$20 million in improper revenue for the firm, which it gained by using "false trading statements, pre-trade estimates, and post-trade reports" in its efforts to shield the compensation it was earning on the transactions.<sup>234</sup> Paul G. Levenson, Director of the SEC's Boston regional office, stated, "Agreeing to a fee arrangement and then secretly tucking in hidden, unauthorized markups is fraudulent mistreatment of customers."<sup>235</sup>

The second order was between the SEC and State Street Bank and Trust Co. ("State Street Bank"), which operated a securities trading platform. While the platform had been marketed as "fair and transparent," State Street Bank provided one subscriber with a "last look" option, which gave the subscriber a period of time within which it could "reject a match to a quote," which it did 57 times, each of which had a \$1 million face value.<sup>236</sup> State Street Bank failed to tell the counterparties to the potential transaction that the subscriber had rejected their orders with the last-look function.<sup>237</sup> Additionally, State Street Bank informed another subscriber that the platform did not even have a last-look function and did not mention that the function was being developed.<sup>238</sup>

In commenting on the settlement, Kathryn A. Pyszka, Associate Director of the SEC's Chicago regional office, stated, "Firms that run trading platforms cannot mislead subscribers about their order handling operations."<sup>239</sup>

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<sup>229</sup> *Supra* note 224.

<sup>230</sup> *Id.*

<sup>231</sup> *Id.*

<sup>232</sup> Press Release, U.S. Sec. & Exch. Comm'n, *State Street Paying Penalties to Settle Fraud Charges and Disclosure Failures*, Rel. No. 2017-159 (Sept. 7, 2017), <https://www.sec.gov/news/press-release/2017-159>.

<sup>233</sup> *In re State St. Global Mkts. LLC, State St. Global Advisors Funds Distribs. LLC & State St. Bank & Trust Co.*, Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933, and Section 15(b) and 21(c) of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order, Sec. Exch. Act Rel. No. 81543, at \*2 (Sept. 7, 2017), <https://www.sec.gov/litigation/admin/2017/33-10411.pdf>.

<sup>234</sup> Press Release, U.S. Sec. & Exch. Comm'n, *State Street Paying Penalties to Settle Fraud Charges and Disclosure Failures*, Rel. No. 2017-159 (Sept. 7, 2017), <https://www.sec.gov/news/press-release/2017-159>.

<sup>235</sup> *Id.*

<sup>236</sup> *In re State St. Bank & Trust Co.*, Order Instituting Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933, Making Findings, and Imposing a Cease-and-Desist Order, Sec. Exch. Act Rel. No. 10410, at \*3-4, ¶¶ 7-16 (Sept. 7, 2017), <https://www.sec.gov/litigation/admin/2017/33-10410.pdf>.

<sup>237</sup> *Id.*

<sup>238</sup> *Id.*

<sup>239</sup> *Supra* note 234.



### Settlements

### Accounting and Books and Records Settlements

#### ***Aegerion Pharmaceuticals***

On Sept. 22, 2017, the SEC announced that Aegerion Pharmaceuticals, a subsidiary of Novelon Therapeutics, agreed to a \$4.1 million settlement of allegations that it misled its investors in 2013.<sup>240</sup> The SEC alleged that over 2013 and 2014, Aegerion represented to investors that a “vast majority” of patients who received prescriptions for its drug Juxtapid were purchasing the drug.<sup>241</sup> In actuality, the company’s records showed that only 50 percent of the prescriptions were actually filled.<sup>242</sup> In addition to the SEC settlement, Aegerion also settled allegations filed by the Department of Justice regarding how Aegerion marketed the drug, resulting in an additional \$36 million payment, including fines and settlement of federal and state civil liability claims.<sup>243</sup>

#### ***Osiris Therapeutics, Inc.***

On Nov. 2, 2017, the SEC reached a settlement with Osiris Therapeutics Inc. in connection with misleading statements made to investors and the company’s unlawful accounting practices.<sup>244</sup> Over a period of two years, the SEC alleged that four former executives “routinely overstated” the performance of the company and issued fraudulent financial statements to its investors.<sup>245</sup> Osiris “improperly recognized revenue using artificially inflated prices, backdated documents to recognize revenue in earlier periods, and prematurely recognized revenue upon delivery of products to be held on consignment.”<sup>246</sup> The efforts undertaken were designed to create the impression that the company was consistently exceeding expectations.<sup>247</sup> While Osiris settled the charges and paid a penalty of \$1.5 million, the litigation is still ongoing against the executives.<sup>248</sup>

#### ***In re Provectus Biopharmaceuticals, Inc.***

The SEC pursued charges against Provectus Biopharmaceuticals Inc. (“Provectus”) due to its former CEO and CFO using the company to obtain millions of dollars in unreported perks consisting of travel advances and expense reimbursements used for their personal benefit.<sup>249</sup> The internal accounting controls implemented by Provectus were “insufficient,” according to the SEC, as they did not detect the “improper and unauthorized payments, which were not accurately recorded in the company’s books and records.”<sup>250</sup> The effect of the defective accounting controls was a misrepresentation of the benefits, running in the millions, paid to the two executives.

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240 Press Release, U.S. Sec. & Exch. Comm’n, *Pharmaceutical Company Paying Penalty for Misleading Investors About Sales Metric*, Rel. No. 2017-175 (Sept. 22, 2017), <https://www.sec.gov/news/press-release/2017-175>.

241 *Id.*

242 *Id.*

243 Press Release, U.S. Dep’t of Justice, *Drug Maker Aegerion Agrees to Plead Guilty; Will Pay More Than \$35 Million to Resolve Criminal Charges and Civil False Claims Allegations*, Rel. No. 17-1044 (Sept. 22, 2017), <https://www.justice.gov/opa/pr/drug-maker-aegerion-agrees-plead-guilty-will-pay-more-35-million-resolve-criminal-charges-and>.

244 Press Release, U.S. Sec. & Exch. Comm’n, *SEC Charges Biotech Company, Executives With Accounting Fraud*, Rel. No. 2017-207 (Nov. 2, 2017), <https://www.sec.gov/news/press-release/2017-207>.

245 *Id.*

246 *Id.*

247 *Id.*

248 *Id.*

249 Press Release, U.S. Sec. & Exch. Comm’n, *SEC Charges Biopharmaceutical Company With Failing to Properly Disclose Perks for Executives*, Rel. No. 2017-229 (Dec. 12, 2017), <https://www.sec.gov/news/press-release/2017-229>.

250 *In re Provectus Biopharmaceuticals, Inc.*, Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-and-Desist Order, Sec. Exch. Act Rel. No. 82292, at \*2, ¶ 2 (Dec. 12, 2017), <https://www.sec.gov/litigation/admin/2017/34-82292.pdf>.

### Settlements

Regarding the charges and the settlement, Stephanie Avakian, Co-Director of the SEC's Enforcement Division, stated, "Reimbursement of travel and entertainment expenses, and other perks paid to executives, can be material information, and companies must ensure that the perks they pay for executives are properly recorded and disclosed in public filings."<sup>251</sup> Provectus settled with the SEC and agreed to undertake certain actions to address its then-existing accounting deficiencies.

Notably, the settlement did not include a penalty, but according to Steven Peikin, Co-Director of the SEC's Enforcement Division, this is attributable to "the proactive remediation and cooperation by the company's new leadership. . . . Provectus fired wrongdoers, took other steps to remedy its controls, and provided SEC staff with critical information regarding its former executives' expense reimbursement abuses."<sup>252</sup>

#### **Four Points Capital Partners LLC**

In a press release issued on Dec. 6, 2017, the SEC noted that it was continuing a "crackdown on brokers who defraud customers."<sup>253</sup> The statement was made in connection with SEC complaints against two brokers formerly affiliated with Four Points Capital Partners LLC. The brokers were accused of churning in the customers' accounts "by engaging in excessive trading in disregard of their customers' trading objectives and risk tolerance for the purpose of generating commissions."<sup>254</sup> They engaged in "in-and-out trading that was almost certain to lose money for customers while yielding commissions for themselves."<sup>255</sup> Their actions caused customers to lose nearly \$574,000 while they received more than \$280,000 in commissions.<sup>256</sup>

According to Sanjay Wadhwa, Senior Associate Director of the SEC's New York Regional Office, the SEC is intensifying its focus on "unscrupulous brokers and their harmful practices."<sup>257</sup> One of the brokers settled with the SEC, agreeing to disgorge his "ill-gotten gains with interest," pay a \$160,000 penalty, be permanently enjoined from similar violations in the future, and be barred from the securities industry and penny stock trading. The action remains pending against the other broker.<sup>258</sup>

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<sup>251</sup> *Supra* note 249.

<sup>252</sup> *Id.*

<sup>253</sup> Press Release, U.S. Sec. & Exch. Comm'n, *SEC Continues Crackdown on Brokers Defrauding Customers*, Rel. No. 2017-223 (Dec. 6, 2017), <https://www.sec.gov/news/press-release/2017-223>.

<sup>254</sup> Compl., *SEC v. Berkey & Fischer*, No. 17-cv-09552, at \*9, ¶ 33 (S.D.N.Y. Dec. 6, 2017), <https://www.sec.gov/litigation/complaints/2017/comp-pr2017-223.pdf>.

<sup>255</sup> *Supra* note 253.

<sup>256</sup> *Id.*

<sup>257</sup> *Id.*

<sup>258</sup> *Id.*



## Investment Adviser and Hedge Fund Cases

### Investment Adviser and Hedge Fund Cases

Although it is always hazardous to identify trends based on one year of SEC enforcement activity, SEC enforcement actions in the investment adviser/hedge fund area in 2017 appear to reflect an SEC focus on Main Street firms rather than large Wall Street firms. Whether this is a result of a shift in enforcement focus or simply the result of coincidence remains to be seen. What is clear is that the SEC brought far fewer actions in 2017.<sup>259</sup> Chairman Jay Clayton made comments in Nov. that some are interpreting as a shift in focus away from Wall Street to Main Street,<sup>260</sup> and the cases summarized below represent the bulk of actions against investment advisers and hedge funds. In nearly every case (with the exception of two Ponzi scheme cases), the money customers lost totaled less than \$1 million and the defendants were small-time players. This contrasts with prior years' disgorgement and penalties, which often ran into the tens of millions of dollars, largely paid by high-profile Wall Street firms.

#### ***In the Matter of Millennium Management LLC***

On Oct. 31, 2017, the SEC announced a settlement with Millennium Management LLC, an investment advisory firm, stemming from allegations that Millennium engaged in short-selling securities during the five-day restricted period before a public offering and thereafter covered the short through the offering, in violation of Rule 105 of Regulation M of the Exchange Act.<sup>261</sup> Rule 105 prohibits persons from purchasing in covered offerings where the person has shorted the same securities during the restricted period.<sup>262</sup>

Millennium allegedly sold short several issuers' stocks in 2012. According to the order instituting proceedings, in each case, the company sold the stock short within five days of the issuers selling more stock in secondary offerings, through which Millennium covered their short positions.<sup>263</sup> This conduct resulted in unlawful profits of more than \$286,000.<sup>264</sup>

Millennium submitted a settlement offer, and the commission accepted it. Under the settlement, Millennium paid approximately \$338,000 in disgorgement and interest, and a \$300,000 civil penalty.<sup>265</sup>

#### ***SEC v. Newsholme***

On Sept. 6, 2017, Scott Newsholme, an investment adviser and tax preparer, was arrested by FBI and IRS agents and charged with defrauding clients of more than \$1.8 million.<sup>266</sup> The criminal complaint charged Newsholme with one count each of mail fraud, wire fraud, and securities fraud in connection with his use of investor funds for personal expenses, including purchases of vehicles and bedroom furniture, payment of casino debts, bank transfers to his personal account, and ATM withdrawals.<sup>267</sup>

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259 Ed Beeson, *SEC Enforcement Activity Plunged With Dawn of Trump Era*, Law360 (Nov. 14, 2017), <https://www.law360.com/articles/984979/sec-enforcement-activity-plunged-with-dawn-of-trump-era>.

