2014 Year-End Securities Litigation and Enforcement Highlights

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Welcome to the 2014 Year-End Report from the Baker Hostetler Securities Litigation and Regulatory Enforcement practice team. Its purpose is to provide a periodic survey, apart from our team Executive Alerts, on matters we believe to be of interest to sophisticated General Counsel, Chief Compliance Officers, Compliance Departments, legal departments, and members of the securities and commodities industries at financial institutions, private investment funds, and public companies.

We issue this Securities Litigation and Enforcement Highlights Report at mid-year and shortly after year-end. We hope you find the information and commentary useful and welcome your comments and suggestions. We encourage you to contact any of the practice team members listed at the end of the Report.

This Report highlights recent significant developments in:

- ***Supreme Court cases***, including the United States Supreme Court dismissal of the writ of *certiorari* in *Public Employees' Retirement System of Mississippi v. IndyMac MBS, Inc.* and its review of the scope of Section 11 of the Securities Act of 1933 (Securities Act);
- ***Securities law cases***, including the United States Court of Appeals for the Second Circuit's application of *Morrison* to whistleblower anti-retaliation provisions and liability under Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") and the United States Court of Appeals for the Ninth Circuit's decisions regarding the pleading standard for loss causation;
- ***Insider trading cases***, including the impact of the Second Circuit's decision in *United States v. Newman* and the United States Securities and Exchange Commission's (SEC) use of administrative proceedings for insider trading enforcement actions;
- ***Civil and regulatory settlements***, including the historic billion dollar settlements by Citigroup and Bank of America related to their conduct prior to the Financial Crisis of 2008;
- ***Investment adviser and hedge fund cases***, including enforcement actions relating to misappropriation of client assets, improper disclosures, and high-frequency trading;

- ***Commodities and futures regulation and cases***, including settlements of manipulation cases relating to foreign exchange rates (FX) and the London Interbank Offered Rates (LIBOR);
- ***Securities policy and regulatory developments***, including the adoption of rules by the SEC relating to money market funds, credit agencies, and the technology infrastructure of the United States securities markets; and
- ***The SEC's Cooperation Program***, including the first settlements pursuant to the Municipalities Continuing Disclosure Cooperation Initiative (MCDC Initiative) and several settlements reflecting significant cooperation credit in the form of reduced civil penalties.

I. Supreme Court Cases Review

After a momentous start to the year—with three securities law decisions by the United States Supreme Court, including the landmark decision in *Halliburton Co. v. Erica P. John Fund, Inc.*[1] (as discussed in our 2014 Mid-Year Report)—the Supreme Court docket had fewer securities-related events in the second half of 2014. Specifically, over the past six months the Supreme Court (i) dismissed a case that concerned the tolling provisions of the Securities Act and (ii) heard oral arguments about whether statements of opinion in registration statements that are not subjectively false are nevertheless actionable under Section 11 of the Securities Act (Section 11).

The Supreme Court Dismisses Review of *IndyMac* on Whether Filing of Class Action Tolls Statute of Repose

On September 19, 2014, the Supreme Court dismissed the writ of *certiorari* in *Public Employees' Retirement System of Mississippi v. IndyMac MBS, Inc.* (*IndyMac*) just days before it was scheduled to hear oral argument.[2] The Supreme Court had granted *certiorari* in this case on March 10, 2014, on the issue of whether the filing of a putative class action effectively tolls the statute of repose under the Securities Act.[3] The plaintiffs in *IndyMac* were hoping to overturn a 2013 Second Circuit decision that held that

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[1] 134 S.Ct. 2398 (2014).

[2] *Pub. Emps.' Ret. Sys. of Ms. v. IndyMac MBS, Inc.*, 135 S.Ct. 42 (2014).

[3] *Pub. Emps.' Ret. Sys. of Ms. v. IndyMac MBS, Inc.*, 134 S.Ct. 1515 (2014).

securities plaintiffs could not toll the statute of repose under the Securities Act by filing a class action lawsuit.[4]

The Supreme Court issued no reason as to why it dismissed *IndyMac* from its docket, except that it now believed the writ of certiorari had been "improvidently granted" in this case.[5] The speculation is that, in preparation for oral argument, the Supreme Court learned of a pending settlement that promised to rid this case of all but one of the claims against the named underwriter defendants. Hence, the Supreme Court opted to dismiss the case rather than risk having most of it voluntarily dismissed before the Supreme Court's final adjudication of the issues on appeal.

The dismissal will leave intact the split in the circuit courts as to whether the clock stops on a deadline to sue for securities fraud when a class action is filed. This disagreement arises from the Supreme Court's 1974 holding in *American Pipe & Construction Co. v. Utah* (*American Pipe*), where the Supreme Court held that the filing of a putative class action effectively tolls any statute of limitations.[6] Since then, circuit courts—and in particular the United States Circuit Courts of Appeals for the Second and Third Circuits—have disagreed as to whether the holding in *American Pipe* applies equally to the statute of repose under the Securities Act.[7]

The remaining circuit split will likely mean that the Supreme Court will soon have another opportunity to resolve this disagreement, and such a decision would serve as another important litmus test as to whether this Supreme Court is more partial to a broader, pro-plaintiff interpretation of the securities laws or a narrower, pro-defendant interpretation. If the Supreme Court sides with the Second Circuit's narrower interpretation, plaintiffs will likely opt out of class actions and bring their own claims rather than have their clock run out and be stuck with an unfavorable class action settlement.

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[4] *Pub. Emps.' Ret. Sys. of City of Detroit v. IndyMac MBS, Inc.*, 721 F.3d 95 (2d Cir. 2013).

[5] *Pub. Emps.' Ret. Sys. of Ms. v. IndyMac MBS, Inc.*, 135 S.Ct. 42 (2014).

[6] *Am. Pipe & Constr. Co. v. Utah*, 414 United States 538 (1974).

[7] Compare *Pub Emps.' Ret. Sys of City of Detroit v. IndyMac MBS, Inc.*, 721 F.3d 95 (2d Cir. 2013) with *Joseph v. Wiles*, 223 F.3d 1155 (10th Cir. 2000).

The Supreme Court Hears Oral Argument in *Omnicare*

On November 3, 2014, the Supreme Court heard oral arguments in the highly anticipated appeal in *Omnicare, Inc. v. Laborers District Council Construction Industry Pension Fund*.[8] The Supreme Court granted *certiorari* on this case in March 2014 to determine whether an untrue statement of opinion is actionable under Section 11 irrespective of whether the defendants actually believed the statement was false at the time it was made.[9]

The *Omnicare* defendants seek to overturn the Sixth Circuit Court of Appeals decision, which held that the pension fund plaintiff stated a cause of action under Section 11 by alleging that a registration statement contained a false statement of material fact even though that statement was framed as a belief or opinion and there was no indication that the defendants believed the statement to be false when it was made.[10] In so holding, the United States Court of Appeals for the Sixth Circuit determined that the fund was not required to plead or prove that the defendants subjectively knew the statement was false.

At oral argument, the defendants invoked the Supreme Court's 1991 decision in *Virginia Bankshares, Inc. v. Sandberg*[11]—which required that a plaintiff suing under the Exchange Act must plead knowledge of falsity to state a claim of fraud against the parties who made the alleged false statement—and argued that its holding applied equally to Section 11 claims. This position, which was rejected by the Sixth Circuit, has been supported by recent decisions by the United States Courts of Appeals for the Second and Ninth Circuits dismissing Section 11 claims on this ground.[12]

The Supreme Court justices seemed largely unimpressed by the defendants' arguments that the *Virginia Bankshares* opinion could apply in the Section 11 context. During oral argument, the justices noted that Congress intended Section 11 to impose strict liability on issuers, directors,

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[8] Oral Argument, *Omnicare, Inc. v. Laborers Dist. Council Constr. Indus. Pension Fund*, No. 13-435 (Nov. 3, 2014).

[9] *Omnicare, Inc. v. Laborers Dist. Council Constr. Indus. Pension Fund*, 134 S.Ct. 1490 (2014).

[10] *Ind. State Dist. Council of Laborers & HOD Carriers Pension & Welfare Fund v. Omnicare, Inc.*, 719 F.3d 498 (6th Cir. 2013).

[11] *Va. Bankshares, Inc. v. Sandberg*, 501 United States 1083 (1991).

[12] *See Fait v. Regions Fin. Corp.*, 655 F.3d 105 (2d Cir. 2011) and *Rubke v. Cap. Bancorp. Ltd.*, 551 F.3d 1156 (9th Cir. 2009).

underwriters, accountants, and other actors that are responsible for providing information in registration statements. This legislative intent is different from the intent behind claims under the Exchange Act.

How the Supreme Court decides this case will have a significant effect on securities litigation arising out of the offering of a security. If the Supreme Court overturns the Sixth Circuit's holding in *Omnicare*, it would dilute the *in terrorem* effect of Section 11 by forcing plaintiffs to plead—and later prove—that statements of belief in registration statements were subjectively false (*i.e.*, the defendant knew it was untrue). Conversely, if the Supreme Court affirms the lower court's decision, it will uphold the strict liability nature of Section 11 and should provide the securities plaintiff bar with an easier path to certification and settlement.

It should be noted that the Obama administration took a middle ground in its *amicus* brief in this case, arguing that a statement of opinion is actionable under Section 11 if it was subjectively false (as the *Omnicare* defendants contend) or if there was no reasonable basis for the opinion at the time it was made (which the *Omnicare* defendants contest).[13]

The Supreme Court is expected to issue its decision in this case early in 2015.

What to Look for in 2015

Other than *Omnicare*, no securities law cases are currently pending adjudication by the Supreme Court. However, there are three late-2014 securities-related cases where the defendant has petitioned the Supreme Court for review.

On October 20, 2014, defendant Joseph Contorinis filed a petition for writ of certiorari[14] to appeal a Second Circuit decision that ordered him to disgorge all the profits derived from his insider trading scheme.[15] Contorinis argues that the SEC cannot order him to disgorge these profits because they ultimately accrued to the company and the disgorgement remedy cannot extend beyond the amount of

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[13] Brief for the United States as Amicus Curae in Support of Vacatur and Remand, *Omnicare, Inc. v. Laborers Dist. Council Constr. Indus. Pension Fund*, No. 13-435 (June 12, 2014).

[14] Petition for Writ of Certiorari, *Contorinis v. Sec. & Exch. Comm'n*, No. 14-471 (Oct. 20, 2014).

[15] *Sec. & Exch. Comm'n v. Contorinis*, 743 F.3d 296 (2d Cir. 2014).

personal gain obtained by a particular defendant.[16] Should the Supreme Court decide to review this case, the issue on appeal would be whether a defendant in an SEC civil enforcement action can be ordered to disgorge profits that he or she never received, possessed, or controlled, but that instead accrued directly to innocent parties. A decision by the Supreme Court to deny or grant Contorinis's petition is expected in early 2015.

On November 12, 2014, the defendant in *United States v. McGee* filed a petition for writ of certiorari[17] to appeal a decision by the United States Court of Appeals for the Third Circuit that upheld his conviction for insider trading under SEC Rule 10b5-2, which defines a "relationship of trust or confidence" for the purposes of the misappropriation theory. McGee was convicted for insider trading based on trading on material, non-public information that he learned from someone he knew from Alcoholics Anonymous meetings.[18] Among other things, McGee's petition questions whether SEC Rule 10b5-2 was invalidly promulgated in 2000 because it conflicts with the holdings of the Supreme Court in its seminal insider trading cases, *United States v. O'Hagan*, 521 U.S. 642 (1997); *Dirsts v. Securities and Exchange Commission*, 463 United States 646 (1983); and *Chiarella v. United States*, 445 U.S. 222 (1980). McGee argued in his petition that these cases, as recently emphasized by the United States Court of Appeals for the Second Circuit's decision in *United States v. Newman* (discussed herein in the Insider Trading section), require a fiduciary duty as the basis for insider trading liability, which was not present in his case. McGee also argued that the government's reliance on SEC Rule 10b5-2 to extend liability for insider trading beyond fiduciary relationships is a constitutional overreach by the executive branch because it directly contradicts Supreme Court precedent. As McGee pointed out in his petition and reply brief, at least two Supreme Court justices recently indicated a willingness to consider the validity of SEC Rule 10b5-2 in Justice Antonin Scalia's statement joined by Justice Clarence Thomas denying the petition for writ of certiorari in *United States v. Whitman*, No. 14-29 (November 10, 2014). If the Supreme Court accepts review of this case, it will put SEC Rule 10b5-2 in the cross-hairs.