260 *Id.*

261 *In re Millennium Mgmt. LLC*, Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-and-Desist Order, Sec. Exch. Act Rel. No. 81989 (Oct. 31, 2017), <https://www.sec.gov/litigation/admin/2017/34-81989.pdf>.

262 *Id.* at 2.

263 *Id.* at 4-6.

264 *Id.* at 2.

265 *Id.* at 5.

266 Press Release, Monmouth County Investment Adviser And Tax Preparer Charged In \$1.8 Million Investment Fraud Scheme, U.S. Dept. of Justice (Sept. 6, 2017), <https://www.justice.gov/usao-nj/pr/monmouth-county-investment-adviser-and-tax-preparer-charged-18-million-investment-fraud>.

267 *Id.*

### Investment Adviser and Hedge Fund Cases

According to the criminal complaint, Newsholme owned and operated at least three different financial advisory and tax return businesses. Between 2007 and 2016, he allegedly told clients that their money would be invested in traditional securities as well as in, among other things, bond instruments, including a bond investment in a video-game production company involved in the production of a film.<sup>268</sup> The government has alleged that even after his arrest in Sept. 2017 and his release on bail, Newsholme continued his scheme,<sup>269</sup> which prompted the judge overseeing his criminal trial to temporarily remand him to prison.<sup>270</sup>

In a separate civil action, the SEC filed a complaint against Newsholme alleging he stole over \$1 million from his clients to pay for his gambling habits and other personal expenses.<sup>271</sup> The complaint alleges that Newsholme preyed on unsophisticated clients and used Ponzi-like tactics to perpetuate his scheme, such as using funds from newer investors to make payments to other investors who requested withdrawals of funds.<sup>272</sup> Moreover, when clients gave him checks for investments, Newsholme allegedly cashed them at local check-cashing stores and deposited the money in his personal bank account.<sup>273</sup>

Previously, in 2014, FINRA barred Newsholme from associating with member firms for his failure to reply to requests for information but allowed him to retain his license.<sup>274</sup> Newsholme consented in 2015 to an order from the New Jersey Bureau of Securities that found he made untrue statements regarding securities and engaged in unethical or dishonest securities business practices.<sup>275</sup> Despite these activities, he continued to attract clients. The Commission alleges violations of the Exchange Act, Securities Act, and Advisers Act and seeks disgorgement and civil penalties.<sup>276</sup> Both the criminal case and SEC enforcement action remain pending.

#### **SEC v. Drake**

On Nov. 8, 2017, the SEC filed a civil enforcement action against Jeremy Joseph Drake, an investment adviser, alleging that he defrauded two clients, a professional athlete and his spouse, of \$1.2 million by charging undisclosed fees.<sup>277</sup> Through an arrangement with his advisory company, Drake allegedly personally received approximately \$900,000 of these fees as incentive-based compensation. Drake met the clients in 2008, when he worked for another investment adviser.<sup>278</sup> The clients ultimately placed more than \$35 million of their assets under Drake's management.<sup>279</sup>

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268 *Id.*

269 *Id.*; Motion to Remand and/or Revoke Bail (ECF No. 12) (D.N.J. filed Oct. 27, 2017).

270 Order of Detention (ECF No. 18) (D.N.J. filed Oct. 27, 2017).

271 *SEC v. Newsholme*, No. 17-cv-6813 (ECF No. 1) (D.N.J. filed Sept. 6, 2017), <https://www.sec.gov/litigation/complaints/2017/comp-pr2017-156.pdf>.

272 *Id.* at 6.

273 *Id.* at 5.

274 *Id.* at 4.

275 *Id.*

276 *Id.* at 16-18.

277 *SEC v. Drake*, No. 17-cv-6204 (ECF No. 1) (C.D. Cal. Aug. 22, 2017).

278 *Id.* at 4.

279 *Id.*

### Investment Adviser and Hedge Fund Cases

The clients signed an investment advisory agreement (“IA Agreement”) in 2009, which stated that they would pay 1 percent fees on assets entrusted to the management of Drake.<sup>280</sup> Over the ensuing years, Drake made false oral representations supported by falsified documents that the clients were receiving rebates on those fees, making the effective fee only 0.15 percent to 0.20 percent.<sup>281</sup> When the clients questioned the accuracy of the representations related to the rebated fees, Drake created a fake persona acting as a representative from the company that was the custodian of the clients’ assets (“Stenson”).<sup>282</sup> Drake sometimes acted as Stenson, and at other times persuaded a friend to stand in to assure the clients falsely that their fees were far less than stated in the IA Agreement.<sup>283</sup>

The Commission alleges that Drake breached his fiduciary duties to the clients and seeks disgorgement and civil penalties for Advisers Act violations.<sup>284</sup> This case is pending.

#### ***SEC v. Berkey, et al.***

On Dec. 6, 2017, the SEC initiated a civil enforcement action in the Southern District of New York against two registered representatives, defendants Zachary Berkey and Daniel T. Fischer, for allegedly defrauding elderly and other unsophisticated investors.<sup>285</sup> The complaint alleges that over several years, the defendants each invested their clients’ money in a high-cost, in-and-out trading scheme through which the clients lost more than \$573,000 and the defendants earned more than \$280,000 in commissions.<sup>286</sup>

The Commission alleges the defendants determined the amount of commissions they charged their customers, on top of a flat-rate fee for each trade.<sup>287</sup> Because they charged such high fees and commissions, the securities purchased needed to rise significantly to make a profit, which rarely occurred.<sup>288</sup> The complaint avers that “due to the costs imposed on the customers, the accounts handled by Berkey and Fischer had to increase in average of, respectively, 58.19% and 70.26%, on a yearly basis before the customer would see a single dollar of profit.”<sup>289</sup> The defendants allegedly traded very frequently, with the average position held for under a month.<sup>290</sup>

The Commission alleges securities fraud and other violations of the federal securities laws for recommending unsuitable trades, making material misrepresentations and omissions, churning, and unauthorized trading.<sup>291</sup> The complaint sought to enjoin the defendants as well as to obtain disgorgement, interest, and civil penalties.<sup>292</sup> On Dec. 21, 2017, the court entered a stipulated final

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280 *Id.* at 4.

281 *Id.* at 4-9.

282 *Id.* at 9-10.

283 *Id.* at 10-11.

284 *Id.* at 12-14.

285 *SEC v. Berkey, et al.*, No. 17-cv-9552 (ECF No.1) (S.D.N.Y. filed Dec. 6, 2017), <https://www.sec.gov/litigation/complaints/2017/comp-pr2017-223.pdf>.

286 *Id.* at 2.

287 *Id.* at 6.

288 *Id.*

289 *Id.* at 7.

290 *Id.*

291 *Id.* at 11-12.

292 *Id.* at 13.



### Investment Adviser and Hedge Fund Cases

judgment against one of the defendants, permanently enjoining him from violating the various securities laws, imposing a civil penalty of \$160,000 and ordering disgorgement of \$174,515, plus over \$13,500 in prejudgment interest.<sup>293</sup> The case is still pending against the other defendant.

#### **SEC v. Smith**

On Dec. 7, 2017, the SEC initiated a civil enforcement action in the Eastern District of Pennsylvania against Paul W. Smith, a registered representative, who allegedly defrauded unsophisticated customers for nearly 25 years.<sup>294</sup> The complaint alleges Smith created false account statements with fictitious balances, engaging in a Ponzi-like scheme to further his securities fraud.<sup>295</sup>

The complaint states that Smith used new investor money to pay back redeeming investors and for his personal expenses.<sup>296</sup> Total client losses were \$2.35 million, approximately \$250,000 of which Smith allegedly used to write checks to himself.

The complaint alleges violations of the Securities Act, Exchange Act and Advisers Act and seeks to enjoin Smith and obtain disgorgement with interest and civil penalties.<sup>297</sup> Smith has agreed to a settlement under which he is permanently enjoined from violating various securities laws and must pay \$363,000 in disgorgement and interest.<sup>298</sup> The disgorgement amount will be satisfied upon the issuance of a final judgment in his parallel criminal case; Smith is due to be sentenced in May 2018.<sup>299</sup>

#### **SEC v. Scronic**

On Oct. 5, 2017, the SEC initiated a civil enforcement action against an adviser, Michael Scronic, the Commission accuses of running a \$21 million Ponzi scheme.<sup>300</sup> Scronic told his investors (mostly friends and family) that he ran a hedge fund engaged in a risky options trading strategy that had a history of making clients money.<sup>301</sup> The complaint alleges that instead of making money for his clients, his activity “sustained dramatic and consistent losses” of the funds invested by clients. Overall, since 2010, Scronic’s brokerage account has had cumulative deposits of \$20.8 million, withdrawals of \$2.9 million, and investment losses of \$15.8 million.<sup>302</sup> The Commission alleged that during the period from Jan. 2015 to July 2017, Scronic withdrew or transferred \$2.2 million to his personal bank accounts, and that only \$6,000 remains in the brokerage account.<sup>303</sup>

The complaint alleges Securities Act, Exchange Act and Advisers Act violations and seeks disgorgement and civil penalties.<sup>304</sup> This case is pending. A federal criminal case has also been filed and is pending.<sup>305</sup>

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293 *Id.*; Final Judgment as to Defendant Daniel T. Fischer (ECF No. 12) (Dec. 21, 2017).

294 *SEC v. Smith*, No. 17-cv-5480 (ECF No. 1) (E.D. Pa. Dec. 7, 2017), <https://www.sec.gov/litigation/complaints/2017/comp-pr2017-224.pdf>.

295 *Id.* at 2.

296 *Id.* at 3.

297 *Id.* at 9-12.

298 *Id.*; Final Judgment as to Defendant Paul W. Smith (ECF No. 2) (Dec. 20, 2017).

299 *United States v. Smith*, 17-cr-00626 (ECF No. 10) (E.D. Pa. Dec. 18, 2017).

300 *SEC v. Scronic*, No. 17-cv-7615 (ECF No. 1) (S.D.N.Y. Oct 5, 2017).

301 *Id.* at 1-2.

302 *Id.* at 6.

303 *Id.* at 7.

304 *Id.* at 13-14.

305 *United States v. Scronic*, No. 17-mj-7351 (ECF No. 1) (S.D.N.Y. Oct. 3, 2017).

### Investment Adviser and Hedge Fund Cases

#### ***SEC v. Shapiro et al.***

On Dec. 20, 2017, the SEC initiated a civil enforcement action against a hedge fund operator Robert Shapiro (“Shapiro”), and his funds and management company (the funds and management company together, “Woodbridge”), alleging that the defendants executed a \$1.2 billion Ponzi scheme, which defrauded over 8,400 investors.<sup>306</sup> Shapiro allegedly told investors that Woodbridge lent money at high rates to third-party borrowers and that the interest payments on the loans funded high returns for his investors.<sup>307</sup> The Commission avers that Woodbridge only generated only \$13.7 million of interest income during the execution of the billion-dollar scheme and that Shapiro used new investor money to pay back older investors.<sup>308</sup>

According to the complaint, Shapiro and Woodbridge funneled nearly \$330 million to investors through the scheme and spent almost \$175 million on operating expenses, including \$65 million in sales commissions.<sup>309</sup> Shapiro allegedly pocketed \$21 million for personal expenses.