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[16] Petition for Writ of Certiorari, *Contorinis v. Sec. & Exch. Comm'n*, No. 14-471 (Oct. 20, 2014).

[17] Petition for Writ of Certiorari, *United States v. McGee*, No. 14-541 (Nov. 12, 2014).

[18] *United States v. McGee*, No. 13-3183 (3rd Cir. Aug. 14, 2014).

On December 6, 2014, the defendant in *Stiefel Laboratories, Inc. v. Finnerty* filed a petition for writ of certiorari[19] to appeal a decision by the United States Court of Appeals for the Eleventh Circuit that held that a corporation has a duty to update prior truthful statements and its failure to do is actionable under the securities laws.[20] Should the Supreme Court decide to review this case, the issue on appeal would be whether such a duty exists under Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder. In support of its petition, the defendant notes that there is a split among many circuit courts on this issue, making the issue ripe for Supreme Court review.[21] A decision by the Supreme Court to deny or accept this petition is expected in early 2015.

[19] Petition for Writ of Certiorari, *Stiefel Labs, Inc. v. Finnerty*, No. 14-687 (Dec. 6, 2014).

[20] *Finnerty v. Stiefel Labs., Inc.*, 756 F.3d 1310 (11th Cir. 2014).

[21] Petition for Writ of Certiorari, *Stiefel Labs, Inc. v. Finnerty*, No. 14-687 (Dec. 6, 2014).

II. Securities Law Cases

The United States Supreme Court has not been alone in deciding issues of securities law in 2014. In the latter half of the year, notable rulings have issued from the United States Courts of Appeals for the Second and Ninth Circuits.

Decisions Applying Morrison: The Continuing Evolution of the Presumption Against Extraterritoriality

The United States Court of Appeals for the Second Circuit issued two significant rulings in recent months stemming from the Supreme Court's recent decision in *Morrison v. National Australia Bank Ltd.*, 561 U.S. 247 (2010), which held that "by virtue of the presumption against extraterritorial application of U.S. statutes, § 10(b) of the Securities Exchange Act of 1934, the basic antifraud provision of the U.S. securities laws has no extraterritorial application, and no civil suit under that section may be brought unless predicated on a purchase or sale of a security listed on a domestic exchange or on a domestic purchase or sale of another security."[22]

Liu v. Siemens AG

On August 14, 2014, the Second Circuit issued its decision in *Liu v. Siemens AG,* holding that, much like Section 10(b) of the Exchange Act, the whistleblower anti-retaliation

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[22] *Parkcentral Global Hub Ltd. v. Porsche Auto. Holdings SE*, 763 F.3d 198, 200 (2d. Cir. 2014).

provision of the Dodd-Frank Act, 15 U.S.C. § 78u-6(h)(1), did not apply extraterritorially.[23] Put simply, the anti-retaliation provision "prohibits employers from retaliating against whistleblower employees who make certain protected disclosures."[24] The plaintiff, a non-U.S. citizen, brought a claim based on alleged retaliatory acts taken outside the territorial jurisdiction of the United States by his former employer, a German corporation, after the plaintiff internally reported allegedly corrupt practices to his superiors. The only connection to the United States alleged by the plaintiff was that, at all relevant times, Siemens AG's shares were listed on the New York Stock Exchange.

Following the Supreme Court's reasoning in *Morrison*, the court in *Liu* noted that "nothing in the text of the provision . . . or in the legislative history of the Dodd-Frank Act suggests that Congress intended the anti-retaliation provision to regulate the relationships between foreign employers and their foreign employees working outside the United States." … "Given the strong presumption that statutes are limited to domestic application in the absence of clear expression of congressional intent to the contrary," the Second Circuit concluded that Dodd-Frank Act's anti-retaliation provision was not intended to apply to wholly extraterritorial conduct and actors. Thus, because neither of the parties was domestic and the "whistleblowing, the alleged corrupt activity, and the retaliation all occurred abroad," the Second Circuit dismissed the plaintiff's claim as an untenable attempt to extend a domestic provision to acts occurring outside the territorial jurisdiction of the United States.

Parkcentral Global Hub Ltd. v. Porsche Automobile Holdings SE

The next day, the Second Circuit issued its decision in *Parkcentral Global Hub Ltd. v. Porsche Automobile Holdings SE*, affirming the dismissal of a complaint based on *Morrison*'s holding regarding extraterritoriality.[25] In that case, the plaintiffs sued over certain unique swap agreements for which the contractual parties' obligations were keyed to the value of a particular security. The agreements concerned the value of shares of Volkswagen AG, a German corporation traded on European exchanges; the plaintiffs stood to profit under the agreements if

[23] *Liu Meng-Lin v. Siemens AG*, 763 F.3d 175, 183 (2d Cir. 2014).

[24] *Id.* at 177.

[25] *Parkcentral*, 763 F.3d at 201-02.

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Volkswagen's shares declined in value. The plaintiffs alleged that, in entering the swap agreements, they relied to their detriment on allegedly fraudulent statements by nonparties to the swap agreements: specifically, statements by another German corporation, Porsche Automobile Holding SE, and its executives that Porsche did not intend to take over Volkswagen. When Porsche later did so, the value of Volkswagen's stock increased and the plaintiffs lost money under their swap agreements. The allegedly fraudulent statements at issue "were made primarily in Germany, but were also accessible in the United States and were repeated [t]here by the defendants," whereas the swap agreements themselves were concluded domestically.[26]

Relying on *Morrison*, the Second Circuit found that "imposition of liability under § 10(b) on these foreign defendants with no alleged involvement in plaintiffs' transactions, on the basis of the defendants' largely foreign conduct, for losses incurred by the plaintiffs in securities-based swap agreements based on the price movements of foreign securities would constitute an impermissibly extraterritorial extension of the statute."[27] The Second Circuit held that while *Morrison* "unmistakably made a domestic securities transaction (or transaction in a domestically listed security) necessary to a properly domestic invocation of Section 10(b)," under these circumstances, this fact alone was not "sufficient to state a properly domestic claim under the statute."[28] The Second Circuit further reasoned that if a domestic transaction alone were sufficient to invoke the protection of Section 10(b), "[i]t would require courts to apply the statute to wholly foreign activity clearly subject to regulation by foreign authorities solely because a plaintiff in the United States made a domestic transaction, even if the foreign defendants were completely unaware of it."[29] While the particular plaintiffs in *Parkcentral* had not alleged sufficient domestic activity under *Morrison*, the Second Circuit allowed that Section 10(b) might be properly invoked in other circumstances "to govern fraud in connection with transactions in securities-based swap agreements where the transactions are domestic and where the defendants are alleged to have sufficiently subjected themselves to the statute."[30] To give

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[26] *Id.* at 201.

[27] *Id.*

[28] *Id.* at 215.

[29] *Id.*

[30] *Id.* at 217.

the *Parkcentral* plaintiffs the opportunity to plead such circumstances (if they existed), the court remanded the case with instructions that the district court entertain a motion by plaintiffs to file an amended complaint.

As Circuit Judge Leval emphasized in his concurring opinion, the Second Circuit did not "identify, or rely on, any single factor or bright-line rule" in concluding that the *Parkcentral* plaintiffs failed to plead sufficient domestic activity.[31] Rather, the court conducted a fact-driven analysis, looking beyond the mere location of the parties and participants to other key events, transactions, and activities to determine whether a case is properly brought before U.S. courts. As Judge Leval noted, a bright-line rule "would defeat the longstanding principle enunciated by the Supreme Court that § 10(b) 'should be construed not technically and restrictively, but flexibly to effectuate its remedial 13 purposes,'" and thus the court's use of a "flexible, multi-factor test" is more appropriate to determine the proper invocation of United States jurisdiction.[32]

Loginovskaya v. Batratchenko

Less than a month after the *Liu* and *Parkcentral* decisions, on September 4, 2014, the Second Circuit issued its decision in Loginovskaya v. Batratchenko,[33] further exploring the implications of the Morrison decision on reach of U.S. statutes to activity occurring outside the United States. The Loginovskaya plaintiff had raised claims under the Commodity Exchange Act (CEA), which "serves the crucial purpose of protecting the innocent individual investor—who may know little about the intricacies and complexities of the commodities market—from being misled or deceived."[34] The plaintiff, a Russian citizen living in Russia, was solicited to invest with a global financial services organization based in New York; as part of two investment contracts, the plaintiff transferred hundreds of thousands of dollars to the defendants' accounts in New York. The plaintiff later learned that the defendants had been investing her funds inconsistently with her contracts; namely, her funds had been used to extend unsecured loans to an investment entity tied to the defendants. When it was revealed that plaintiff's investment was lost, she

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[31] *Id.* at 218.

[32] *Id.* at 221 [quoting *SEC v. Zandford*, 535 United States 813, 819 (2002)].

[33] *Loginovskaya v. Batratchenko*, 764 F.3d 266 (2d Cir. 2014).

[34] *Id.* at 270 [quoting *Commodity Futures Trading Comm'n v. R.J. Fitzgerald & Co.*, 310 F.3d 1321, 1329 (11th Cir. 2002)].

commenced a lawsuit alleging that the "defendants engaged in fraudulent conduct in violation of CEA § 4o."[35]

The Commodity Exchange Act "is silent as to extraterritorial reach."[36] Considering the recent Morrison decision and the presumption against the extraterritorial application of statutes, the Second Circuit looked to the focus of Section 22 of the Commodity Exchange Act, the source of the private right of action under which the plaintiff brought suit, to determine whether the statute was intended to apply extraterritorially. Finding that Section 22 was focused on the actual commodities transactions, the Second Circuit found that the "private right of action brought under CEA § 22 is limited to claims alleging a commodities transaction within the United States."[37] Although the *Loginovskaya* case involved U.S. entities and U.S. banks generally within the Commodity Exchange Act's reach, none of the commodities transactions at issue had occurred in the United States.[38] Hence, there was no basis for the plaintiff to bring a private cause of action, and the Second Circuit upheld the district court's dismissal of the plaintiff's claims.

As the *Liu*, *Parkcentral*, and *Loginovskaya* decisions demonstrate, post-*Morrison* courts are continuing to weigh the allegations raised by plaintiffs to determine whether the claims' connections to the United States are minor, fortuitous, or only tangentially domestic and whether the allegations involve transactions that are predominantly foreign, as these allegations may determine that a plaintiff's claims are not properly brought before U.S. courts. In particular, courts are examining closely where the securities at issue are traded, bought, or sold and which U.S. or foreign exchanges are implicated by the precise securities transactions alleged.

NASDAQ OMX Group, Inc. v. UBS Securities, LLC: Determining Federal or State Jurisdiction

On October 31, 2014, the Second Circuit issued its decision in *NASDAQ OMX Group, Inc. v. UBS Securities, LLC*,[39] delineating the scope of securities-related cases that may be heard by the federal courts. The case centered on

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[35] *Id.* at 269.

[36] *Id.* at 271.

[37] *Id.* at 268.

[38] *Id.* at 275.

[39] *NASDAQ OMX Group, Inc. v. UBS Securities, LLC*, 770 F.3d 1010 (2d Cir. 2014).

claims arising from Facebook's May 2012 initial public offering (IPO). UBS had initiated an arbitration proceeding against NASDAQ Stock Market LLC, which conducted the IPO, raising New York state law claims for indemnification and damages. NASDAQ, in turn, filed a federal declaratory judgment action in the United States District Court for the Southern District of New York seeking to forestall the arbitration. NASDAQ successfully obtained a preliminary injunction, and UBS appealed.