Most of the Woodbridge companies filed for protection under Chapter 11 of the U.S. Bankruptcy Code.<sup>310</sup> Without admitting to the alleged fraud, as of this writing they have petitioned the court to retain restructuring specialists and hire a chief restructuring officer<sup>311</sup> and are seeking authorization for post-petition financing.<sup>312</sup>

The Commission seeks permanent injunctive relief to enjoin Shapiro and Woodbridge from violating several sections of the Securities Act and Exchange Act, a freeze on the assets of Shapiro and Woodbridge that are not included in the bankruptcy estate, the appointment of a receiver, disgorgement, civil penalties, and other relief.<sup>313</sup> The court granted the SEC’s emergency motion for the receiver appointment and asset freeze.<sup>314</sup> This matter is pending.

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306 *SEC v. Shapiro*, No. 17-24624 (ECF No. 1) (S.D. Fla. Dec. 20, 2017).

307 *Id.* at 1.

308 *Id.* at 1, 4.

309 *Id.* at 4.

310 *In re Woodbridge Group of Companies LLC, et al.*, No. 17-12560 (jointly administered) (Bankr. D. Del. Dec. 4, 2017).

311 *Id.*, Notice of Filing of Revised Proposed Order Authorizing the Debtors to (I)(A) Retain Development Specialists, Inc. as Restructuring Advisor, (B) Designate Bradley D. Sharp as Chief Restructuring Officer, *Nunc Pro Tunc* to January 26, 2018, and (C) to Utilize Additional DSI Personnel; and (II) Approving the Agreement Related Thereto, (ECF No. 565) (filed Feb. 13, 2018).

312 *Id.*, Notice of Entry of Fourth Interim DIP Order and Final Hearing on Proposed DIP Financing, (ECF No. 578) (filed Feb. 14, 2018).

313 *Id.* at 42.

314 *Id.*; Order Granting Motion (ECF No. 12) (S.D. Fla. Dec. 20, 2017).



## SEC Cooperation and Whistleblower Programs

### SEC Cooperation and Whistleblower Programs

The SEC's Cooperation and Whistleblower programs continued to play a major role in the SEC's enforcement program during the second half of 2017. The following are some of the more significant developments during this period for those programs.

#### Cooperation Program

The SEC continued to acknowledge and reward cooperation during the second half of 2017, particularly in the form of reduced civil penalties. Some of the more notable settlements involving cooperation credit are discussed below.

##### ***In the Matter of Banca IMI Securities Corp.***

As noted in the Settlements section above, on Aug. 18, 2017, the SEC announced a settled order with Banca IMI Securities Corp. ("BISC"), an indirect, wholly-owned subsidiary of Italian bank Intesa Sanpaolo SpA, for allegedly requesting the issuance of, and receiving American Depositary Receipts ("ADRs") without possessing the required underlying foreign shares.<sup>315</sup> Without admitting or denying the SEC's findings, BISC agreed to (i) cease and desist from committing or causing any violations and any future violations of Section 17(a)(3) of the Securities Act, (ii) be censured, (iii) pay disgorgement and prejudgment interest in the amount of approximately \$20 million, and (iv) pay a civil penalty in the amount of \$15,000 – or over two-thirds of the disgorgement amount.<sup>316</sup>

The SEC's order indicates that it considered BISC's cooperation in the investigation and its remedial actions in determining the amount of the penalty to be assessed, and BISC expressly acknowledged that the SEC did not impose a civil penalty greater than \$15 million, due to its cooperation and remedial actions.<sup>317</sup>

##### ***In the Matter of SunTrust Investment Services, Inc.***

On Sept. 14, 2017, the SEC announced a settled order against SunTrust Investment Services ("SunTrust") for allegedly collecting more than \$1.1 million in avoidable fees by improperly recommending expensive share classes of various mutual funds when cheaper shares of the same funds were available.<sup>318</sup> Without admitting or denying the order's findings, SunTrust agreed to (i) cease and desist from committing or causing any violations or future violations of Sections 206(2), 206(4) and 207 of the Advisers Act and Rule 206(4)-7 thereunder; (ii) be censured; (iii) pay a disgorgement and prejudgment interest of approximately \$41,000; (iv) provide the SEC with an accounting of reimbursement to be paid by SunTrust to affected clients; and (v) pay a civil penalty of approximately \$1.1 million.<sup>319</sup> The order noted that in determining to accept SunTrust's offer of settlement, the SEC considered SunTrust's remedial efforts, which included, among other things, crediting fees back to clients, rebating affected client investment accounts and issuing new compliance guidelines.<sup>320</sup>

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315 Press Release, U.S. Sec. & Exch. Comm'n, *Banca IMI Securities to Pay \$35 Million for Improper Handling of ADRs in Continuing SEC Crackdown*, Rel. No. 2017-144 (Aug. 18, 2017), <https://www.sec.gov/news/press-release/2017-144>.

316 *Id.*

317 *Id.*

318 Press Release, U.S. Sec. & Exch. Comm'n, *SunTrust Charged with Improperly Recommending Higher-Fee Mutual Funds*, Rel. No. 2017-165 (Sept 14, 2017), <https://www.sec.gov/news/press-release/2017-165>.

319 *In the Matter of SunTrust Investment Servs., Inc.*, Order Instituting Administrative and Cease-and-Desist Proceedings, Pursuant to Section 15(b) of the Securities Act of 1934 and Sections 203(e) and 203(k) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order, <https://www.sec.gov/litigation/admin/2017/34-81611.pdf>.

320 *Id.*

### SEC Cooperation and Whistleblower Programs

#### ***In the Matter of YourPeople, Inc., dba Zenefits FTW Insurance Services and Parker Conrad***

On Oct. 26, 2017, the SEC settled with YourPeople, Inc., d.b.a. Zenefits FTW Insurance Services (“Zenefits”), a San Francisco-based software company whose insurance business accounted for 90 percent of its revenues, and its founder, Parker Conrad, for allegedly misleading investors in a private offering.<sup>321</sup> Zenefits was also alleged to have made false statements about whether its employees were properly licensed to sell insurance.<sup>322</sup> Without admitting or denying the findings, Zenefits agreed to: (i) cease and desist from committing or causing any violations of Section 17(a)(2) of the Securities Act and (ii) pay a civil penalty of \$450,000.<sup>323</sup> Zenefits expressly acknowledged in the order that the SEC did not impose a civil penalty in excess of \$450,000, based on its cooperation.<sup>324</sup>

The SEC’s order also notes that it considered Zenefits’ remedial acts and cooperation in imposing the penalty, which included the implementation of new controls to prevent the recurrence of violations.<sup>325</sup> The new controls included, among other things, (i) requiring all employees who performed the transactions in question to obtain nonresident producer licenses; (ii) creating the position of a chief compliance officer, and establishing a compliance team; and (iii) retaining a national accounting firm to test operations of the new licensing controls and report those results to various state insurance regulators.<sup>326</sup>

#### ***In the Matter of Beaumont Financing Authority***

In this action, the SEC sent a clear message of the harsher sanctions that may result for bond issuers and their underwriters who do not avail themselves of the opportunity to self-report violations under the SEC’s well-publicized Municipalities Continuing Disclosure Cooperation Initiative (the “MCDC Initiative”).

On Aug. 23, 2017, the SEC announced that a municipal financing authority in Beaumont, California, the Beaumont Financing Authority, and its then-executive director agreed to settle charges that they made false statements about prior compliance with continuing disclosure obligations in five bond offerings.<sup>327</sup> In a separate order, the underwriting firm behind the bond offering and its co-founder agreed to settle charges related to the offerings for failing to conduct reasonable due diligence on the continuing disclosure representations.<sup>328</sup>

In consenting to the SEC order without admitting or denying the findings, the Beaumont Financing Authority agreed to retain an independent consultant to review its policies and procedures.<sup>329</sup> In addition, the order required that Beaumont establish appropriate and comprehensive policies,

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321 Press Release, U.S. Sec. & Exch. Comm’n, *San Francisco Software Company and Founder Settle Charges of Misleading Investors About Business*, File No. 3-18263 (Oct. 27, 2017), <https://www.sec.gov/litigation/admin/2017/33-10429-s.pdf>.

322 *Id.*

323 *In the Matter of YourPeople, Inc. dba Zenefits FTW Insurance Services and Parker Conrad*, Order Instituting Cease-and-Desist Proceedings, Pursuant to Section 8A of the Securities Act of 1933, Making Findings, and Imposing a Cease-and-Desist Order, No. 3-18263, <https://www.sec.gov/litigation/admin/2017/33-10429.pdf>.

324 *Id.*

325 *Id.*

326 *Id.*

327 Press Release, U.S. Sec. & Exch. Comm’n, *Muni Bond Issuer and Underwriter Charged with Disclosure Failures*, Rel. No. 2017-148 (Aug. 23, 2017), <https://www.sec.gov/news/press-release/2017-148>.

328 *Id.*

329 *Id.*

### SEC Cooperation and Whistleblower Programs

procedures, and training for employees, as well as designate a compliance officer in order to ensure future compliance with continuing disclosure agreements.<sup>330</sup> In the same order, the Beaumont Financing Authority's former executive director, without admitting or denying the allegations, agreed to settle charges that he approved and signed the misleading offering documents.<sup>331</sup> In addition, he agreed to pay a \$37,500 penalty and is barred from participating in any future municipal bond offerings.<sup>332</sup>

Similarly, the underwriter and its co-founder consented to a separate SEC order without admitting or denying the SEC's findings.<sup>333</sup> The underwriter agreed to pay a \$150,000 penalty and retain an independent compliance consultant to review its policies and procedures.<sup>334</sup> The co-founder agreed to pay a \$15,000 penalty and serve a suspension from the securities industry for six months.<sup>335</sup>

Notably, the SEC indicated in the release accompanying the settlement offers that its Enforcement Division uncovered the violations as part of a review of municipal issuers and underwriters that did not voluntarily self-report under the agency's MCDC Initiative.<sup>336</sup> The SEC noted that had the Beaumont Financing Authority and its underwriter self-reported the violations pursuant to the MCDC Initiative, they would have been eligible for more lenient remedies.<sup>337</sup>

#### **SEC v. Herrera Work Product Decision**

Finally, on Dec. 5, 2017, a Southern District of Florida federal magistrate judge issued a decision in *SEC v. Herrera*<sup>338</sup> that has alarmed many members of the securities enforcement bar who routinely represent public companies attempting to cooperate with SEC investigations. In *SEC v. Herrera*, the magistrate judge held that attorney "oral downloads" of interview notes and memoranda provided to the SEC waived the work-product privilege with respect to those materials as to third-party litigants.<sup>339</sup>

During the SEC investigation, in self-reporting the results of an internal investigation to the SEC on behalf of its client, General Cable Corp., law firm Morgan Lewis & Bockius LLP ("Morgan Lewis") provided "oral downloads" of the results of witness interviews using interview notes and memoranda created during its internal investigation.<sup>340</sup> The SEC subsequently charged General Cable Corp. and two of its former executives in connection with the conduct that was the subject of the internal investigation. Thereafter, the two former executives issued a third-party subpoena to Morgan Lewis calling for the production of the interview memoranda and notes shared with the SEC.<sup>341</sup>

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330 *Id.*

331 *Id.*

332 *Id.*

333 *Id.*

334 *Id.*

335 *Id.*

336 *Id.*

337 *Id.*

338 *SEC v. Herrera*, No. 1:17-cv-20301-JAL, 2017 WL 6041750 (S.D. Fla. Dec. 5, 2017).

339 *Id.*

340 *Id.*

341 *Id.*



### SEC Cooperation and Whistleblower Programs

Although Morgan Lewis objected to production of the materials based on the work-product privilege, the court held that the oral downloads to the SEC from the interview memoranda and notes constituted a waiver of the work-product privilege because it amounted to a voluntary disclosure of otherwise privileged information to an adversary.<sup>342</sup> Notably, the court considered detailed oral summaries of witness interviews to be the functional equivalent of disclosing the underlying notes and memoranda.<sup>343</sup> This decision prompted much consternation among commentators and members of the securities enforcement bar, because providing oral downloads to the SEC and Department of Justice has been a common practice in cooperating with a government investigation while attempting to preserve attorney work-product and attorney-client privilege protections for employee statements memorialized in attorney notes and memoranda of interviews. The decision stands as a cautionary note to practitioners and clients on the risks attendant to self-disclosing the detailed results of witness interviews to the SEC or other government agencies.

### Whistleblower Developments

As evidenced by the SEC's 2017 Whistleblower Report, the SEC received an increasing number of tips – over 4,400 – during its 2017 fiscal year, which represents an increase of nearly 50 percent since the 2012 fiscal year.<sup>344</sup> Based on these tips, the SEC reports that it ordered awards totaling nearly \$50 million to 12 individuals in the 2017 fiscal year.<sup>345</sup> In addition, in Dec. 2017, the SEC reported that the whistleblower program had awarded more than \$179 million to 50 whistleblowers since issuing its first award in 2012.<sup>346</sup> During the second half of 2017, the SEC announced the following awards under its Whistleblower Program:

- On Dec. 5, 2017, the SEC announced an award in excess of \$4 million to a former company insider who alerted the agency to a widespread, multiyear securities law violation and, thereafter, continued to provide important information and assistance throughout the SEC's investigation.<sup>347</sup>
- On Nov. 30, 2017, the SEC announced an award of more than \$8 million each to two whistleblowers whose critical information and continuing assistance helped the agency bring the underlying enforcement action.<sup>348</sup> The first whistleblower alerted the SEC to the particular misconduct that would become the focus of the staff's investigation.<sup>349</sup> The second whistleblower provided additional significant information and ongoing cooperation to the staff during the investigation and saved the SEC a substantial amount of time and agency resources.<sup>350</sup>

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342 *Id.*

343 *Id.*

344 U.S. Sec. & Exch. Comm'n, 2017 Annual Report to Congress on the Dodd-Frank Whistleblower Program (Nov. 15, 2017) (hereinafter "2017 Whistleblower Report").

345 *Id.*

346 Press Release, U.S. Sec. & Exch. Comm'n, *Former Company Insider Earns More Than \$4.1 Million for Whistleblower Tip*, Rel. No. 2017-222 (Dec. 5, 2017), <https://www.sec.gov/news/press-release/2017-222>.

347 *Id.*

348 Press Release, U.S. Sec. & Exch. Comm'n, *More Than \$16 Million Awarded to Two Whistleblowers*, Rel. 2017-216 (Nov. 30, 2017), <https://www.sec.gov/news/press-release/2017-216>.

349 *Id.*

350 *Id.*

### SEC Cooperation and Whistleblower Programs

- On Oct. 12, 2017, the SEC announced an award in excess of \$1 million for providing the SEC with new information and substantial corroborating documentation of a securities law violation by a registered entity that impacted retail customers.
- On July 27, 2017, the SEC announced an award in excess of \$1.7 million to a company insider who provided the agency with critical information that helped stop a fraud that otherwise would have been difficult to detect.<sup>351</sup> As a result, millions of dollars were returned to harmed investors.<sup>352</sup>
- On July 25, 2017, the SEC announced an award of nearly \$2.5 million to an employee of a domestic government agency whose whistleblower tip helped launch an SEC investigation and whose continued assistance enabled the SEC to address a company's misconduct.<sup>353</sup>

### Whistleblower Protection Under Dodd-Frank

#### *Digital Realty Trust Inc. v. Somers, No. 16-1276*

As discussed in the Supreme Court Cases section above and in BakerHostetler's Dec. 15, 2017 Executive Alert,<sup>354</sup> the Supreme Court heard oral argument in a private retaliation case on whether whistleblowers are entitled to protection under Dodd-Frank even when they do not report wrongdoing to the SEC.<sup>355</sup> In its Feb. 21, 2018 decision, the Court agreed that the text of Dodd-Frank expressly defines whistleblowers as individuals who report suspected fraud to the SEC, and employees who were fired after informing their supervisors of the misconduct, but not the SEC, are not shielded by Dodd-Frank's whistleblower protections.<sup>356</sup> Justice Ginsburg explained that the Court's reading aligns with Congress' intent of encouraging whistleblowers to alert the SEC of fraud.<sup>357</sup>

While employers may have advised whistleblowers to report fraud through internal reporting systems, the *Somers* decision now mandates that whistleblowers report to the SEC to avoid the risk of losing protection from retaliation.

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351 Press Release, U.S. Sec. & Exch. Comm'n, *SEC Announces Whistleblower Award of More than \$1.7 Million*, Rel. No. 2017-134 (July 27, 2017), <https://www.sec.gov/news/press-release/2017-134>.

352 *Id.*

353 Press Release, U.S. Sec. & Exch. Comm'n, *SEC Announces \$2.5 Million Whistleblower Award*, Rel. No. 2017-130 (July 25, 2017), <https://www.sec.gov/news/press-release/2017-130>.

354 Executive Alert, BakerHostetler, *Supreme Court's Upcoming Whistleblower Decision May Dramatically Impact Compliance Programs* (Dec. 15, 2017), <http://e.bakerlaw.com/rv/ff003649d252c5952ca768c3db4284fc8d30e302/p=9068118>

355 See Oral Arg. Tr., *Somers v. Digital Realty Trust, Inc.*, No. 16-1276 (U.S. Nov. 28, 2017), [https://www.supremecourt.gov/oral\\_arguments/argument\\_transcripts/2017/16-1276\\_i426.pdf](https://www.supremecourt.gov/oral_arguments/argument_transcripts/2017/16-1276_i426.pdf).

356 *Digital Realty Tr., Inc.*, 2018 WL 987345, at \*4.

357 *Id.*

0.9623	0.10	2,925.40		
0.0000	0.00	2,553.66		
7,331	0.05	2,513.97		
0	0.00	1,100.00		
7,243	0.00	1,320.00		
7,448	-0.03	1,088.00		
86,720	-0.07	1,306.00	1,453	
86,000	0.31	12,061.85	9	917
24,622	0.02	12,061.85	7,254	4
0	-0.15	3,700.00	8	430
0	0.00	4,440.00	89	2,5
14,073	0.00	2,540.00		

## CFTC Cases and Developments

### CFTC Cases and Developments

During the latter half of 2017, the U.S. Commodity Futures Trading Commission (“CFTC”) entered the nascent field of regulating cryptocurrencies and their futures contracts and derivatives. In Oct. 2017, the CFTC released its “Primer” on virtual currencies and their related tokens, making it clear that they may be considered commodities or derivative contracts subject to CFTC regulations. Thereafter, the Commission began to crack down on fraudulent schemes related to the sale of bitcoin. As part of this crackdown, the CFTC penalized entities that violated record-keeping protocols, which would otherwise prevent employee fraud and misinformation in company filings.

### Record-Keeping Violations and Supervision Failures Result in Large Fines

Businesses regulated by the CFTC should be vigilant in complying with record-keeping and reporting requirements. The CFTC showed a flurry of activity in late 2017 in this area, ordering large monetary fines for problems ranging from the deliberate manipulation of data reported to failing to adequately supervise employees or software that led to the unsatisfactory reporting of data.

The CFTC also cracked down on those entities that failed to register as a commodity pool operator (“CPO”) while working with a commodity pool, investment trust, syndicate or similar types of businesses. Companies and individuals conducting business as an unregistered CPO faced penalties ranging from \$150,000<sup>358</sup> to more than \$2.5 million.<sup>359</sup>

#### *In the Matter of Cargill, Inc.*

In Nov. 2017, Cargill, an agricultural giant and swap dealer, agreed to pay a \$10 million fine for violating the Commodity Exchange Act and the CFTC’s regulations on reporting mid-market marks (“marks”), inaccurately reporting the percentage that certain commodities were hedged, failing to supervise its employees and failing to take corrective measures after it became aware of its noncompliance.<sup>360</sup>

It is often difficult to determine the price of a complex swap.<sup>361</sup> To provide greater transparency, CFTC regulations require swap dealers trading complex swaps to provide their counterparties with marks, an objective value of the swap that does not include profits and overhead, among other values.<sup>362</sup>

Beginning in 2013, Cargill used a method for calculating its marks that was different from the method required by the CFTC, and it did not inform its counterparties or its swap data repository of this practice.<sup>363</sup> Instead of recognizing all of its revenue in its markup price, Cargill recognized only 10 percent of its expected revenue on the day of the swap and amortized the rest of its revenue over the next 60 days.<sup>364</sup> This method effectively concealed 90 percent of Cargill’s expected

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358 Press Release, U.S. Commodity Futures Trading Comm’n, *CFTC Orders Dallas, Texas-based W Resources, LLC to Pay a \$150,000 Civil Monetary Penalty for Registration Violations*, Rel. No. 7608-17 (Sept. 5, 2017), <http://www.cftc.gov/PressRoom/PressReleases/pr7608-17>.

359 See Press Release, U.S. Commodity Futures Trading Comm’n, *Federal Court Sanctions Gerard Suite and STA Opus LLC for Commodity Pool Fraud and Frank Collins for Misappropriation of Customer Funds*, Rel. No. 7647-17 (Nov. 17, 2017), <http://www.cftc.gov/PressRoom/PressReleases/pr7647-17>; see also Press Release, U.S. Commodity Futures Trading Comm’n, *Federal Court Enters More than \$2 Million Judgment against Grand Island, Nebraska, Resident Who Controlled International Fraudulent Scheme*, Rel. No. 7626-17 (Oct. 10, 2017), <http://www.cftc.gov/PressRoom/PressReleases/pr7626-17>.

360 Press Release, U.S. Commodity Futures Trading Comm’n, *CFTC Orders Cargill, Inc. to Pay a \$10 Million Civil Monetary Penalty for Providing Inaccurate Mid-Market Marks on Swaps, Which Concealed Cargill’s Full Mark-up, in Violation of Swap Dealer Business Conduct and Reporting Requirements, and for Failing to Supervise Swap Dealer Employees*, Rel. No. 7640-17 (Nov. 6, 2017), <http://www.cftc.gov/PressRoom/PressReleases/pr7640-17>.

361 Matt Levine, *Swap Prices & Awkward Meetings*, (Nov. 7, 2017), Bloomberg.com, <https://www.bloomberg.com/view/articles/2017-11-07/swap-prices-and-awkward-meetings>.

362 Order, *In the Matter of Cargill, Inc.* CFTC Docket No. 18-03, at \*5 (Nov. 6, 2017), <http://www.cftc.gov/idc/groups/public/@enforcementactions/documents/legalpleading/cargillorder110617.pdf> (citing *Business Conduct Standards for Swap Dealers and Major Swap Participants With Counterparties*, 77 Fed. Reg. 9,734, 9,768 (Feb. 17, 2012)).

363 *Id.* at \*6-7.

364 *Id.* at \*2.