The Second Circuit considered whether federal question jurisdiction properly applied to enjoin an arbitration of solely state law claims under the federal jurisdictional doctrine "prevent[ing] a plaintiff from avoiding federal jurisdiction by framing in terms of state law a complaint, the real nature of which is federal, or by omitting to plead necessary federal questions in a complaint."[40] Applying a four-part test previously developed by the Supreme Court,[41] the Second Circuit concluded that "federal question jurisdiction applie[d] to all four of UBS's state claims."[42] This determination was in part based on the fact that the "singular duty" underlying UBS's claims, "NASDAQ's duty to operate a fair and orderly market," is "derive[d] directly from federal law" because NASDAQ itself is registered as a national security exchange under Section 6 of the Exchange Act.[43] The Second Circuit held that UBS's claims "necessarily raise disputed issues of federal law of significant interest to the federal system as a whole, and that the adjudication of state claims presenting such disputes in the federal courts would not disrupt any federal-state balance envisioned by Congress."[44] In a lengthy dissent, the Hon. Chester J. Straub opined that the exercise of federal jurisdiction in this case was not proper and that the controversy was one of New York state law. As Judge Straub opined, "[i]t simply cannot be true that every time a case involves a famous company or a multibillion-dollar IPO, federal courts have jurisdiction."[45] Judge Straub

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[40] *Id.* at 1019 (citation and quotations omitted).

[41] *Id.* at 1020. This test, as adopted by the Second Circuit, states that the federal courts' "jurisdiction over a state law claim will lie if a federal issue is: (1) necessarily raised, (2) actually disputed, (3) substantial, and (4) capable of resolution in federal court without disrupting the federal-state balance approved by Congress." *Id.* [quoting *Gunn v. Minton*, 133 S.Ct. 1059, 1065 (2013)].

[42] *NASDAQ*, 770 F.3d at 1020.

[43] *Id.* at 1021.

[44] *Id.* at 1031.

[45] *Id.* at 1036.

noted in particular that “NASDAQ’s rules are not federal and the Exchange Act is not actually in dispute.” [46]

Loss Causation

The Ninth Circuit recently issued two opinions regarding the standard for pleading loss causation, “the causal relationship between a material misrepresentation and the economic loss suffered by an investor,” for the purposes of securities fraud claims.[47]

Loos v. Immersion Corporation

On August 8, 2014, the Ninth Circuit issued its decision in *Loos v. Immersion Corp.*, further defining the level of detail necessary to establish loss causation based on the public revelation of fraudulent activity by the issuer of securities. The class action plaintiff in *Loos* brought claims of securities fraud on behalf of investors in Immersion Corp. after the company’s earnings suffered for several quarters and the company subsequently announced an internal investigation into its revenue accounting processes. Following the announcement, Immersion’s stock price dropped, and Immersion later filed revised earnings statements after uncovering errors in its accounting practices.

The Ninth Circuit held that the class action plaintiff failed to plead loss causation adequately where he alleged only that the stock price dropped after the company announced the existence of the internal investigation. As the Ninth Circuit explained, a securities fraud plaintiff must, at a minimum, “allege that the decline in the defendant’s stock price was proximately caused by a revelation of fraudulent activity rather than by changing market conditions, changing investor expectations, or other unrelated factors.” The Ninth Circuit agreed with a prior holding by the Eleventh Circuit in finding that, in and of itself, “[t]he announcement of an investigation does not ‘reveal’ fraudulent practices to the market” sufficient to establish proximate cause of an investor’s financial losses.

Oregon Public Employees Retirement Fund v. Apollo Group Inc.

Four months later, on December 16, 2014, the Ninth Circuit issued its opinion in *Oregon Public Employees Retirement*

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[46] *Id.* at 1037.

[47] *Loos v. Immersion Corp.*, 762 F.3d 880, 890 (9th Cir. 2014).

Fund v. Apollo Group Inc., holding that all elements of a securities fraud action, including loss causation, are subject to the heightened pleading standards for fraud claims under Rule 9(b) of the Federal Rules of Civil Procedure.[48] The class action plaintiffs sued on behalf of stockholders in Apollo Group Inc., alleging that Apollo made false and misleading statements of material fact and that certain of its officers and directors traded on inside information related to those false statements or had control person liability based on the making of the statements.

The Ninth Circuit found that not all aspects of the plaintiffs' claims were alleged with sufficient particularity. After analyzing the positions of the other circuits, the Ninth Circuit specifically found that "Rule 9(b) applies to all elements of a securities fraud action, including loss causation." The court based this finding in part on Rule 9(b)'s application to common law fraud, from which the securities fraud laws are derived, as well as the language of Rule 9(b) itself, as "[l]oss causation is a part of the 'circumstances' constituting fraud." The Ninth Circuit also noted that this pleading standard "creates a consistent standard through which to assess pleadings" in securities fraud actions, as opposed to a "piecemeal standard" for different elements of the securities cause of action.

Both the *Loos* and the *Oregon Public* decisions have implications for plaintiffs attempting to bring claims under Rule 10b-5 of the Exchange Act where a plaintiff cannot point to particularized facts regarding the acts or omissions the plaintiff alleges resulted in fraud or deceit in connection with the purchase or sale of a security. Although the Supreme Court has held that a demonstration of loss causation by all plaintiffs is not a prerequisite to class certification in securities fraud class actions,[49] these decisions show that plaintiffs must take care to plead detailed allegations of loss causation to maintain securities fraud causes of actions.

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[48] *Oregon Public Employees Retirement Fund v. Apollo Group Inc.*, No. 12–16624, 2014 WL 7139634, at *4 (9th Cir. Dec. 16, 2014).

[49] See *Erica P. John Fund, Inc. v. Halliburton Co.*, 131 S. Ct. 2179 (2011).

III. Insider Trading Cases

The SEC continued to make insider trading enforcement actions a priority, bringing 80 such actions during fiscal year 2014. [50] By our count, the SEC brought at least 17 cases and six administrative proceedings in the second half of 2014. These actions covered various types of illicit activity and relationships of trust (including golfing buddies and service providers) as well as alleged misconduct that was both domestic and global in scope. The SEC noted that its 2014 efforts include "implementing and developing next generation analytical tools to help identify patterns of suspicious trading."[51] These cases showed the government's interest in continuing to prioritize insider trading cases and rising push-back by the courts and juries.

Aggressively pursuing insider trading since taking office in 2009, the United States Attorney for the Southern District of New York, Preet Bharara, suffered his first loss, breaking his success rate of 85 consecutive convictions and guilty pleas in insider trading cases. Rengan Rajaratnam, charged with conspiracy to commit insider trading in connection with the broader insider trading scheme at Galleon Group LLC, was acquitted of one count of conspiracy to commit insider trading, after the other insider trading charges were

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[50] Release, United States Securities and Exchange Commission, SEC's FY 2014 Enforcement Actions Span Securities Industry and Include First-Ever Cases, Rel. No. 2014-230 (Oct. 16, 2014), http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370543184660#.VLQj2KQo4y9.

[51] *Id.*

dismissed.[52] Over three months later, on October 23, 2014, the SEC entered into a settlement with Rengan Rajaratnam in connection with charges of insider trading. The terms of the settlement included an industry bar and $841,000 in civil penalty, interest, and disgorgement.[53] Other notable developments for U.S. Attorney Bharara include the sentencing of Mathew Martoma, the CR Intrinsic Investors, LLC, portfolio manager who was found guilty of insider trading in connection with the SAC Capital insider trading scheme. On September 8, 2014, United States District Court Judge Paul G. Gardephe sentenced Martoma to nine years' imprisonment, noting that his actions were "deeply corrosive to our financial markets."[54]

United States v. Newman

Perhaps the most significant insider trading development in 2014 was the Second Circuit's decision in *United States v. Newman*. As we discussed fully in our Executive Alert, the Second Circuit vacated the insider trading convictions of two former hedge fund portfolio managers, Todd Newman and Anthony Chiasson, and directed that the charges against them be dismissed with prejudice.[55] At bottom, the Second Circuit held:

1. A tippee is liable for insider trading if he knew, or should have known, of the breach of fiduciary duty by the inside tipper;

2. A breach of confidentiality based on a personal relationship is not sufficient to prove a personal benefit; and

3. A remote tippee must have knowledge that the tipper received a personal benefit.

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[52] *Rengan Rajaratnam Cleared in First Loss for United States Crackdown on Insider Trading*, BLOOMBERG (July 8, 2014), http://www.bloomberg.com/news/2014-07-08/rengan-rajaratnam-cleared-of-conspiracy-in-first-loss-for-u-s-.html; *United States v. Rajaratnam*, 13-cr-00211 (S.D.N.Y. July 1, 2014).

[53] Release, United States Securities and Exchange Commission, Rengan Rajaratnam Agrees to Settle Insider Trading Charges, Rel. No. 2014-237 (Oct. 23, 2014), http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370543274751#.VMejzlqjJFJ.

[54] Release, United States Department of Justice, SAC Capital Portfolio Manager Mathew Martoma Sentenced in Manhattan Federal Court to Nine Years for Insider Trading (Sept. 8, 2014), http://www.justice.gov/usao/nys/pressreleases/September14/MathewMartomaSentencingPR.php.

[55] 2014 WL 6911278 (2d Cir. Dec. 10, 2014).

This decision has significant implications for criminal insider trading prosecutions and those brought civilly by the SEC. Fundamentally, it will make it more difficult for the government to charge alleged remote tippees (like the defendants in *Newman,* who were three or four persons removed from the corporate insiders) with violations of the federal securities laws. The court appeared critical of the government for bringing criminal insider trading charges against Newman and Chiasson at a point when neither corporate insider had been charged criminally for insider trading and one had also not been charged administratively or civilly.

The Second Circuit grounded its analysis in the Supreme Court's long-standing insider trading decisions of *Dirks v. SEC*[56] and *Chiarella v. United States*[57] from the early 1980s, which established that "insider trading liability is based on breaches of fiduciary duty." The decision clarified the boundaries for tippee liability by holding that the government must prove beyond a reasonable doubt that a tippee has knowledge of the personal benefit to the tipper. Finally, the decision restricts what constitutes a personal benefit in the context of insider trading by now requiring a *quid pro quo* relationship.

According to the Second Circuit, the government's criminal case against Newman and Chiasson suffered from similar flaws that contributed to its loss in the criminal insider trading prosecution of Rengan Rajaratnam,[58] as well as the SEC's losses in 11 insider trading cases or claims over the past year. As we pointed out last month in a BNA Securities Regulation & Law Report article,[59] the SEC pushed the envelope in those cases, including in *SEC v. Bauer*, No. 03-cv-1427 (E.D. Wisc.); *SEC v. Obus*, No. 06-cv-3150 (S.D.N.Y.); and *SEC v. Schvacho*, 12-cv-2557 (N.D. Ga.). Similarly, the Second Circuit appeared to be reining in the government.

Since the *Newman* decision, a number of defendants have sought to challenge their convictions and guilty pleas. On January 22, 2015, U.S. District Judge Andrew L. Carter, Jr.,

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[56] 463 United States 646 (1983).

[57] 445 United States 222 (1980).

[58] *United States v. Rajaratnam*, 13-cr-00211 (S.D.N.Y. July 1, 2014).

[59] Marc D. Powers, Jonathan A. Forman, and Margaret E. Hirce, *A Call for Better SEC Accountability Before Bringing Insider Trading Cases*, BLOOMBERG BNA, SECURITIES REGULATION & LAW REPORT, 46 SRLR 2214 (Nov. 17, 2014).

of the United States District Court for the Southern District of New York vacated the guilty pleas of four defendants, which related to an insider trading scheme involving IBM stock, as insufficient under *Newman*.[60] The day after Judge Carter issued his order, the government filed a Petition for Rehearing and Rehearing En Banc with the Second Circuit in the *Newman* case stating that "[t]he Opinion breaks with Supreme Court and Second Circuit precedent, conflicts with the decisions of other circuits, and threatens the effective enforcement of the securities laws."[61] On January 26, 2014, the SEC filed a motion for leave to file an amicus brief in support of the government, noting that the issue addressed by the *Newman* decision is "exceptionally important to the Commission because the panel's narrowed definition of personal benefit and lack of clarity about the evidence required to establish such benefit could negatively affect the Commission's ability to effectively police and deter insider trading, which would undermine investor confidence in the fairness and integrity of the securities markets."[62]

The SEC's Use of Administrative Proceedings in Insider Trading Cases

At a June 2014 speech, the SEC's director of enforcement, Andrew Ceresney, indicated that the SEC intended to bring more insider trading cases in administrative proceedings before SEC administrative law judges.[63] Many commented that this decision was in reaction to the SEC's recent losses in federal court, particularly given the SEC's success rate in administrative proceedings. However, Director Ceresney rejected this idea, noting that administrative proceedings are sometimes preferable due to the "sophisticated trier of fact" experienced in securities laws. Director Ceresney also noted that the proceedings offer a more streamlined process. Yet the use of administrative proceedings had been the recent subject of much discussion and criticism. Notably, in a November 2014 speech, United States District Judge Jed Rakoff was critical of the SEC's increasing use of its own administrative judges, cautioning the SEC against

[60] Order, *United States v. Thomas Conradt*, 12-cr-887 (S.D.N.Y. Jan. 22, 2015).