## 2017 YEAR-END SECURITIES LITIGATION AND REGULATORY ENFORCEMENT HIGHLIGHTS

### CFTC Cases and Developments

revenue and was in direct contravention of the CFTC's regulations barring the use of profits and other cost adjustments in calculating marks.<sup>365</sup> The CFTC found evidence that Cargill decided to calculate marks in this manner because proper calculations could have resulted in lost profits.<sup>366</sup> Thus, Cargill's actions also violated regulations requiring Cargill to disclose its material incentives and conflicts of interest.<sup>367</sup>

Cargill's \$10 million fine also included penalties for failing to supervise its employees, who were reporting percentages for particular commodities that were hedged.<sup>368</sup> Instead of reporting the actual percentage hedged, Cargill's employees reported to Cargill's counterparties that the account was either 100 percent or zero percent hedged, based on its short or long positions, respectively.<sup>369</sup>

In conjunction with the CFTC's press release, the CFTC Director of Enforcement, James McDonald, commented that the CFTC will "vigorously pursue" companies like Cargill that "undermine the fairness and integrity of our markets. ... Participants in our markets are entitled to trust that information they receive from counterparties complies with governing laws and regulations."<sup>370</sup>

#### ***In the Matter of Merrill, Lynch, Pierce, Fenner & Smith, Inc.***

On Sept. 22, 2017, Merrill Lynch was ordered to pay a civil monetary penalty of \$2.5 million for record-keeping violations and for failing to adequately supervise its traders for conduct that occurred in 2009 and 2010.<sup>371</sup> In late 2010, the Chicago Mercantile Exchange and Chicago Board of Trade ("CME Group") made inquiries into the trading practices of certain traders at the swap desk at Merrill Lynch.<sup>372</sup> The CFTC found that these traders made misleading statements to the CME Group that the block trades they executed were not influenced by certain trades that they made minutes before.<sup>373</sup>

The CFTC further concluded that Merrill Lynch's compliance and legal department inadequately supervised the response to the CME Group investigation, having only "minimal oversight" over the business operations support group, the group principally responsible for the employees' responses in the investigation.<sup>374</sup> For example, Merrill Lynch's business operations group did not inform its legal team of suspicious information in the five-minute window prior to the execution of the block trade, and instead provided the legal team with an abridged version of the trading

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365 *Id.* at \*7.

366 Press Release, U.S. Commodity Futures Trading Comm'n, *CFTC Orders Cargill, Inc. to Pay a \$10 Million Civil Monetary Penalty for Providing Inaccurate Mid-Market Marks on Swaps, Which Concealed Cargill's Full Mark-up, in Violation of Swap Dealer Business Conduct and Reporting Requirements, and for Failing to Supervise Swap Dealer Employees*, Rel. No. 7640-17 (Nov. 6, 2017), <http://www.cftc.gov/PressRoom/PressReleases/pr7640-17>.

367 *Id.*

368 Order, *In the Matter of Cargill, Inc.*, CFTC Docket No. 18-03, at \*3 (Nov. 6, 2017), <http://www.cftc.gov/rdc/groups/public/@enforcementactions/documents/legalpleading/cargillorder110617.pdf>.

369 *Id.*

370 Press Release, U.S. Commodity Futures Trading Comm'n, *CFTC Orders Cargill, Inc. to Pay a \$10 Million Civil Monetary Penalty for Providing Inaccurate Mid-Market Marks on Swaps, Which Concealed Cargill's Full Mark-up, in Violation of Swap Dealer Business Conduct and Reporting Requirements, and for Failing to Supervise Swap Dealer Employees*, Rel. No. 7640-17 (Nov. 6, 2017), <http://www.cftc.gov/PressRoom/PressReleases/pr7640-17>.

371 Press Release, U.S. Commodity Futures Trading Comm'n, *CFTC Orders Merrill, Lynch, Pierce, Fenner & Smith Incorporated to Pay \$2.5 Million to Settle Charges of Supervision Failures and Recordkeeping Violations*, Rel. No. 7615-17 (Sept. 22, 2017), <http://www.cftc.gov/PressRoom/PressReleases/pr7615-17>.

372 *Id.*

373 Order, *In the Matter of Merrill, Lynch, Pierce, Fenner & Smith Inc.*, U.S. Commodity Futures Trading Comm'n, CFTC Docket No. 17-25, at \*2-3 (Sept. 22, 2017).

374 See 17 C.F.R. § 166.3; Order, *In the Matter of Merrill, Lynch, Pierce, Fenner & Smith Inc.*, CFTC Docket No. 17-25, at \*4 (Sept. 22, 2017), <http://www.cftc.gov/rdc/groups/public/@enforcementactions/documents/legalpleading/enfmerrillorder092217.pdf>.

### CFTC Cases and Developments

analysis.<sup>375</sup> The CFTC also noted that Merrill Lynch's compliance and legal team never conducted its own interviews of any of the traders and failed "to stay adequately informed" about the CME Group's investigation.<sup>376</sup> The CFTC concluded that the team's failure to stay informed was the reason the legal team did not detect that the traders made misleading statements.

The CFTC also found that Merrill Lynch committed multiple record-keeping violations.<sup>377</sup> For most of 2010, Merrill Lynch had incomplete, inaccurate and illegible records of its block trades because it did not have adequate procedures for preparing and maintaining its records.<sup>378</sup> Merrill Lynch was found to have violated regulations requiring the company to maintain accurate and complete records and for failing to have proper procedures in place to ensure that the records were in compliance.<sup>379</sup>

#### ***In the Matter of Citibank***

On Sept. 25, 2017, Citibank was ordered to pay \$550,000 to settle civil monetary penalties for record-keeping violations stemming from a design flaw in its swap data reporting system.<sup>380</sup> In particular, Citibank's system did not update its records when there was a change in the Legal Entity Identifier (LEI), "a unique 20-character, alpha-numeric code, used to uniquely identify legally distinct entities that act as counterparties to swap transactions."<sup>381</sup> Because of this design flaw, Citibank was not updating LEI information for thousands of swaps over the course of 16 months, resulting in violations of over a dozen regulations.<sup>382</sup>

The CFTC found Citibank's failure to report changes in LEIs was due in part to its inadequate supervision and noted that Citibank failed to implement its policy that would have made it compliant.<sup>383</sup>

### **Sp spoofing and Other Market Manipulation Tactics**

Sp spoofing is a tactic used to manipulate the market by bidding or offering an option or futures contract with the intent to cancel the bid or offer before execution.<sup>384</sup> Sp spoofing is prohibited under the Commodities Exchange Act and is regulated by the CFTC.<sup>385</sup> In 2010, sp spoofing was criminalized under Dodd-Frank.<sup>386</sup> In the latter half of 2017, the Seventh Circuit addressed and rejected a criminal defendant's argument that the definition of sp spoofing under Dodd-Frank was unconstitutionally vague, and the CFTC continued to crack down on sp spoofing activities by both individuals and companies.

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375 Order, *In the Matter of Merrill, Lynch, Pierce, Fenner & Smith Inc.*, CFTC Docket No. 17-25, at \*4 (Sept. 22, 2017).

376 *Id.*

377 *Id.* at \*6.

378 Order, *In the Matter of Merrill, Lynch, Pierce, Fenner & Smith Inc.*, CFTC Docket No. 17-25, at \*7 (Sept. 22, 2017) (citing 17 C.F.R. §§ 1.31, 1.35, 166.3).

379 *Id.* at \*5; *see* 17 C.F.R. §§ 1.31, 1.35.

380 Press Release, U.S. Commodity Futures Trading Comm'n, *CFTC Orders Citibank, N.A. and London-based Citigroup Global Markets Limited to Pay a \$550,000 Penalty for Swap Data Reporting Violations Involving Legal Entity Identifier Information and Related Supervision Failures*, Rel. No. 7616-17 (Sept. 25, 2017), <http://www.cftc.gov/PressRoom/PressReleases/pr7616-17>.

381 Order, *In the Matter of Citibank, N.A. & Citigroup Global Markets Ltd.*, CFTC Docket No. 17-26, at \*2 (Sept. 25, 2017).

382 *Id.* at \*3.

383 *Id.* at \*4.

384 7 U.S.C. § 6c(a)(5).

385 7 U.S.C. §§ 2, 6c(a)(5).

386 *United States v. Coscia*, 866 F.3d 782, 786 (7th Cir. 2017).



### CFTC Cases and Developments

#### ***United States v. Coscia***

In 2016, Michael Coscia was the first person convicted of spoofing, whereupon he was sentenced to 36 months in prison.<sup>387</sup> Evidence at trial showed that Coscia used an algorithm where he placed a small order to sell copper futures at a higher price than the current market price and simultaneously placed larger orders to buy copper futures at an increasingly higher price.<sup>388</sup> This “created the illusion of market movement” by increasing the perceived value of the futures contracts until he was able to sell his small order at a higher price.<sup>389</sup> Coscia’s algorithm was designed to cancel the larger orders in milliseconds once one of the larger orders was filled or when his small order was sold.<sup>390</sup>

Coscia appealed his conviction to the Seventh Circuit, challenging the definition of spoofing under the statute as unconstitutionally vague.<sup>391</sup> The circuit court disagreed, noting that the statute specifically defines spoofing.<sup>392</sup> In its opinion, the court laid out the difference between legitimate cancellations and spoofing. The court defined legitimate cancellations, such as “fill-or-kill orders” (orders that must be filled in their entirety immediately or be canceled altogether), as cancellations that were dependent on the “arrival of *certain subsequent events*.”<sup>393</sup> In contrast, spoofers “intend[ed] to cancel the order *at the time the order was placed*.”<sup>394</sup>

The Seventh Circuit also rejected Coscia’s argument that the design of his algorithm provided an insufficient basis to uphold his conviction.<sup>395</sup> In comparing Coscia’s trading to that of other futures traders, the court found that most traders executed over 90 percent of their futures orders compared with Coscia’s fraction of 1 percent of futures orders executed.<sup>396</sup>

Although the *Coscia* opinion does not address or clarify all the potential iterations of spoofing, it serves as precedent upholding the constitutionality of criminal prosecutions of spoofing under Dodd-Frank. Accordingly, the Department of Justice likely will continue to criminally prosecute spoofing in appropriate instances.

#### ***In re Matter of Simon Posen***

In July 2017, the CFTC issued a settled order charging Simon Posen, a New Yorker who manually traded crude oil, gold, silver and copper, with spoofing violations.<sup>397</sup> The order alleged that Posen executed his spoofing scheme by placing a small “iceberg” order after placing one or more larger orders with gradually increasing or decreasing prices depending on whether he was attempting to inflate or bring down the price of the commodity being traded. Thereafter, once the iceberg order

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387 *Id.* at 785; *see* 18 U.S.C. § 1348(1).

388 *Coscia*, 866 F.3d at 788.

389 *Id.*

390 *Id.*

391 *Id.* at 792-93.

392 *Id.* at 793.

393 *Id.* at 795 (emphasis in original).

394 *Id.* (emphasis in original).

395 *Id.* at 794.

396 *Id.* at 796.

397 Press Release, U.S. Commodity Futures Trading Comm’n, *CFTC Orders New York Trader Simon Posen to Pay a \$635,000 Civil Monetary Penalty and Permanently Bans Him from Trading in CFTC-Regulated Markets for Spoofing in the Gold, Silver, Copper, and Crude Oil Futures Markets*, Rel. No. 7594-17 (July 26, 2017), <http://www.cftc.gov/PressRoom/PressReleases/pr7594-17>.

### CFTC Cases and Developments

was filled, Pozen allegedly would cancel the larger orders.<sup>398</sup> According to the order, Pozen did this for over three years, making “thousands of trades.”<sup>399</sup>

Without admitting or denying the findings and conclusions of the CFTC’s order, Pozen agreed to pay a civil monetary penalty of \$635,000. Pozen was also permanently prohibited from trading in CFTC-regulated markets in the future.<sup>400</sup>

#### ***In the Matter of Arab Global Commodities DMCC***

In its settlement order with Arab Global Commodities DMCC (“AGC”), the CFTC described the alleged violations by AGC and outlined several actions companies can take in order to reduce their liability for spoofing.

AGC, a proprietary trading company based in Dubai, had at least one of its traders spoof the COMEX copper futures market over a period of six months.<sup>401</sup> A branch of AGC was alerted to suspicions of spoofing, but the branch failed to escalate the concern.<sup>402</sup> Although the CFTC found that AGC did not adequately address the issue until the CME Group started an investigation,<sup>403</sup> it approvingly noted that AGC “promptly terminated” the involved trader after the CME Group investigation started.<sup>404</sup> The CFTC made a point of commenting on AGC’s cooperation and remediation during the early stages of the CME investigation. The CFTC specifically observed that AGC “proactively implemented remedial measures and processes to deter similar misconduct in the future, including implementing significant structural, compliance, and policy measures, as well as updating its training to reflect the prohibition against spoofing.”<sup>405</sup> As a result, AGC settled for \$300,000 in civil monetary penalties for its spoofing activities,<sup>406</sup> a sum, the order implies, that could have been larger had AGC not cooperated.

One lesson learned from AGC is that companies in the industry that face the risk of spoofing can seek to prevent spoofing practices by educating their employees about the prohibition against spoofing and putting in place a mechanism for reporting and detecting spoofing activities. Such measures may help a company reduce monetary penalties or prevent harsher sanctions if spoofing becomes an issue.

#### ***In the Matter of Statoil ASA***

Norwegian company Statoil ASA settled CFTC charges of swap manipulation in violation of § 9(a) (2) of the Commodity Exchange Act for a total of \$4 million in civil penalties.<sup>407</sup> According to the

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398 Order, *In the Matter of Simon Posen*, CFTC Docket No. 17-20, at \*2 (July 26, 2017).

399 Press Release, U.S. Commodity Futures Trading Comm’n, *CFTC Orders New York Trader Simon Posen to Pay a \$635,000 Civil Monetary Penalty and Permanently Bans Him from Trading in CFTC-Regulated Markets for Spoofing in the Gold, Silver, Copper, and Crude Oil Futures Markets*, Rel. No. 7594-17 (July 26, 2017), <http://www.cftc.gov/PressRoom/PressReleases/pr7594-17>.

400 Order, *In the Matter of Simon Posen*, CFTC Docket No. 17-20, at \*3-4 (July 26, 2017); see 7 U.S.C. § 1a(40) (2012).

401 Press Release, U.S. Commodity Futures Trading Comm’n, *CFTC Finds that Proprietary Trading Firm Arab Global Commodities DMCC Engaged in Spoofing of Copper Futures Contract*, Rel. No. 7627-17 (Oct. 10, 2017), <http://www.cftc.gov/PressRoom/PressReleases/pr7627-17>.

402 Order, *In the Matter of Arab Global Commodities DMCC*, U.S. Commodity Futures Trading Comm’n, CFTC Docket No. 18-01, at \*2 (Oct. 10, 2017).

403 *Id.* at \*2.

404 *Id.* at \*3.

405 *Id.*

406 Press Release, U.S. Commodity Futures Trading Comm’n, *CFTC Finds that Proprietary Trading Firm Arab Global Commodities DMCC Engaged in Spoofing of Copper Futures Contracts*, Rel. No. 7627-17 (Oct. 10, 2017), <http://www.cftc.gov/PressRoom/PressReleases/pr7627-17>.

407 Press Release, U.S. Commodity Futures Trading Comm’n, *CFTC Finds Statoil ASA Attempted to Manipulate the Argus Far East Index, a Propane Benchmark, to Benefit Statoil’s NYMEX-cleared Swaps Position*, Rel. No. 7643-17 (Nov. 14, 2017).

### CFTC Cases and Developments

settlement order, Statoil purchased propane cargoes in anticipation of the fall of the Argus Far East Index (“Argus FEI”), an index of propane prices.<sup>408</sup> The CFTC discovered communications between Statoil traders showing that they intentionally purchased these propane cargoes to “have a good impact” on the index because it would create the appearance that demand for propane was high.<sup>409</sup> Since the price of Statoil’s New York Mercantile Exchange (NYMEX)-cleared OTC swaps was directly connected to the Argus index, Statoil stood to benefit from maintaining a high Argus FEI.<sup>410</sup> Notably, Statoil’s purchases of propane cargoes were not enough to artificially inflate the settlement price because there was too much propane available in the market for Statoil to affect the price with the purchases during the execution of the scheme.<sup>411</sup>

### Anti-Fraud Enforcement

The second half of 2017 included three additional significant anti-fraud enforcement settlements against individuals and companies. Two of these settlements involved the fraudulent marketing to the public of the opportunity to learn from so-called trading experts.

#### ***CFTC v. Jeffrey Slemmer, et al.***

One significant anti-fraud settlement for the CFTC involving individuals in the latter half of 2017 was the consent order approved by a Florida federal court between the CFTC and Jeffrey Slemmer, Christian Dorrian, Adam Roth and their respective businesses.<sup>412</sup> The court approved a settlement order for more than \$2.7 million in restitution and an additional civil monetary penalty for the same amount, yielding a total settlement amount of approximately \$5.4 million.<sup>413</sup>

According to the order, the defendants convinced more than 60 investors to invest at least \$2.7 million in precious metals.<sup>414</sup> However, the defendants invested only a fraction of the money and misappropriated the rest for their personal benefit.<sup>415</sup> To perpetuate their alleged fraud, the defendants issued trade confirmations and account statements to the investors, falsely representing their ownership and values of the precious metals.<sup>416</sup> These defendants also allegedly pressured their investors to exchange their precious metals for diamonds that were worth only “a fraction of the amount that they represented to customers.”<sup>417</sup>

The order found that the defendants engaged in a scheme to defraud, made fraudulent misrepresentations, misappropriated customer funds, issued false statements, acted as an

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408 Order, *In the Matter of Statoil ASA*, CFTC Docket No. 18-04, at \*2 (Nov. 14, 2017).

409 *Id.* at \*3.

410 *Id.* at \*4.

411 *Id.* at \*3.

412 Press Release, U.S. Commodity Futures Trading Comm’n, *Federal Court Orders Jeffrey Slemmer, Christian Dorrian, Adam Roth, and Their Florida-Based Companies to Pay over \$5.4 Million in Restitution and a Penalty in CFTC Precious Metals and Diamonds Anti-Fraud Action*, Rel No. 7603-17 (Aug. 17, 2017), <http://www.cftc.gov/PressRoom/PressReleases/pr7603-17>.

413 *Id.* at \*11.

414 *Id.*

415 *Id.*

416 Consent Order, *U.S. Commodity Futures Trading Comm’n v. Jeffrey Slemmer, et al.*, No. 9:16-CV-80867-WPD, at \*11 (S.D.Fl. 2017), available at <http://www.cftc.gov/idc/groups/public/@enforcementactions/documents/legalpleading/enfberkleyhardassetsorder08161.pdf>.

417 *Id.* at \*8.

### CFTC Cases and Developments

unregistered futures commission merchant and engaged in illegal, off-exchange transactions.<sup>418</sup> For the last charge, the defendants were found to have engaged in commodities transactions with people and entities that were not approved by the CFTC to trade precious metals.<sup>419</sup>

#### **CFTC v. United Business Servicing, LLC, et al.**

Joseph Dufresne, his wife Megan Renkow, and their companies United Business Servicing, LLC and United Business, Inc. entered into a consent order with the CFTC to settle charges of their engagement in “a systematic pattern of false statements and omissions.”<sup>420</sup> The respondents operated a website called “SchoolofTrade.com” where they claimed that Dufresne had experience as a professional futures trader and hedge fund operator.<sup>421</sup> The website offered three tiers of membership, each allowing purported access to more materials; the highest tier offered access to “cutting-edge algorithmic trading technology” for a one-time fee of \$4,999.<sup>422</sup> Dufresne also operated a “Live Trade Room,” where clients could “shadow” him making trades.<sup>423</sup> Although claiming to have traded since 2000, Dufresne did not open futures and foreign exchange trading accounts until late 2007, and he listed on his application that he had no prior experience.<sup>424</sup>

Pursuant to the consent order, Dufresne and Renkow were ordered to pay restitution of over \$3.9 million and civil penalties of \$1 million. Dufresne and Renkow were also prohibited from trading in any market regulated by the CFTC and from registering with the CFTC.<sup>425</sup>

#### **CFTC v. Symons, et al. (“Real Time Trade Room”)**

Kevin Michael Symons and his company, FTS Financial, Inc., agreed to settle a case with the CFTC that was pending in the U.S. District Court for the Southern District of New York.<sup>426</sup> The California-based company and Symons were alleged to have marketed a fraudulent service in the form of the “Real Time Trade Room.”<sup>427</sup> The scheme required customers to pay a fee in order to watch an “expert” in futures contracts trade in “real time.” Customers were told to follow the expert’s trades in order to make money.<sup>428</sup> However, this “expert” never actually traded futures contracts.<sup>429</sup>

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418 *Id.* at \*9-15.

419 *Id.* at \*12.

420 Press Release, U.S. Commodity Futures Trading Comm’n, *Federal Court Orders California Residents Joseph Dufresne, Megan Renkow, and Their Companies to Pay More than \$4.9 Million in Restitution and a Monetary Penalty for Fraud in Connection with Offering and Selling Futures Trading Strategies and Systems*, Rel. No. 7651-17 (Nov. 28, 2017), <http://www.cftc.gov/PressRoom/PressReleases/pr7627-17>.

421 Consent Order, *U.S. Commodity Futures Trading Comm’n v. United Business Servicing, LLC*, No. 2:16-CV-07358-JAK (JCx), at \*12 (W.D. Cal. 2017), available at <http://www.cftc.gov/idc/groups/public/@lrenforcementactions/documents/legalpleading/enfunitedsentorder112217.pdf>.

422 *Id.* at \*9.

423 *Id.* at \*18.

424 *Id.* at \*12.

425 Press Release, U.S. Commodity Futures Trading Comm’n, *Federal Court Orders California Residents Joseph Dufresne, Megan Renkow, and Their Companies to Pay More than \$4.9 Million in Restitution and a Monetary Penalty for Fraud in Connection with Offering and Selling Futures Trading Strategies and Systems*, Rel. No. 7651-17 (Nov. 28, 2017), <http://www.cftc.gov/PressRoom/PressReleases/pr7627-17>.

426 Maria Nikolova, *CFTC Approves Settlement with “Real Time Trade Room” Promoters*, FinanceFeeds (Oct. 25, 2017 8:57 AM), <https://financefeeds.com/cftc-approves-settlement-real-time-trade-room-promoters/>.

427 *Id.*

428 *Id.*

429 *Id.*

### CFTC Cases and Developments

For perpetuating this fraud for more than a year, FTS Financial agreed to pay \$2.4 million in disgorgement for the company and to pay the same amount in civil monetary fines.<sup>430</sup> Symons also agreed to be personally liable for \$289,000 in disgorgement and an additional \$100,000 in civil penalties.<sup>431</sup>

### Cryptocurrency

As of the end of 2017, the total market cap for cryptocurrencies had risen to above \$500 billion, with the most well-known of the cryptocurrencies, bitcoin, cornering more than half the market. Bitcoin saw a remarkable rise in prices in 2017, bouncing back from a value of less than \$1,000 in 2016 to cresting over \$17,000 in Dec. 2017.<sup>432</sup> That remarkable rise was the precursor to a significant fall in value in Jan. 2018. The popularity of cryptocurrencies has forced the CFTC, along with the SEC, to consider how to protect investors by regulating a technology that touts itself as free from government regulation.