[61] Petition of the United States of America for Rehearing and Rehearing En Banc, *United States v. Newman*, 13-1837 (2d Cir. Jan. 23, 2015).

[62] Motion for Leave to File an Amicus Curiae Brief Supporting the Position of the United States for Rehearing or Rehearing En Banc, *United States v. Newman*, 13-1837 (2d Cir. Jan. 26, 2014).

[63] Brian Mahoney, *SEC Could Bring More Insider Trading Cases In-House*, LAW360 (June 11, 2014), http://www.law360.com/articles/547183/sec-could-bring-more-insider-trading-cases-in-house.

becoming "a law unto itself."[64] Director Ceresney addressed these comments, defending the SEC's use of administrative proceedings and noting that they "produce prompt decisions" and benefit from "specialized fact finders."[65]

Despite these concerns, the SEC had filed six administrative proceedings (by our count) in the second half of 2014. For example, on September 30, 2014, the SEC brought an enforcement action against Jordan Peixoto, a Deloitte & Touche analyst, for alleged insider trading of Herbalife Ltd. Stock.[66] Peixoto allegedly received the information from his friend Filip Szymik, an analyst at Pershing Square Capital Management, regarding Pershing's negative view of Herbalife. Peixoto purchased put options in Herbalife based upon this material, nonpublic information, thus resulting in illicit trading profits of only $47,100. A month after the SEC filed its action, Peixoto filed a complaint in the United States District Court for the Southern District of New York against the SEC, seeking declaratory and injunctive relief, claiming the SEC's administrative proceedings violated his due process and equal protection rights.[67] On December 15, 2014, the SEC filed a motion to dismiss its case against Peixoto, due to the unavailability of two witnesses. Despite the SEC's explanation, many have posited that the SEC moved to dismiss the *Peixoto* action based upon the *Newman* decision.

Service Providers

***SEC v. Michael Anthony Dupre Lucarelli*, No. 14-cv-6933 (S.D.N.Y.);**
***United States v. Lucarelli,* No. 14-cr-00632 (S.D.N.Y.)**

On August 26, 2014, the SEC and DOJ brought insider trading charges against Michael Anthony Dupre Lucarelli, a director at the Manhattan investor relations firm

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[64] *United States judge criticizes SEC use of in-house court for fraud cases*, REUTERS (Nov. 5, 2014), http://www.reuters.com/article/2014/11/05/us-sec-fraud-rakoff-idUSKBN0IP2EG20141105.

[65] Speech, Remarks to the American Bar Association's Business Law Section Fall Meeting, delivered by SEC Enforcement Director Andrew Ceresney (Nov. 21, 2014), http://www.sec.gov/News/Speech/Detail/Speech/1370543515297#.VL1s3VqjJFI.

[66] *In the Matter of Jordan Peixoto*, Exchange Act Rel. No. 73263, Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934 and Notice of Hearing (Sept. 30, 2014), http://www.sec.gov/litigation/admin/2014/34-73263.pdf.

[67] *Peixoto v. SEC*, 14-cv-8364 (S.D.N.Y. Oct. 20, 2014).

Lippert/Heilshorn & Associates, Inc. Lucarelli obtained and traded information relating to the material business developments (e.g., earnings reports or clinical trial results) of his firm's clients by accessing draft press releases of his firm's clients. As highlighted by the SEC and DOJ, Lucarelli opened a brokerage account in order to complete the trades, and concealed the name of his employer on the application. As a result of the trades, Lucarelli made between nearly $500,000 and $1 million in illegal profits. On September 25, 2014, Lucarelli entered a guilty plea in the DOJ action and agreed to forfeit nearly $1 million. Lucarelli is awaiting sentencing, and faces 20 years in prison. The SEC action is pending.

One notable aspect of the Lucarelli case is the evidence obtained by the FBI agents in the course of the investigation. The FBI executed a search warrant "to search the office of Michael A. Lucarelli, the defendant, at [Lippert/Heilshorn & Associates, Inc.], including closed and locked containers therein."[68] The federal agents, during the course of the search, unlocked Lucarelli's briefcase and found a draft press release for a client, TREX Company, stating financial results. The federal agents took a photograph of the draft press release and returned it to the briefcase, "so as not to prematurely advise Lucarelli of the existence of our investigation."[69] Lucarelli then traded TREX stock in possession of the material, nonpublic information and made nearly $90,000 in profits.

***SEC v. Dimitry Braverman and Vitaly Pupynin*, No. 14-cv-7482 (S.D. Fla.); *United States v. Dimitry Braverman*, No. 14-cr-00748 (S.D.N.Y.)**

On September 16, 2014, the SEC and DOJ charged Dmitry Braverman, a senior IT employee of the global law firm Wilson, Sonsini, Goodrich & Rosati, P.C., of insider trading for trading on confidential information regarding clients' proposed corporate deals. Braverman traded in his own account on information concerning eight corporate deals. After an attorney at his law firm, Matthew H. Kluger, was charged by the SEC and DOJ in an unrelated insider trading case, Braverman ceased trading for 18 months. When Braverman began trading again, he did so in a brokerage account held in the name of his Russian relative

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[68] Complaint, *United States v. Lucarelli*, 14-cr-00632 (S.D.N.Y. Aug. 25, 2014).

[69] *Id.*

Vitaly Pupynin. As a result, Braverman made over $300,000 in illegal profits. On November 13, 2014, Braverman pled guilty to securities fraud and is awaiting sentencing.[70]

As noted by Daniel M. Hawke, the chief of the SEC Enforcement Division's Market Abuse Unit, when the charges were brought against Braverman, "[i]nsider trading by employees of law firms and other professional organizations is an important enforcement focus for us. We've enhanced our detection capabilities, and we're refining our investigative approaches to enable us to more easily identify those who abuse their positions of trust and confidence."[71]

***SEC v. Frank Tamayo*, No. 14-cv-05844 (D.N.J.); *United States v. Frank Tamayo*, No. 14-cr-00543 (D.N.J.)**

Frank Tamayo was charged with insider trading by the DOJ on September 19, 2014, and by the SEC on September 22, 2014, in connection with an alleged scheme to trade on confidential information regarding pending corporate deals obtained by a law firm managing clerk.[72] Tamayo, a Citibank N.A. mortgage broker, allegedly acted as a "middleman" between Steven Metro, a managing clerk at the law firm Simpson Thatcher & Bartlett LLP in New York, and Vladimir Eydelman, Tamayo's stockbroker, in a scheme to trade on material, nonpublic information about 13 corporate deals.[73] For five years, Metro allegedly took

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[70] Release, United States Department of Justice, Former Senior Systems Engineer At National Law Firm Pleads Guilty In Manhattan Federal Court To Insider Trading (Nov. 13, 2014), http://www.justice.gov/usao/nys/pressreleases/November14/BravermanPleaPR.php.

[71] Release, United States Securities and Exchange Commission, SEC Charges IT Employee At Law Firm With Insider Trading Ahead of Merger Announcements, Rel. No. 2014-197 (Sept. 16, 2014), http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370542965393#.VL_qv6Qo4y8.

[72] Release, United States Securities and Exchange Commission, SEC Charges Brooklyn Man for Facilitating Insider Trading Scheme Via Post-It Notes At Grand Central Terminal, Rel. No. 23089 (Sept. 22, 2014), http://www.sec.gov/litigation/litreleases/2014/lr23089.htm.

[73] In connection with this scheme, the SEC had charged Steven Metro and Vladimir Eydelman with insider trading on March 20, 2014. Release, United States Securities and Exchange Commission, SEC Charges Law Firm Managing Clerk and Stockbroker in $5.6 Million Insider Trading Scheme, Rel. No. 22948 (Mar. 19, 2014), http://www.sec.gov/litigation/litreleases/2014/lr22948.htm. The DOJ also charged Metro and Eydelman with securities fraud and tender offer fraud. Release, United States Department of Justice, More than $33 Million in Alleged Illegal Trades Netted $5.6 Million Over Four-Year Scheme (Mar. 19, 2014),

confidential information about these corporate deals from the firm's computer system, and he then passed the information, including the names of the securities and general timing for purchase, to his former law school classmate, Tamayo. Tamayo would write the tip on a Post-it Note or napkin and meet Eydelman in Grand Central to share the information, after which Tamayo allegedly destroyed the Post-it Note or napkin, sometimes by eating the document. As a result of this scheme, the participants allegedly made over $5.6 million in profits.

On September 19, 2014, Tamayo pled guilty to criminal information charging him with one count each of securities fraud, tender offer fraud, and conspiracy to commit securities fraud.[74] As part of the guilty plea, Tamayo agreed to forfeit over $1 million. Tamayo faces a maximum of 25 years' imprisonment, and he is currently awaiting sentencing. The SEC actions, as well as the criminal case against Metro, are pending. On January 15, 2014, Eydelman agreed to make a guilty plea.[75]

***SEC v. Shivbir S. Grewal and Preetinder Grewal*, No. 14-cv-02026 (C.D. Cal.)**

On December 22, 2014, the SEC brought insider trading charges against Shivbir S. Grewal, a lawyer at a California law firm and former outside counsel for Spectrum Pharmaceuticals, and his wife,rewal, for trading on material, nonpublic information concerning demand for one of Spectrum Pharmaceutical's drugs.[76] Mr. Grewal allegedly learned of this material, (nonpublic information) in the course of his duties as outside counsel, and then tipped his wife. Both Mr. Grewal and his wife sold their shares prior to the announcement of the expected decline in demand, and avoided losses of approximately $45,000. The Grewals

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http://www.justice.gov/usao/nj/Press/files/Metro,%20Steven%20and%20Eydelman,%20Vladimir%20Charged%20News%20Release.html.

[74] Release, United States Department of Justice, Mortgage Broker Admits Trading on Inside Information Stolen From Prominent New York Law Firm (Sept. 19, 2014), http://www.justice.gov/usao/nj/Press/files/Tamayo,%20Frank%20Plea%20News%20Release.html.

[75] Joseph Ax, *Ex-Morgan Stanley to plead guilty in napkin eating scheme*, REUTERS (Jan. 15, 2015), http://www.reuters.com/article/2015/01/15/insidertrading-plea-napkins-idUSL1N0UU33120150115.

[76] Release, United States Securities and Exchange Commission, SEC Charges Corporate Attorney and Wife with Insider Trading On Client's Confidential Information, Rel. No. 23167 (Dec. 22, 2014), http://www.sec.gov/litigation/litreleases/2014/lr23167.htm.

settled with the SEC for $90,000 in fines and disgorgement. According to the terms of the settlement, Mr. Grewal is restricted from representing an entity regulated by the SEC, or any publicly traded company, before the SEC. Regarding the case, Michele Wein Layen, the director of the SEC's Los Angeles office, stated "[a]n attorney owes a client a duty of trust when presented with confidential information. Shivbir Grewal attempted to avoid personal financial losses by breaching his duty to protect that nonpublic information, and in the end he pays a heavier price for exploiting it."

"Golfing Buddy" Cases

SEC v. Eric McPhail, 14-cv-12958 (D. Mass.); *United States v. McPhail*, 14-cr-10201 (D. Mass.)