As described more fully in the Securities Policy and Regulatory Developments section below, in July 2017, the SEC issued an Investor Bulletin warning companies looking to capitalize on this boom that the SEC's regulatory authority extended to tokens and coins "in certain cases."<sup>433</sup> Following the SEC's lead, LabCFTC, an initiative created by the CFTC in May 2017 to engage with FinTech and RegTech solutions and specifically to help address the need for regulation of digital markets,<sup>434</sup> issued a "Primer" in Oct. 2017 stating:

"There is no inconsistency between the SEC's analysis and the CFTC's determination that virtual currencies are commodities and that virtual tokens may be commodities or derivatives contracts depending on the particular facts and circumstances."<sup>435</sup>

In determining whether the item being traded is a commodity, the CFTC will "look[] beyond form and consider[] the actual substance and purpose of an activity when applying the federal commodities laws and CFTC regulations."<sup>436</sup>

In addition to regulating cryptocurrencies as a commodity, a position the CFTC took back in 2015,<sup>437</sup> the CFTC will also be regulating futures contracts on bitcoin and fully collateralized digital currency swaps.<sup>438</sup> The CFTC has stated that it is working with the CME Group in futures contract design and settlement, and they are coordinating efforts to monitor the market for potential manipulation and dislocation.<sup>439</sup>

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430 *Id.*

431 *Id.*

432 Bitcoin (USD) Price, CoinDesk, <https://www.coindesk.com/price/>.

433 U.S. Sec. & Exch. Comm'n, Investor Bulletin: Initial Coin Offerings 2 (2017), [https://www.sec.gov/oiea/investor-alerts-and-bulletins/ib\\_coinofferings](https://www.sec.gov/oiea/investor-alerts-and-bulletins/ib_coinofferings).

434 Marc D. Powers, "2017 Mid-Year Securities Litigation & Enforcement Highlights" at 55-56 (July 28, 2017), <https://www.bakerlaw.com/alerts/2017-mid-year-securities-litigation-and-enforcement-highlights>.

435 U.S. Commodity Futures Trading Comm'n, "A CFTC Primer on Virtual Currencies" (Oct. 17, 2017), [http://www.cftc.gov/idc/groups/public/documents/file/labcfcc\\_primercryptocurrencies100417.pdf](http://www.cftc.gov/idc/groups/public/documents/file/labcfcc_primercryptocurrencies100417.pdf).

436 *Id.*

437 *In the Matter of Coinflip, Inc.*, CFTC Docket No. 15-29, at \*3 (Sept. 17, 2015).

438 Press Release, U.S. Commodity Futures Trading Comm'n, *CFTC Statement on Self-Certification of Bitcoin Products by CME, CFE and Cantor Exchange*, Rel No. 7654-17 (Dec. 1, 2017); Press Release, U.S. Commodity Futures Trading Comm'n, *CFTC Grants DCO Registration to LedgerX LLC*, Rel No. 7592-17 (July 24, 2017), <http://www.cftc.gov/PressRoom/PressReleases/pr7592-17>.

439 Press Release, U.S. Commodity Futures Trading Comm'n, *CFTC Statement on Self-Certification of Bitcoin Products by CME, CFE and Cantor Exchange*, Rel No. 7654-17 (Dec. 1, 2017).

### CFTC Cases and Developments

#### ***CFTC v. Gelfman, et al.***

On Sept. 21, 2017, the CFTC brought an action against a Brooklyn computer programmer for an alleged fraudulent bitcoin scheme involving more than \$600,000.<sup>440</sup> The CFTC charged Gelfman and his company, Gelfman Blueprint, Inc., for fraudulent solicitation, misappropriation, issuing false account statements and falsely claiming to have a computer trading program that employed “a high-frequency, algorithmic trading strategy” called Jigsaw.<sup>441</sup>

The defendants purportedly represented to investors that they were generating an average monthly increase of 7 to 9 percent in bitcoin balances.<sup>442</sup> The CFTC alleged that in reality, the defendants owned less than 10 percent of the number of bitcoins they claimed to own, and the program Jigsaw made infrequent trades that resulted in trading losses.<sup>443</sup> As in other typical Ponzi schemes, Gelfman instead paid his investors from funds received from other investors. In addition, he allegedly lied about his computer being hacked, in order to conceal his fraud.<sup>444</sup>

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440 Press Release, U.S. Commodity Futures Trading Comm’n, *CFTC Charges Nicholas Gelfman and Gelfman Blueprint, Inc. with Fraudulent Solicitation, Misappropriation, and Issuing False Account Statements in Bitcoin Ponzi Scheme*, Rel. No. 7614-17 (Sept. 21, 2017), <http://www.cftc.gov/PressRoom/PressReleases/pr7614-17>.

441 *Id.*

442 Compl. ¶ 18, *CFTC v. Gelfman Blueprint, Inc. & Nicholas Gelfman*, No. 1:17-CV-07181 (S.D.N.Y. Sept. 21, 2017) [hereinafter *Gelfman*, Compl.].

443 *Gelfman*, Compl. ¶¶ 21, 28-31; Press Release, U.S. Commodities Futures Trading Comm’n, *CFTC Charges Nicholas Gelfman and Gelfman Blueprint, Inc. with Fraudulent Solicitation, Misappropriation, and Issuing False Account Statements in Bitcoin Ponzi Scheme*, Rel. No. 7614-17 (Sept. 21, 2017), <http://www.cftc.gov/PressRoom/PressReleases/pr7614-17>.

444 *Gelfman*, Compl. ¶ 2.





## Securities Policy and Regulatory Developments

### Securities Policy and Regulatory Developments

In the second half of 2017, there has been significant activity with respect to the relationship between the financial services industry, digital currencies and the Internet. Specifically, the SEC and CFTC have issued guidance and regulations regarding virtual currencies and trading in coins or digital tokens. The SEC also addressed issues of cybersecurity in the wake of a 2016 breach of the EDGAR system and late disclosure of the same. Assessing the Commission's internal risk profile and re-evaluating its systems and security have since become priorities, as Chairman Clayton permitted the SEC to expand personnel in order to aid in the SEC's efforts to protect network security.

### Cryptocurrencies and Initial Coin Offerings

Like the CFTC, the SEC has devoted attention to regulating cryptocurrencies and initial coin offerings (ICOs). For example, on July 25, 2017, the SEC issued a Report of Investigation pursuant to Section 21(a) of the Securities Exchange Act regarding an SEC investigation of The Decentralized Autonomous Organization (The DAO), a virtual organization, and "its use of distributed ledger or block chain technology to facilitate the offer and sale of DAO Tokens to raise capital."<sup>445</sup> In its investigation, the SEC applied existing U.S. federal securities laws to The DAO and this new virtual manner of raising capital. The SEC concluded that The DAO tokens are securities and therefore The DAO must comply with any and all U.S. federal securities laws when offering and selling them. The SEC reiterated that regardless of whether securities are distributed with blockchain technology or purchased with virtual currencies, the parties to the transaction must comply with applicable securities laws.<sup>446</sup>

Additionally, if virtual tokens or coins are considered securities, federal and state securities laws have licensure and registration requirements for investment professionals and their firms that offer, transact in or advise on investments. Despite the SEC's application of securities laws, regulations and licensure requirements to the cryptocurrency realm, challenges remain regarding enforcement, particularly with respect to recovering investor funds.<sup>447</sup> For example, because of the nature of the Internet, it may be difficult for law enforcement officials to investigate ICOs. Tracing money can be more cumbersome because traditional banks are not used, and ICOs and virtual currency transactions and users may be anywhere in the world.<sup>448</sup> This significant international scope necessarily means that U.S. regulators will likely often face extraterritorial jurisdiction arguments and will have to rely on international regulators to assist in effective enforcement and to freeze assets overseas.<sup>449</sup> Further, there is no central authority where user information is filed, so the SEC or other enforcement agencies may have difficulty gathering relevant information in investigations or enforcement actions.<sup>450</sup>

Given the SEC's recent pronouncements and its increased activity in regulating virtual currencies and virtual currency exchanges, entities engaging in these types of transactions and activities would be well-advised to be sure they are adhering to applicable regulations and licensure

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445 U.S. Sec. & Exch. Comm'n, *Investor Bulletin: Initial Coin Offerings*, [https://www.sec.gov/oiea/investor-alerts-and-bulletins/ib\\_coinofferings](https://www.sec.gov/oiea/investor-alerts-and-bulletins/ib_coinofferings).

446 *Id.*

447 *Id.*

448 *Id.*

449 *Id.*

450 *Id.*

### Securities Policy and Regulatory Developments

requirements. Additionally, parties approached about investing in or with or becoming involved with entities raising capital for virtual currencies or virtual currency exchanges should be aware of the regulatory risks and the potential for unsavory actors to be involved in fraudulent activities. Because of the ease with which one can set up blockchain technology to create an ICO that looks impressive, fraudsters have used this space to perpetrate fraudulent investment schemes.<sup>451</sup> Therefore, virtual transactions, tokens or coins may be susceptible to fraud, technical glitches, hacks or malware.<sup>452</sup> There will likely continue to be a concentrated effort by the SEC and the CFTC to enforce applicable law and initiate enforcement actions related to virtual currencies, ICOs and virtual currency exchanges.

### Cybersecurity

On Sept. 20, 2017, SEC Chairman Clayton issued a statement on the importance of cybersecurity to the SEC and market participants.<sup>453</sup> Cyber intrusions, which “can create significant risks to the operational performance of market participants and of markets as a whole,”<sup>454</sup> are a concern for the SEC right now not only because of the risk to the market but also because of the recent disclosure of the incident when unauthorized persons gained access to SEC filings. Clayton also detailed the agency’s approach to cybersecurity as an organization and a regulatory body.

In May 2017, Chairman Clayton initiated an assessment of the SEC’s internal risk profile and approach to cybersecurity from regulatory and oversight perspectives.<sup>455</sup> This assessment has since been extended and expanded upon as the SEC has learned of unauthorized access to the EDGAR filing system in 2016.<sup>456</sup> Specifically, in Aug. 2017, the SEC learned that unauthorized access to EDGAR in 2016 may have provided the basis for illicit gain through trading. Upon learning about this incident, Chairman Clayton directed an immediate internal investigation, which found that the incident did not result in unauthorized access to personally identifiable information, jeopardize the operations of the Commission, or result in systemic risk.<sup>457</sup> However, the investigation did determine that “an EDGAR test filing accessed by third parties as a result of that intrusion contained the names, dates of birth and social security numbers of two individuals.”<sup>458</sup>

Consequently, Chairman Clayton authorized the immediate hiring of additional personnel and technology consultants to aid in the SEC’s efforts to protect its’ network security.<sup>459</sup> The Commission is also in the process of evaluating its cybersecurity risk governance structure,

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451 *Id.*

452 *Id.*

453 Press Release, U.S. Securities & Exch. Comm’n, *SEC Chairman Clayton Issues Statement on Cybersecurity*, Rel. No. 2017-170 (Sept. 20, 2017), <https://www.sec.gov/news/press-release/2017-170>.

454 U.S. Sec. & Exch. Comm’n, Chairman Jay Clayton Statement, on Cybersecurity (Sept. 20, 2017), <https://www.sec.gov/news/public-statement/statement-clayton-2017-09-20>.

455 *Id.*

456 See Press Release, U.S. Securities & Exch. Comm’n, *SEC Chairman Clayton Issues Statement on Cybersecurity*, Rel. No. 2017-170 (Sept. 20, 2017), <https://www.sec.gov/news/press-release/2017-170>; Press Release, U.S. Securities & Exch. Comm’n, *Chairman Clayton Provides Update on Review of 2016 Cyber Intrusion Involving EDGAR System*, Rel. No. 2017-186 (Oct. 2, 2017), <https://www.sec.gov/news/press-release/2017-186>.

457 Press Release, U.S. Securities & Exch. Comm’n, *SEC Chairman Clayton Issues Statement on Cybersecurity*, Rel. No. 2017-170 (Sept. 20, 2017), <https://www.sec.gov/news/press-release/2017-170>.

458 Press Release, U.S. Securities & Exch. Comm’n, *Chairman Clayton Provides Update on Review of 2016 Cyber Intrusion Involving EDGAR System*, Rel. No. 2017-186 (Oct. 2, 2017), <https://www.sec.gov/news/press-release/2017-186>.

459 *Id.*



### Securities Policy and Regulatory Developments

including outlining plans for the management of internal cybersecurity risks and for the Commission's disclosure-based and supervisory efforts. On Sept. 20, 2017, Chairman Clayton outlined specific plans to manage internal risks. These plans consist of the incorporation of cybersecurity considerations in disclosure-based and supervisory efforts, coordination with other government entities, and the enforcement of the federal securities laws against cyber threat actors and market participants that do not meet their disclosure obligations.<sup>460</sup>

On Sept. 25, 2017, the SEC announced two new initiatives, the Cyber Unit and the Retail Strategy Task Force, that will build on its Enforcement Division's ongoing efforts to address cyber-based threats and protect retail investors.<sup>461</sup> The Cyber Unit, under the direction of Robert A. Cohen,<sup>462</sup> will be focused on cyber-related misconduct including (1) market manipulation schemes involving false information spread through electronic and social media, (2) hacking to obtain material nonpublic information, (3) violations involving distributed ledger technology and ICOs, (4) misconduct perpetrated using the dark web, (5) intrusions into retail brokerage accounts, and (6) cyber-related threats to trading platforms and other critical market infrastructure.<sup>463</sup> This Unit complements Chairman Clayton's efforts to address the SEC's internal cybersecurity risks, and will work as part of the Enforcement Division to detect and pursue fraudulent conduct in this technological and data-driven landscape.<sup>464</sup>

The Retail Strategy Task Force will work with SEC staff, including the Office of Investor Education and Advocacy and the SEC's National Exam Program, to identify large-scale misconduct affecting retail investors.<sup>465</sup> The Retail Strategy Task Force will also focus on "develop[ing] proactive, targeted initiatives to identify misconduct impacting retail investors."<sup>466</sup>

### Administrative Law Judges' Appointments Ratified by SEC

On Nov. 29, 2017, the United States Solicitor General submitted a brief to the Supreme Court in *Raymond J. Lucia and Raymond J. Lucia Companies, Inc. v. Securities and Exchange Commission*, asking the Court to determine whether the SEC's Administrative Law Judges ("ALJs") are inferior officers who must be appointed under the Appointments Clause of the Constitution.<sup>467</sup> To the surprise of many, in his brief, the Solicitor General agreed with the petitioners in *Lucia* that the Supreme Court should determine whether SEC ALJs are inferior officers under the Appointments Clause, but recommended that the Supreme Court appoint an *amicus curiae* to defend the contrary opinion. The Solicitor General also reversed the government's position on the issue and agreed that ALJs are inferior officers who must be appointed by the Commission in

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460 Press Release, U.S. Securities & Exch. Comm'n, *SEC Chairman Clayton Issues Statement on Cybersecurity*, Rel. No. 2017-170 (Sept. 20, 2017), <https://www.sec.gov/news/press-release/2017-170>. See also U.S. Sec. & Exch. Comm'n, Chairman Jay Clayton, *Statement on Cybersecurity* (Sept. 20, 2017), <https://www.sec.gov/news/public-statement/statement-clayton-2017-09-20>.

461 Press Release, U.S. Securities & Exch. Comm'n, *SEC Announces Enforcement Initiatives to Combat Cyber-Based Threats and Protect Retail Investors*, Rel. No. 2017-176 (Sept. 25, 2017), <https://www.sec.gov/news/press-release/2017-176>.

462 Robert A. Cohen is the newly appointed Chief of the Cyber Unit. Mr. Cohen has been co-chief of the Market Abuse Unit since 2015 alongside Joseph Sansone. Mr. Cohen will leave the Market Abuse Unit to head up the Cyber Unit, and Mr. Sansone will remain as Chief of the Market Abuse Unit. See Press Release, U.S. Securities & Exch. Comm'n, *SEC Announces Enforcement Initiatives to Combat Cyber-Based Threats and Protect Retail Investors*, Rel. No. 2017-176 (Sept. 25, 2017), <https://www.sec.gov/news/press-release/2017-176>.

463 *Id.*

464 *Id.*

465 *Id.*

466 *Id.*

467 Press Release, U.S. Sec. & Exch. Comm'n., *SEC Ratifies Appointment of Administrative Law Judges*, Rel. No. 2017-215 (Nov. 30, 2017), <https://www.sec.gov/news/press-release/2017-215>.

### Securities Policy and Regulatory Developments

accordance with the requirements of the Appointment's Clause. The Solicitor General also raised concern over whether the limits on the ability to remove ALJs for cause pass constitutional muster and asked the Supreme Court to consider this issue as well.

In response, the SEC took immediate steps, relying on the doctrine of ratification, to ratify the prior unconstitutional appointments of its ALJs.<sup>468</sup> The ratification purports to cure the constitutional deficiency while *Lucia* is under review.<sup>469</sup>

The Commission has taken the position that by ratifying these appointments, it has conformed with the Appointments Clause and resolved concerns about whether these ALJs, in presiding over administrative proceedings, violate the Clause.<sup>470</sup> The SEC also directed that this ratification will require the ALJs to review all open administrative proceedings and decide whether or not to ratify said actions.<sup>471</sup> It remains to be seen whether the Commission's actions will withstand Supreme Court scrutiny, or whether the removal issue will derail these efforts.

### Securities Industry Implements Two-Day Settlement Period on Securities Transactions

On Sept. 5, 2017, the shortened two-day settlement period was successfully implemented for most securities transactions. This implementation is pursuant to Rule 15c6-1, which was adopted earlier this year. The first transactions covered by this amended rule were settled on Sept. 7, 2017.<sup>472</sup>

This change is significant for the industry, as the last time the settlement period was changed was in 1993, when the standard settlement cycle was moved from five business days to three business days. The shortened settlement period should reduce credit, market and liquidity risks for central counterparties, their members and other market participants. Largely enabled by significant advances in technology, it should also enhance efficiency throughout the financial sector.<sup>473</sup>

SEC Chairman Clayton stated that this change is a "significant accomplishment" and that "[g]oing forward, investors and other market participants will be able to receive the proceeds of their securities transactions one day sooner, thereby enhancing the overall efficiency of the U.S. securities markets."<sup>474</sup> Commissioner Michael Piwowar stated that it is "a smooth transition to a new environment that provides greater efficiency and less risk to the American people."<sup>475</sup>

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468 Order, U.S. Sec. & Exch. Comm'n, *In re Pending Administrative Proceedings*, <https://www.sec.gov/litigation/opinions/2017/33-10440.pdf>.

469 Pete Schroeder, "U.S. Securities and Exchange Commission ratifies administrative law judges," Reuters (Nov. 30, 2017), <https://www.reuters.com/article/us-usa-sec-judges/u-s-securities-and-exchange-commission-ratifies-administrative-law-judges-idUSKBN1DU250>.

470 Press Release, U.S. Sec. & Exch. Comm'n., *SEC Ratifies Appointment of Administrative Law Judges*, Rel No. 2017-215 (Nov. 30, 2017), <https://www.sec.gov/news/press-release/2017-215>.

471 *Id.*

472 Press Release, U.S. Securities & Exch. Comm'n, *Commission Statement on T+2 Implementation*, Rel. No. 2017-163 (Sept. 11, 2017), <https://www.sec.gov/news/press-release/2017-163>.

473 *Id.*

474 *Id.*

475 *Id.*

### Securities Policy and Regulatory Developments

### SEC Monitoring Impact of Hurricanes and Providing Regulatory Relief for Affected Companies and Other Affected Persons

The SEC continues to monitor closely the impacts of the 2017 hurricanes on investors and capital markets. SEC Chairman Clayton stated that in monitoring the impacts, the SEC also “will be making sure investors have access to their securities accounts, evaluating the need to extend deadlines for filings and other regulatory requirements, and keeping a watchful eye for storm-related scams.”<sup>476</sup> As part of its effort to be vigilant in protecting investors from potential scams designed to prey on the victims of the hurricanes, in early Sept. the SEC issued an alert warning investors to be careful not to fall prey to investment scams related to hurricanes Harvey and Irma and providing guidance on how to avoid such scams.

In other action, the SEC used its power to suspend the trading of securities of Texas-based Grupo Resilient International (GRI) for 10 days and generally to prohibit a broker-dealer from soliciting investors to buy or sell the stock until certain reporting requirements were met.<sup>477</sup> GRI allegedly inaccurately claimed that the company added a “FEMA approved contractor” to its board and would be deploying workers to assist in relief efforts. In suspending trading, the SEC stated that there were questions regarding the accuracy and adequacy of GRI’s statements.<sup>478</sup>

Additionally, the SEC announced on Sept. 28, 2017, that it would be providing regulatory relief to publicly traded companies, investment companies, accountants, transfer agents, municipal advisers and others affected by hurricanes Harvey, Irma and Maria.<sup>479</sup> The commission issued an order conditionally exempting affected persons from certain requirements of the federal securities laws for periods following the events<sup>480</sup> and adopted interim final temporary rules extending filing deadlines for certain reports and forms to be filed pursuant to Regulation Crowdfunding and Regulation A.<sup>481</sup>

### SEC Forms Fixed Income Market Structure Advisory Committee

On Nov. 9, 2017 the SEC formed the Fixed Income Market Structure Advisory Committee and announced its first members. This Committee was formed to focus on corporate bond and municipal securities markets, and will provide the SEC with advice and information on the efficiency and resiliency of these markets as well as identify any potential regulatory improvements.<sup>482</sup> This committee will resemble the committee formed in Feb. 2015 on the equity markets, which consists of a panel of industry experts and academics.<sup>483</sup>

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476 Press Release, U.S. Securities & Exch. Comm’n, *SEC Monitoring Impact of Hurricane Irma on Capital Markets, Continues to Monitor Impacts of Hurricane Harvey*, Rel. No. 2017-164 (Sept. 13, 2017), <https://www.sec.gov/news/press-release/2017-164>.

477 Press Release, U.S. Securities & Exch. Comm’n, *SEC Suspends Trading in Company Purporting Involvement in Hurricane Harvey Relief Efforts*, Rel. No. 2017-173 (Sept. 22, 2017), <https://www.sec.gov/news/press-release/2017-173>.

478 *Id.*

479 Press Release, U.S. Securities & Exch. Comm’n, *SEC Provides Regulatory Relief and Assistance for Hurricane Victims*, Rel. No. 2017-181 (Sept. 28, 2017), <https://www.sec.gov/news/press-release/2017-181>.

480 Securities & Exchange Commission, Release Nos. 81760 & 32842, Sept. 28, 2017, <https://www.sec.gov/rules/other/2017/34-81760.pdf>.

481 17 C.F.R. Parts 227 & 230, Regulation Crowdfunding and Regulation A Relief and Assistance for Victims of Hurricane Harvey, Hurricane Irma, and Hurricane Maria, U.S. Securities & Exch. Comm’n, <https://www.sec.gov/rules/interim/2017/33-10416.pdf>.

482 Press Release, U.S. Securities & Exch. Comm’n, *SEC Announces the Formation and First Members of Fixed Income Market Structure Advisory Committee*, Rel. No. 2017-209 (Nov. 9, 2017), <https://www.sec.gov/news/press-release/2017-209>.

483 John McCrank, *U.S. SEC close to forming group to scrutinize the bond market*, Reuters (Oct. 27, 2017), <https://www.reuters.com/article/us-usa-sec-bonds/u-s-sec-close-to-forming-group-to-scrutinize-the-bond-market-idUSKBN1CW2TD>.



**Securities Policy  
and Regulatory  
Developments**

The idea of this committee originated with SEC Chairman Clayton in July 2017 in order to advise the regulator on the bond market.<sup>484</sup> Commissioner Piwowar said that the committee will look at “pre-trade transparency, the complexities of the municipal bond market, and bond market liquidity.”<sup>485</sup>

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484 *Id.*

485 *Id.*

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