On July 11, 2014, the SEC filed a complaint charging seven individuals, many of whom were "golfing buddies," with insider trading.[77] On July 9, 2014, two of the defendants, Eric McPhail and Douglas A. Parigian, were indicted by a grand jury in the United States District Court for the District of Massachusetts on charges including conspiracy and securities fraud (the indictment was unsealed on July 11, 2014).[78] McPhail, an employee at a stone fabrication company, allegedly had a close personal relationship with an executive at American Superconductor[79] through golf at their country club. McPhail allegedly misappropriated material, nonpublic information disclosed in confidence by the executive regarding business developments of American Superconductor, including earnings results and business deals. McPhail then supposedly tipped the other defendants, five golfing buddies—Douglas A. Parigian, John J. Gilmartin, Douglas Clapp, James A. Drohen, and John C. Drohen—and one college friend, Jamie A. Meadows. McPhail and the other defendants allegedly exchanged emails concerning the information and then traded in American Superconductor securities on the basis of this information to make over $554,000 in profits. The SEC settled with four of the defendants, Gilmartin, Clapp, James A. Drohen, and John C. Drohen. Without admitting or denying the allegations, each defendant agreed to pay a

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[77] Release, United States Securities and Exchange Commission, SEC Charges Group of Amateur Golfers in Insider Trading Ring, Rel. No. 23040 (July 11, 2014), http://www.sec.gov/litigation/litreleases/2014/lr23040.htm.

[78] Release, United States Department of Justice, Two Men Charged With Insider Trading Of Stock In American Superconductor Corporation (July 11, 2014), http://www.justice.gov/usao-ma/pr/two-men-charged-insider-trading-stock-american-superconductor-corporation.

[79] The corporate insider has yet to be charged by the SEC or DOJ.

civil penalty and disgorgement, in total an amount over $145,000.

The SEC case against the remaining defendants is pending. In the SEC case, defendants McPhail and Parigian filed separate motions to dismiss in which they argued that the SEC failed to sufficiently allege that a fiduciary duty existed between McPhail and the corporate insider.[80] As argued in McPhail's motion, "[t]he complaint is crystal clear that, other than being a friend and golfing buddy of the AMSC executive, McPhail had no inherent business relationship with the executive from which one might infer a fiduciary relationship of trust and confidence in business matters."

***SEC v. John Patrick O'Neill & Robert H. Bray*, No. 14-cv-13381 (D. Mass.); *United States v. John Patrick O'Neill*, No. 14-cr-10317 (D. Mass.); *United States v. Robert H. Bray*, No. 14-cr-10356 (D. Mass.)**

The SEC and the DOJ charged John O'Neill, a former executive at Eastern Bank Corporation, with insider trading on August 18, 2014. The SEC charged Robert Bray on August 18, 2014, and the DOJ charged him on November 12, 2014. O'Neill and Bray were members of the same country club and frequently played golf together. O'Neill allegedly misappropriated information about Eastern Bank Corporation's potential acquisition of Wainwright Bank & Trust Company. O'Neill then supposedly tipped his friend and member of the same country club with whom he played golf, Robert H. Bray, about this acquisition. In the weeks prior to the merger, Bray allegedly purchased shares of Wainwright. Upon announcement of the merger and the nearly 100 percent price increase in Wainwright stock, Bray allegedly made approximately $300,000 in illegal profit. As stated by Paul G. Levenson, the SEC Boston regional office director, "Country clubs or similar venues may give people a false sense of security that leads them to think they can get away with trading on unlawful stock tips. But as in any social setting, people who trade securities based on confidential information they receive are taking a huge risk

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[80] Memorandum in Support of Motion to Dismiss, *SEC v. Eric J. McPhail*, 14-cv-12958 (D. Mass. Sept. 22, 2014); Memorandum of Law in Support of Motion to Dismiss, *SEC v. Douglas A. Parigian*, 14-cv-12958 (D. Mass. Sept. 27, 2014).

that their illegal tipping and trading will be identified by the SEC."[81]

On December 5, 2014, O'Neill pled guilty to conspiracy to commit securities fraud and is awaiting sentencing. The DOJ action against Bray and the SEC actions against O'Neill and Bray are pending.

Global Insider Trading Cases

SEC v. Juan Cruz Bilbao Hormaeche and Tomas Andres Hurtado Rourke, No. 14-cv-10036 (S.D.N.Y.)

On December 22, 2014, the SEC charged two Chilean nationals with insider trading in connection with trading on material, nonpublic information related to the tender offer by Abbot Laboratories for CFR Pharmaceuticals (CFR), a Chilean corporation.[82] The SEC alleged that Bilbao, a member of the board of directors of CFR, learned of the proposed acquisition during board meetings. According to the SEC, Bilbao used the confidential information learned at these meetings to purchase American depositary shares (ADSs) of CFR in the time period between the proposal in March 2014 and completion of the tender offer on September 23, 2014. Bilbao allegedly purchased these ADSs through his U.S. brokerage account in the name of Somerton Resources Limited, a British Virgin Islands company of which Bilbao is a beneficiary. Bilbao's business associate Hurtado also purchased ADSs for himself through his U.S. brokerage account, and also purchased on Bilbao's behalf. The defendants tendered their ADSs, and Bilbao allegedly made illegal profits of over $10.1 million, and Hurtado made nearly $500,000. The SEC action is currently pending.

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[81] Release, United States Securities and Exchange Commission, SEC Charges Former Bank Executive and Friend With Insider Trading Ahead of Acquisition, Rel. No. 2014-169 (Aug. 18, 2014), http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370542670374#.VL7wMqQo4y8.

[82] Complaint, *SEC v. Juan Cruz Bilbao Hormaeche and Tomas Andres Hurtado Rourke*, 14-cv-10036 (S.D.N.Y. Dec. 22, 2014), http://www.sec.gov/litigation/complaints/2014/comp-pr2014-291.pdf.

IV. Settlements

According to analysis conducted by NERA Economic Consulting, settlement amounts for securities class actions drastically plummeted in 2014.[83] The median settlement in 2014 was $6.5 million, the lowest level in 10 years,[84] and the settlement average has dropped 38 percent from 2013.[85] NERA also noted that the average settlement in the first part of the year was $40 million and only $29 million in the second half of the year after *Halliburton*.[86]

The SEC continues to break new ground on regulatory settlements. On October 16, 2014, the SEC reported that it brought a record 755 enforcement actions yielding $4.16 billion in penalties and disgorgements during the fiscal year ending on September 30, 2014.[87] As highlighted in our 2014 Mid-Year Report, the SEC brought a number of first-of-their kind enforcement actions, including (1) an enforcement action for retaliation against a whistleblower[88],

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[83] Dr. Renzo Comolli and Svetlana Starykh, *Recent Trends in Securities Class Action Litigation : 2014 Full-Year Review*, (Jan. 20, 2015), http://www.nera.com/content/dam/nera/publications/2015/Full_Year_Trends_2014_0115.pdf

[84] *See id.* at p. 28.

[85] *See id.* at p. 26.

[86] *See id.*

[87] Release, United States Securities and Exchange Commission, SEC's FY 2014 Enforcement Actions Span Securities Industry and Include First-Ever Cases, Rel. No. 2014-230 (Oct. 16, 2014), http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370543184660#.VMFYTkfF9Bl.

[88] *In the Matter of Paradigm Capital Management, Inc. and Candace King Weir*, Exchange Act Rel. No. 72393, Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of

(2) an enforcement action for violations of the investment adviser pay-to-play rules[89], and (3) an enforcement action to enforce the recordkeeping requirements established by Rules 17a-25 and 17a-4(f)(3)(v) of the Exchange Act.[90] This year also saw settlement of enforcement actions charging violations of the market access rule, the first market manipulation case against a high-frequency trading firm,[91] the first time the SEC obtained an emergency order blocking a fraudulent municipal offering, and the first SEC action against a broker-dealer for failing to protect a customer's information that had been misappropriated by an employee.

We highlight some of the other noteworthy settlements from the last half of 2014 and their import below.

Civil Settlements

Credit Default Swaps

***In re American International Group Inc., 2008 Securities Litigation*, No. 1:08-cv-04772 (S.D.N.Y.)**

On August 4, 2014, AIG announced that it agreed to pay $960 million to settle a consolidated class action filed in the wake of the company's near collapse during the 2008 financial crisis.[92] The agreement is one of the largest settlements ever for a securities fraud class action associated with the 2008 financial crisis. The investors, led by several Michigan pension systems, alleged that AIG concealed the true value of its credit default swaps for two years before AIG's stock plummeted in 2008. Notably, the settlement was agreed upon on July 15, shortly after the

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1934 and Section 203(k) of the Investment Advisers Act of 1940, Making Findings, and Imposing a Cease-and-Desist Order (June 16, 2014), https://www.sec.gov/litigation/admin/2014/34-72393.pdf.

[89] Release, United States Securities and Exchange Commission, SEC Charges Private Equity Firm With Pay-to-Play Violations Involving Political Campaign Contributions in Pennsylvania, Rel. No. 2014-120 (Jun. 20, 2014), http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370542119853.

[90] Release, United States Securities and Exchange Commission, Scottrade Agrees to Pay $2.5 Million and Admits Providing Flawed "Blue Sheet" Trading Data, Rel. No. 2014-14 (Jan. 29, 2014), http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370540696906.

[91] *See Infra*, Section V.C., for discussion of *In the Matter of Athena Capital Research, LLC,* Proc. No. 3-16199.

[92] Kat Greene, *AIG Pays $960M to Settle Securities Fraud Class Action*, LAW360 (Aug. 4, 2014), http://www.law360.com/articles/564123/aig-pays-960m-to-settle-securities-fraud-class-action.

Supreme Court refused to overturn the fraud-on-the market presumption in *Halliburton v. Erica P. John Fund*.

FHFA Mortgage-Backed Securities Settlements

The Federal Housing Finance Agency (FHFA) reached two additional settlements related to the private-label securities lawsuits related to the sales of mortgage-backed securities (MBS) to Fannie Mae and Freddie Mac. The FHFA, which serves as the conservator for Fannie Mae and Freddie Mac, sued 18 financial institutions in September 2011 regarding the quality of $182 billion in mortgages underlying securities sold to Fannie and Freddie.

On August 22, 2014, Goldman Sachs & Co. announced that it agreed to pay more than $3 billion to settle FHFA's claims by repurchasing the mortgage-backed securities that it sold to Fannie and Freddie from 2005 to 2007.[93] Goldman will pay approximately $2.15 billion to Freddie Mac and approximately $1 billion to Fannie Mae. The settlement is worth approximately $1.2 billion, the difference between the $3.15 billion payment and the current value of the securities.

On September 12, 2014, HSBC North America Holdings Inc. agreed to pay $550 million to settle claims that they misrepresented the quality of loans underlying four MBS offerings sold to the government lenders.[94] On August 28, 2014, the district court denied HSBC's motion to dismiss the claims as time-barred, finding that the Supreme Court's ruling in *CTS v. Waldburger* did not restrict a statute of limitations extension under the Housing and Economic Recovery Act.

FHFA still has actions pending against Nomura Holding America, Inc. and The Royal Bank of Scotland Group.

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[93] Release, Federal Housing Finance Agency, FHFA Announces Settlement with Goldman Sachs (Aug. 22, 2014), http://www.fhfa.gov/Media/PublicAffairs/Pages/FHFA-Announces-Settlement-with-Goldman-Sachs.aspx.

The case is *Federal Housing Finance Agency v. Goldman Sachs & Co., et al.,* No. 1:11-cv-06198 (S.D.N.Y.).

[94] Release, Federal Housing Finance Agency, FHFA Announces Settlement with HSBC (Sept. 12, 2014), http://www.fhfa.gov/Media/PublicAffairs/Pages/FHFA-Announces-Settlement-with-HSBC.aspx.

The case is *Federal Housing Finance Agency v. HSBC North America Holdings Inc. et al.*, No. 1:11-cv-06189 (S.D.N.Y.).

LBO and Collusion

***Dahl, et al., v. Bain Capital Partners, LLC, et al.*, No. 1:07-cv-12388 (D. Mass.)**

On September 30, 2014, the United States District Court of the District of Massachusetts granted initial approval of $590 million to settle a class action alleging that Bain Capital, Goldman Sachs, Carlyle Group, and other private equity firms colluded to keep leveraged buyout prices low.[95] The plaintiffs, shareholders of companies that the firms allegedly underpaid for as a result of the defendants' anticompetitive conduct, alleged that the firms followed elaborate bidding rules to artificially deflate prices in 19 separate deals between 2003 and 2009. Goldman Sachs and Bain Capital Partners agreed to pay $67 million and $54 million, respectively, in June 2014. Silver Lake Partners LP reached a $29.5 million deal in July 2014. In August, KKR & Co., Blackstone Group, and TPG Capital LP agreed to pay a total of $325 million and the Carlyle Group agreed to pay $115 million.

Regulatory Settlements

Citigroup and Bank of America Financial Crisis Settlements

On August 21, 2014, the Justice Department announced that it reached the largest civil settlement with a single entity in American history—a $16.65 billion settlement with Bank of America Corporation to resolve federal and state claims against the bank and its subsidiaries, Countrywide Financial Corporation, and Merrill Lynch related to the their subprime mortgage practices prior to the financial crisis.[96] Bank of America agreed to pay a $5 billion penalty under the Financial Institutions Reform, Recovery and Enforcement Act (FIRREA), the largest penalty ever. Bank of America will also pay approximately $1.8 billion to settle federal fraud claims related to the bank's origination and sale of mortgages, $1.03 billion to settle federal and state

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[95] Melissa Lipman, *Goldman, Others Get Initial Approval for $590M LBO Deals*, LAW360 (Sept. 30, 2014), http://www.law360.com/articles/582499/goldman-others-get-initial-approval-for-590m-lbo-deals?article_related_content=1.

[96] Release, United States Department of Justice, United States Department of Justice Bank of America to Pay $16.65 Billion in Historic Justice Department Settlement for Financial Fraud Leading up to and During the Financial Crisis (Aug. 21, 2014), http://www.justice.gov/opa/pr/bank-america-pay-1665-billion-historic-justice-department-settlement-financial-fraud-leading.

securities claims by the FDIC, $135.84 million to the SEC, and $943 million to settle claims by the states of California, Delaware, Illinois, Kentucky, Maryland, and New York. Bank of America will also provide $7 billion in consumer relief, including loan modification for underwater homeowners, refinancing for distressed borrowers, down payment and closing cost assistance to homebuyers, and donations to organizations assisting communities in redevelopment and affordable rental housing. Bank of America also agreed upon a 30 page statement of fact as part of the settlement. A monitor will be appointed to oversee Bank of America's efforts, and the settlement does not block the Justice Department from pursuing criminal cases against the bank or criminal or civil cases against individuals.

On July 14, 2014, the Justice Department announced that Citigroup, Inc. agreed to pay $7 billion to settle federal and state civil claims related to Citigroup's residential-mortgage-backed securities practices prior to the financial crisis.[97] The settlement includes a $4 billion civil penalty under FIRREA. Citigroup will pay $500 million to the FDIC and the attorneys general of California, Delaware, Illinois, Massachusetts, and New York. Citigroup will pay the remaining $2.5 billion in the form of consumer relief. An independent monitor will be appointed to oversee Citigroup's fulfillment of these obligations. The settlement also includes an agreed-upon statement of fact that describes how Citigroup made misrepresentation to investors about the quality of the mortgage loans it securitized and sold. The agreement does not release any individuals from civil charges, nor does it release Citigroup or any individuals from potential criminal prosecution.

Municipal Bonds

***SEC v. City of Harvey, Illinois, et al.*, No. 1:14-cv-4744 (N.D. Ill.)**

On December 5, 2014, the city of Harvey, Illinois, agreed to settle charges that the city misled investors in its municipal bonds.[98] On June 25, 2014, the SEC, for the first time,

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[97] Release, United States Department of Justice, Federal and State Partners Secure Record $7 Billion Global Settlement with Citigroup for Misleading Investors About Securities Containing Toxic Mortgages (July 14, 2014), http://www.justice.gov/opa/pr/justice-department-federal-and-state-partners-secure-record-7-billion-global-settlement.

[98] Release, United States Securities and Exchange Commission, City of Harvey Agrees to Settle Charges Stemming from Fraudulent Bond Offering Scheme, Rel. No. 23149, (Dec. 5, 2014), http://www.sec.gov/litigation/litreleases/2014/lr23149.htm.

obtained an emergency court order to stop the municipality from issuing a fraudulent bond offering. While investigating the city's past bond offerings, the SEC learned that the city had drafted misleading offering documents in advance of a new bond offering. The city will not pay a financial penalty and is settling without admitting or denying wrongdoing. The city must retain an independent consultant and audit firm.

Market Access

In the Matter of Wedbush Securities Inc., Proc. No. 3-15913

On November 20, 2014, the SEC announced that Wedbush Securities agreed to pay a $2.44 million penalty and admit wrong doing to settle charges that firm willfully violated the SEC's market access rule.[99] The SEC alleged that Wedbush failed to have adequate risk controls in place before providing customers access to the market through their systems, granting access to thousands of essentially anonymous overseas traders. Two Wedbush executives agreed to settle charges without admitting or denying the SEC's findings by paying a total of more than $85,000 in disgorgement, prejudgment interest and penalties. This marks the second SEC enforcement action taken over allegedly willful violations of its market access rule.[100]

Failure to Protect Data

In the Matter of Wells Fargo Advisors LLC, Proc. No 3-16153

On September 22, 2014, for the first time, the SEC charged a broker-dealer with failing to protect a customer's material, nonpublic information.[101] Wells Fargo Advisors LLC agreed to pay a $5 million penalty and admit wrongdoing for data-

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[99] Release, United States Securities and Exchange Commission, Wedbush Securities and Two Officials Agree to Settle SEC Case, Rel. No. 2014-263 (Nov. 20, 2014), http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370543504806#.VMGkg0fF9Bk.

[100] *See In the Matter of Knight Capital Americas LLC,* Proc. No. 3-15570. The SEC fined high-frequency trading house Knight Capital Americas LLC $12 million for failing to fix a coding mistake causing hundreds of millions of unwanted trades to be processed.

[101] Release, United States Securities and Exchange Commission, Wells Fargo Advisors Admits Failing to Maintain Controls and Producing Altered Document, Agrees to Pay $5 Million Penalty, Rel. No. 2014-207 (Sep. 22, 2014), http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370543012047#.VMFZwEfF9Bk.

control failures that facilitated insider trading on Burger King's acquisition by 3G Capital and for unreasonably delaying its production and providing an altered internal document related to its compliance review. A Wells Fargo broker learned confidentially of the acquisition and then traded on the nonpublic information. Multiple groups responsible for compliance or supervision within Wells Fargo received indications that the broker was misusing customer information, but they ultimately failed to act. Additionally, Wells Fargo document production initially omitted documents related to the broker's Burger King trades. These documents were produced six months later without explanation.

V. Investment Adviser and Hedge Fund Cases

In a speech on December 11, 2014, SEC Chair Mary Jo White spoke about the "evolution" of the asset management industry since the passage of the Investment Advisers Act of 1940 (Advisers Act), with the industry growing from $4 billion in assets under management at that time to more than $63 trillion today.[102] Chair White explained that this evolution led to "new risks and challenges" and, ultimately, for the SEC to take "important steps to recalibrate its program to better match the current 'facts on the ground.'" She noted that the SEC has "expanded and deepened its oversight of this industry," and emphasized the "significant tools" the SEC has under the federal securities laws to regulate it, including "controls on conflicts of interest," a "reporting and disclosure regime," and "controls on portfolio composition." Consistent with this, the SEC was very active in the second half of 2014 broadly applying these tools to investigate and, ultimately, bring enforcement actions against registered investment advisers and hedge funds in several priority areas, including the misappropriation of and improper custody of client assets, improper disclosures to investors, and manipulative trading activity.

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[102] Speech, United States Securities and Exchange Commission, Enhancing Risk Monitoring and Regulatory Safeguard for the Asset Management Industry, delivered by SEC Chair Mary Jo White before the New York Times DealBook Opportunities for Tomorrow Conference (Dec. 11, 2014), http://www.sec.gov/News/Speech/Detail/Speech/1370543677722#.VL7qT6Qo6e8.

Misappropriation and Custody Issues

In the Matter of Sean C. Cooper

On September 17, 2014, the SEC brought charges against Sean C. Cooper, a former money manager, for charging excessive management fees to the accounts of his former clients and then using this money to make lavish purchases, including a Porsche, and to remodel his multimillion-dollar home.[103]

According to the order instituting proceedings, Cooper managed a hedge fund for San Francisco-based investment advisory firm WestEnd Capital Management LLC. While WestEnd disclosed to clients that it would take a 1.5 percent management fee from their account balances, Cooper withdrew amounts that exceeded this percentage (approximately $320,000 in total) and transferred it to his personal bank account.[104]

WestEnd expelled Cooper, repaid the hedge fund, and ultimately settled charges the SEC brought for failing to effectively supervise Cooper, paying a $150,000 penalty and consenting to an order finding that it had violated various Advisers Act provisions and that it did not reasonably supervise Cooper, who had the sole authority to transfer money out of the accounts, as there were no controls in place to prevent improper withdrawals.[105] The administrative proceeding against Cooper is pending.

In the Matter of Sands Brothers Asset Management, LLC, et al.

On October 29, 2014, the SEC announced charges against

[103] Release, United States Securities and Exchange Commission, Former Hedge Fund Manager in Bay Area Charged With Taking Excess Management Fees to Make Lavish Purchases, Rel. No. 2014-200 (Sept. 17, 2014), http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370542975721#.VL77aKQo6e-.

[104] *In the Matter of Sean C. Cooper*, Investment Advisers Act Rel. No. 3920, Order Instituting Administrative and Cease-and-Desist Proceeding Pursuant to Sections 203(f) and 203(k) of the Investment Advisers Act of 1940, and Section 9(b) of the Investment Company Act of 1940 (Sept. 17, 2014), http://www.sec.gov/litigation/admin/2014/ia-3920.pdf.

[105] *In the Matter of Westend Capital Management, LLC*, Investment Advisers Rel. No. 3919, Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Sections 203(e) and 203(k) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions and Cease-and-Desist Order (Sept. 17, 2014), http://www.sec.gov/litigation/admin/2014/ia-3919.pdf.

an investment advisory firm and three employees for violating the "custody" rule, which requires compliance with certain procedures and rules when an investment adviser has control and/or access to a client's money or securities.[106] Investment advisers with custody of a client's money and securities can comply with this rule by issuing financial statements within 120 days of the end of the fiscal year. The SEC alleged that an investment advisory firm, Sands Brothers Asset Management LLC, was late in issuing these financial statements, and it charged three individuals, including its co-founders and chief compliance officer, with the firm's failure to comply with the custody rule.

According to the SEC, Sands Brothers was perpetually late in providing audited financial statements to its clients.[107] It is alleged that for the fiscal year 2010, Sands Brothers was at least 40 days late in providing their required financial statements to investors in at least 10 private funds; for the fiscal year 2011, the company was six to eight months late for these same funds; and for the fiscal year 2012, the company distributed their audited financial statements to investors three months later than required. The SEC noted in its order instituting the administrative proceeding that Sands Brothers was a repeat offender because it was sanctioned in 2010 for custody rule violations.

Improper Disclosure

In the Matter of F-Squared Investments, Inc. & SEC v. Howard B. Present

On December 22, 2014, the SEC settled with Massachusetts-based investment management firm F-Squared Investments on charges that it defrauded investors through the false advertising of its flagship product.[108] The settlement requires F-Squared to pay $35 million and admit

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[106] Release, United States Securities and Exchange Commission, SEC Announces Charges Against Investment Advisory Firm and Top Officials for Custody Rule Violations, Rel. No. 2014-242 (Oct. 29, 2014), http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370543316114#.VL72E6Qo6e-.

[107] *In the Matter of Sands Brothers Asset Management, LLC, et al.*, Investment Advisers Rel. No. 3960, Order Instituting Administrative and Cease-and-Desist Proceeding Pursuant to Sections 203(e), 203(f), and 203(k) of the Investment Advisers Act of 1940 (Oct. 29, 2014), http://www.sec.gov/litigation/admin/2014/ia-3960.pdf.

[108] Release, United States Securities and Exchange Commission, SEC Charges Investment Manager F-Squared and Former CEO With Making False Performance Claims, Rel. No. 2014-289 (Dec. 22, 2014), http://www.sec.gov/news/pressrelease/2014-289.html#.VL7-6qQo6e.

wrongdoing.[109] On this date the SEC also brought charges against F-Squared's co-founder and president, Howard Present, for making false and misleading statements to investors.

According to the settled order, F-Squared falsely advertised that one of its index portfolios (based on an algorithm) had a successful seven-year track record based on real results for real clients.[110] Yet the algorithm had not been in existence during the seven years of purported returns that were advertised.

According to the SEC's complaint against Present in the United States District Court for the District of Massachusetts, he was responsible for F-Squared's marketing materials, which were provided to current and prospective clients and displayed on its website.[111] He was also allegedly responsible for the SEC filings containing the false disclosures, because he certified those filings.

SEC v. Steven R. Markusen, et al.

On September 8, 2014, the SEC brought charges against Minnesota-based investment advisory firm Archer Advisors LLC; its owner, Steve R. Markusen; and an employee, Jay C. Cope, in the United States District Court for the District of Minnesota for two fraudulent schemes: misappropriating more than $1 million of hedge fund assets via false claimed research expenses and "portfolio pumping."[112]

According to its complaint, the SEC alleges that Archer's management fees were decreasing due to its poor

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[109] We discussed the SEC's new policy of seeking admissions in certain cases in our previous Executive Alert.

[110] *In the Matter of F-Squared Investments, Inc.*, Investment Advisers Rel. No. 3988, Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 and Sections 9(b) and 9(f) of the Investment Company Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order (Dec. 22, 2014), http://www.sec.gov/litigation/admin/2014/ia-3988.pdf.

[111] Complaint, *SEC v. Howard B. Present*, 1:14-cv-14692 (D. Mass. Dec. 22, 2014), http://www.sec.gov/litigation/complaints/2014/comp-pr2014-289.pdf.

[112] Release, United States Securities and Exchange Commission, SEC Charges Minneapolis-Based Hedge Fund Manager With Bilking Investors and Portfolio Pumping, Rel. No. 2014-187 (Sept. 8, 2014), http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370542887344#.VL8BV6Qo6e-.

performance.[113] As a result, Markusen and Cope initiated a scheme to reimburse Markusen for fake research expenses. This money was then routed to the owner's personal checking account to pay for a car and country club dues, among other things.

The SEC also alleges that Markusen and Cope sought to increase the monthly returns reported to investors and hide the extent of the funds' growing losses by "marking the close" of a thinly traded stock, CyberOptics Corp., which also happened to be the funds' largest holding.

In the Matter of The Robare Group, Ltd., et al.

As part of an enforcement initiative by the SEC's Asset Management Unit to root out undisclosed compensation arrangements between investment advisers and brokers, on September 2, 2014, the SEC brought charges against Houston-based investment advisory firm Robare Group Ltd. and its co-owners for recommending that clients invest in certain mutual funds without disclosing that the firm was receiving compensation from the broker offering the funds—approximately $440,000 in total over an eight-year period.[114]

The SEC alleges that Robare ultimately revised its Form ADV in December 2011 to disclose the compensation agreement but that this and later disclosures (which were reviewed and approved by the owners) still incorrectly stated that the firm did not receive any economic benefit from a non-client for providing investment advice and that it "may" receive compensation from the broker when in fact the firm was receiving payments.[115]

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[113] Complaint, *SEC v. Steven R. Markusen, et al.*, 14-cv-3395 (D. Minn. Sept. 8, 2014), http://www.sec.gov/litigation/complaints/2014/comp-pr2014-187.pdf.

[114] Release, United States Securities and Exchange Commission, Houston-Based Investment Advisory Firm and Co-Owners Charged With Failing to Disclose Conflict of Interest to Clients, Rel. No. 2014-183 (Sept. 2, 2014), http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370542808249#.VL8FxaQo6e-.

[115] *In the Matter of the Robare Group, Ltd. et al.*, Exchange Act Rel. No. 72950, Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 15(b)(6) of the Securities Exchange Act of 1934, Sections 203(e), 203(f) and 203(k) of the Investment Advisers Act of 1940, and Section 9(b) of the Investment Company Act of 1940 and Notice of Hearing (Sept. 2, 2014), http://www.sec.gov/litigation/admin/2014/34-72950.pdf.

Manipulative Trading Activity

In the Matter of Athena Capital Research, LLC

The SEC recently brought its first high-frequency trading manipulation case, sanctioning a New York City-based high-frequency trading firm, Athena Capital Research, for placing a substantial number of aggressive, rapid-fire trades in the final two seconds of almost every trading day during a six-month period in order to manipulate the closing prices of thousands of NASDAQ-listed stocks.[116] Athena agreed to pay a $1 million penalty to settle the SEC's charges against them without admitting or denying the findings.

The SEC alleged that Athena created an algorithm to "mark the close" to buy or sell stocks near the close of trading to manipulate their closing price.[117] According to the order, the sheer volume of Athena's last-minute trades—more than 70 percent of the total NASDAQ trading volume of the affected stocks in the seconds before the market close—allowed them to overwhelm the market's liquidity and direct the particular stock's price in its favor.

In its release accompanying the settled order, the SEC made clear that while traders "can certainly use complex algorithms and take advantage of cutting-edge technology," it concluded that Athena's actions amounted to fraud.

The SEC Sanctions Various Firms and Traders for Short-Selling Violations

In the second half of 2014, the SEC continued the initiative it began in the fall of 2013 to increase enforcement of Rule 105 of Regulation M.[118] Rule 105 prohibits the short sale of

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[116] Release, United States Securities and Exchange Commission, SEC Charges New York-Based High Frequency Trading Firm With Fraudulent Trading to Manipulate Closing Prices, Rel. No. 2014-229 (Oct. 16, 2014), http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370543184457#.VL8IMKQo6e8.

[117] *In the Matter of Athena Capital Research, LLC*, Exchange Act Rel. No. 73369, Order Instituting Administrative and Cease-and-Desist Proceedings, Pursuant to Section 21C of the Securities Exchange Act of 1934 and Section 203(e) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order (Oct. 16, 2014), http://www.sec.gov/litigation/admin/2014/34-73369.pdf.

[118] Release, United States Securities and Exchange Commission, SEC Charges 23 Firms With Short Selling Violations in Crackdown on Potential Manipulation in Advance of Stock Offerings, Rel. No. 2013-182 (Sept. 17, 2013), http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370539804376#.VL8MK6Qo6e9.

an equity security during a restricted period, generally five business days before a public offering, and then subsequently purchasing that same security through the offering.

On July 2, 2014, the SEC instituted settled administrative proceedings against five traders for violating Rule 105.[119] Pursuant to the settled order (which did not contain any admissions), each of the five traders agreed to cease and desist from violating Rule 105, to disgorge all of their ill-gotten gains plus prejudgment interest, and to pay an additional penalty equal to 60 percent of the disgorgement amount.

The traders worked for Worldwide Capital Inc., a Long Island, New York-based proprietary firm. They purchased the shares via accounts they opened in their names or names of alter ego corporate entities at large broker-dealers and then executed the short sales of the securities through an account in Worldwide's name at different, smaller broker-dealers. Earlier this year, Worldwide and its owner settled with the SEC on $7.2 million for violations of Rule 105, making it the largest-ever settlement for a Rule 105 violation.[120] The SEC continued this initiative when it announced on September 16, 2014, settlements with 19 firms (including three global firms) and an individual trader for Rule 105 violations.[121] Without admitting or denying the findings, the parties agreed to settle the SEC's charges and paid a combined total of more than $9 million in disgorgement, interest, and penalties.

[119] Release, United States Securities and Exchange Commission, SEC Charges Five Traders with Short Selling Violations, Rel. No. 2014-131 (July 2, 2014), http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370542226857#.VL8KqKQo6e.

[120] Release, United States Securities and Exchange Commission, SEC Announces Largest Monetary Sanction for Rule 105 Short Selling Violations, Rel. No. 2014-43 (Mar. 2, 2014), http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370540883326#.VL8LG6Qo6e8.

[121] Release, United States Securities and Exchange Commission, SEC Sanctions 19 Firms and Individual Trader for Short Selling Violations in Advance of Stock Offerings, Rel. No. 2014-195 (Sept. 16, 2014), http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370542963767#.VL8MWqQo6e.

VI. CFTC Cases and Developments

CFTC Orders Five Banks to Pay Penalties for Manipulation of Foreign Exchange Rates

On November 12, 2014, the CFTC issued five orders filing and settling charges against Citibank N.A., HSBC Bank plc, JPMorgan Chase Bank N.A., The Royal Bank of Scotland plc and UBS AG (the Banks) for attempted manipulation of global FX benchmark rates to benefit the positions of certain traders.[122] The orders, which do not contain any admissions, impose over $1.4 billion in civil penalties.

The orders also require the Banks to cease and desist from further violations and to implement and strengthen their internal controls, which include the supervision of their FX traders.[123] Benchmark rates are important because many individuals and companies rely on the rates to settle financial contracts, and this reliance is premised on the belief in the integrity of these rates.

According to the orders, certain FX traders at the Banks coordinated their trading with traders at other banks to manipulate the FX rates. Some of this conduct allegedly occurred during the same period that the Banks were on notice that the CFTC and other regulators were

[122] Release, Commodity Futures Trading Commission, CFTC Orders Five Banks to Pay over $1.4 Billion in Penalties for Attempted Manipulation of Foreign Exchange Benchmark Rates, Rel. No. PR7056-14 (Nov. 12, 2014), http://www.cftc.gov/PressRoom/PressReleases/pr7056-14.

[123] Release, Rel No. PR7056-14.

investigating other banks for attempting to manipulate LIBOR.

Hammering home the importance of this enforcement action, CFTC Chairman Tim Massad stated, “Integrity of the market place is a paramount concern to the CFTC, and today’s enforcement action should be seen as a message to all market participants that wrongdoing and foul play in the financial markets are unacceptable and will not be tolerated.”[124]

CFTC Charges Lloyds Banking Group and Lloyds Bank with LIBOR Manipulation

On July 28, 2014, the CFTC issued an order against Lloyds Banking Group plc and Lloyds Bank plc (collectively Lloyds) bringing and settling charges for false reporting and attempted manipulation of the LIBOR by employees of Lloyds and HBOS plc.[125] According to the settled order, in which Lloyds neither admitted nor denied the findings, the LIBOR manipulation allowed Lloyds to benefit trading positions. Pursuant to the settlement, Lloyds must now pay a $105 million civil monetary penalty, cease and desist from their violations of the Commodity Exchange Act, and adhere to specific requirements to ensure the integrity of LIBOR submissions in the future.[126]

Before HBOS was acquired by Lloyds in January 2009, the sterling and U.S. dollar LIBOR submitters at each bank allegedly altered LIBOR submissions to benefit the submitters’ and traders’ trading positions. Upon the consolidation of the two companies, the submitters, who were located in separate offices, allegedly coordinated with each other to adjust the LIBOR submissions to their benefit. Additionally, from 2006 to October 2008, the Lloyds yen LIBOR Submitter allegedly colluded with the yen LIBOR Submitter at Coöperatieve Centrale Raiffeisen-Boerenleenbank B.A. (Rabobank) to adjust their respective

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[124] Speech, Commodity Futures Trading Commission, Statement of Chairman Tim Massad on Today’s Forex Enforcement Announcement (Nov. 12, 2014), http://www.cftc.gov/PressRoom/SpeechesTestimony/massadstatement111214.

[125] Release, Commodity Futures Trading Commission, CFTC Charges Lloyds Banking Group and Lloyds Bank with Manipulation, Attempted Manipulation, and False Reporting of LIBOR, Rel. No. PR6966-14 (July 28, 2014), http://www.cftc.gov/PressRoom/PressReleases/pr6966-14.

[126] *Id.*

yen LIBOR submissions to benefit the trading positions of Lloyds and Rabobank.

CFTC Settles Charges Against Morgan Stanley for Failures Relating to Its Know Your Customer Procedures

On September 15, 2014, the CFTC settled charges against Morgan Stanley Smith Barney, LLC (Morgan Stanley) for improper supervision and records violations pertaining to its know your customer rules and procedures.[127] The settled order, in which Morgan Stanley neither admits nor denies the findings, requires Morgan Stanley to pay a $280,000 civil penalty and to disgorge commissions it earned from the accounts.

According to the order, Morgan Stanley failed to diligently supervise its officers, employees, and agents in opening and managing accounts held at Morgan Stanley in the name of a conglomerate that supposedly operated a hedge fund based in the British Virgin Islands. Despite the fact that Morgan Stanley's compliance procedures supposedly identify the British Virgin Islands as a high-risk jurisdiction, the SEC alleged that the opening and handling of these accounts did not trigger Morgan Stanley's know your customer procedures when they should have, allowing the conglomerate to continue a $35 million Ponzi scheme based in the United Kingdom.[128]

[127] Release, Commodity Futures Trading Commission, CFTC Fines Morgan Stanley Smith Barney for Supervision and Records Failures Relating to Its "Know Its Customer" Procedures, Rel. No. PR6998-14 (Sept. 15, 2014), http://www.cftc.gov/PressRoom/PressReleases/pr6998-14.

[128] *Id.*

VII. SEC Policy and Regulatory Developments

In the second half of 2014, the SEC continued to hone in on the problems that precipitated the financial crisis of 2008 by enacting several reforms designed to improve transparency, reduce risk, and enhance technological safeguards in the securities markets.

SEC Adopts Money Market Fund Reform Rules

In July 2014, the SEC adopted amendments to the rules governing money market mutual funds, through the enactment of structural and operational reforms to address run risks in these funds.[129] The new rules build on reforms adopted by the SEC in March 2010 to reduce interest rate, credit, and liquidity risks of money market fund portfolios, which were highlighted by the financial crisis. The new rules, among other things, require institutional prime money market funds to use a floating net asset value (NAV), which allows the share price of these funds to fluctuate based on market-based factors. Money market funds can no longer use the special price and valuation conventions that previously allowed them to maintain a constant share price of $1.00. Instead, the daily share prices of the money market funds will fluctuate along with changes in the market-based value of the funds' investments.

[129] Release, United States Securities and Exchange Commission, SEC Adopts Money Market Fund Reform Rules, Rel. No. 2014-143 (July 23, 2014),
http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370542347679.

In addition, the rules give fund boards the ability to impose liquidity fees on investors or to temporarily suspend redemptions, also known as “gates,” if a fund’s level of weekly liquid assets falls below a certain threshold. These tools can be used by money market managers in periods of stress to prevent investor runs on the funds. The rules also aim to improve transparency and diversification in money market funds by requiring the funds to disclose certain key asset information on their websites, and prohibiting the funds from investing more than 5 percent of their portfolio in a single issuer.

SEC Chair Mary Jo White stated that these reforms will “fundamentally change the way that money market funds operate. They will reduce the risk of runs in money market funds and provide important new tools that will help further protect investors and the financial system. Together, this strong reform package will make our markets more resilient and enhance transparency and fairness of these products for America’s investors.”

SEC Adopts Asset-Backed Securities Reform Rules

In August 2014, the SEC adopted new rules designed to enhance disclosures, transparency, and reporting in order to better protect investors in asset-backed securities (ABS).[130] ABS are securities backed by underlying loans, such as residential and commercial mortgage loans and auto loans and leases, which are bundled and sold to investors. Investors in ABS were hit hard in the 2008 financial crisis, which revealed that many investors were unaware of true risks associated with ABS and exposed a lack of transparency oversight by ABS issuers.

To address these problems and enhance investor protection, the SEC in April 2010 proposed rules to revise the offering process and disclosure and reporting requirements for ABS. The rules, which were enacted in August 2014 after a number of public comment periods, among other things (i) require additional disclosure (including standardized loan-level information) by issuers, (ii) revise the eligibility criteria for using an expedited offering process known as “shelf offerings,” and (iii) make other revisions to the offering and reporting requirements

[130] Release, United States Securities and Exchange Commission, SEC Adopts Asset-Backed Securities Reform Rules, Rel. No. 2014-177 (Nov. 19, 2014), http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370542776577.

for ABS. The rules also require issuers to file a preliminary prospectus with transaction-specific information at least three business days before the offering, giving investors more time to analyze the structure, underlying assets, and contractual rights associated with the ABS.

The loan-level information that issuers must disclose under the new rules must be provided in a standardized, tagged data format called eXtensible mark-up language (XML), which allows investors to more easily analyze the data. The types of information that must be disclosed include the credit quality of obligors, the collateral related to each asset, and cash flows related to a particular asset such as the terms, expected payment amounts, and whether and how payment terms change over time.

SEC Adopts Credit Rating Agency Reform Rules

Also in August 2014, the SEC adopted new rules pursuant to the Dodd-Frank Act to further regulate credit rating agencies with the aim of strengthening conflicts of interest checks and governance controls and enhance transparency.[131] The new rules, which implement 14 rulemaking requirements of the Dodd-Frank Act, are designed to enhance governance, protect against conflicts of interest, and increase transparency to improve the quality of credit ratings, and increase credit rating agency accountability. In particular, they require nationally recognized statistical rating organizations (NRSROs) to enact controls to ensure that (i) any newly developed credit rating methodology is subject to an appropriate review process and disclosed to the public, (ii) any newly developed quantitative models are evaluated and validated prior to being put into use and then periodically reviewed, and (iii) the NRSRO has sufficient competency and resources to evaluate obligors, securities, or money market instructions it has never rated before. They also require the NRSROs to conduct periodic reviews of credit ratings methodologies and internal control structure, including training programs and disciplinary measures.

[131] Release, United States Securities and Exchange Commission, SEC Adopts Credit Rating Agency Reform Rule, Rel. No. 2014-178 (Nov. 19, 2014), http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370542776658.

SEC Adopts New Regulation to Strengthen Technological Infrastructure of Securities Markets

In November 2014, the SEC adopted new rules designed to strengthen the technology infrastructure of the U.S. securities markets.[132] The rules[133]—together comprising Regulation Systems Compliance and Integrity ("Regulation SCI")—impose extensive new compliance obligations on certain alternative trading systems operators, market data information providers, clearing agencies, and national securities exchanges (SCI Entities), designed to reduce the occurrence of systems issues and improve resiliency when systems problems do occur.

Regulation SCI is the SEC's response to a number of high-profile disruptions in the U.S. securities markets involving technology failures, including the October 2012 closure of equities and options markets due to Hurricane Sandy (as discussed in our Executive Alert). The rules, among other things, require SCI Entities to implement reasonably designed written policies and procedures to ensure that their systems that support trading, clearance and settlement, order routing, market data (both consolidated and proprietary), market regulation, and market surveillance are able to maintain the SCI Entity's operational capabilities and promote fair and orderly markets. In the event of a systems disruption, these entities must take corrective action to mitigate harm to investors and market integrity, provide the SEC with immediate notice and status updates, and disseminate information to other affected industry participants. In addition, each SCI Entity will be required to conduct an annual review of its compliance with Regulation SCI and submit a report to the SCI Entity's senior management, its board of directors, and the SEC.

"The rules adopted today mark a historic shift in the Commission's regulation of the U.S. securities markets that will better protect investors by requiring comprehensive new controls for the technological systems that form the core of our current markets," said SEC Chair Mary Jo White. "The rules provide greater accountability for those responsible for

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[132] Release, United States Securities and Exchange Commission, SEC Adopts Rules to Improve Systems Compliance and Integrity, Rel. No. 2014-260 (Nov. 19, 2014), http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370543496356#.VLU7WhFOW0F.

[133] United States Securities and Exchange Commission, Regulations Systems Compliance and Integrity, 17 C.F.R. Parts 240, 242, and 249, http://www.sec.gov/rules/final/2014/34-73639.pdf.

our critical market systems, helping ensure that such systems operate effectively and that any issues are promptly corrected and communicated to market participants and the Commission."

VIII. The SEC Cooperation Program

Although the SEC did not report any non-prosecution agreements, deferred prosecution agreements, or declinations during the second half of 2014 (unlike in previous half years), its Cooperation Program still played a significant role in many different types of enforcement actions resolved throughout that period. In particular, the SEC provided cooperation credit to:

- Two municipal bond issuers—Kings Canyon Joint Unified School District and the state of Kansas—in connection with administrative settlements pursuant to its MCDC Initiative;
- Three companies—Layne Christensen Company; Bio-Rad Laboratories, Inc.; and Bruker Corporation—in connection with administrative settlements of violations of the Foreign Corrupt Practices Act (FCPA); and
- Bank of America Corporation in connection with its administrative settlement of federal securities law violations stemming from its alleged multibillion-dollar overstatement of its regulatory capital.

These settlements reflect the broad influence of the SEC's Cooperation Program and how it can benefit defendants operating locally or globally and subject to enforcement actions of all sizes—from a nominal trading violation to a multibillion-dollar regulatory violation. Despite the apparent differences between these enforcement actions, all but one

of the defendants enjoyed the same benefit.[134] None was required to include any admissions of fact in their settlements, which is a significant benefit in light of recent fears that the SEC's new admissions policy (as discussed in our previous Executive Alert) may soon become the norm and not an exception. Given the SEC's recent emphasis on publicizing the benefits of cooperation (particularly self-reporting and remediation), entities and individuals should take note of the following settlements to better understand how the Cooperation Program may be an advantage to them if they uncover misconduct on their own or are subject to an SEC investigation.

MCDC Initiative

In July 2014, the SEC entered its first settlement under the MCDC Initiative (as discussed in our 2014 Mid-Year Report) with an administrative order charging the Kings Canyon Joint Unified School District with disclosure violations.[135] According to the order, in which Kings Canyon neither admitted nor denied the findings, Kings Canyon failed to submit required continuing disclosures, which made its compliance statement in a November 2010 bond offering materially false. Consistent with the MCDC Initiative and pursuant to the settlement, Kings Canyon was not charged with a scienter violation and was not required to pay a civil penalty. However, Kings Canyon was required to disclose the order in its offering documents and to strengthen its compliance program through (i) establishing written policies and procedures, (ii) training its employees, and (iii) designating a responsible individual for ensuring compliance.

Then, in August 2014, the SEC entered its second settlement under the MCDC Initiative, which was also the third enforcement action against a state for misleading

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[134] Bio-Rad Laboratories, Inc.'s order did not include the standard "no admit, no deny" clause and instead included an admission that the SEC has jurisdiction over Bio-Rad and the subject matter of the proceedings because Bio-Rad contemporaneously settled DOJ criminal charges through a non-prosecution agreement that contained admissions of facts. *See* Release, United States Department of Justice, Bio-Rad Laboratories Resolves Foreign Corrupt Practices Act Investigation and Agrees to Pay $14.35 Million Penalty (Nov. 3, 2014), http://www.justice.gov/opa/pr/bio-rad-laboratories-resolves-foreign-corrupt-practices-act-investigation-and-agrees-pay-1435.

[135] *In the Matter of Kings Canyon Joint Unified School District*, Securities Act Rel. No. 9610, Order Instituting Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order (July 8, 2014), https://www.sec.gov/litigation/admin/2014/33-9610.pdf.

pension disclosures.[136] According to the order against the state of Kansas, in which the state neither admitted nor denied the findings, Kansas failed to disclose in eight bond offerings between August 2009 and July 2010 the significant unfunded liability in the state's pension system as well as the concomitant risk of non-appropriation of debt service. The order alleged that these disclosure deficiencies resulted from "insufficient procedures and poor communications" between different state agencies involved with the bond offerings. Consistent with the MCDC Initiative and pursuant to the settlement, Kansas was not charged with a scienter violation and was not required to pay a civil penalty. However, unlike Kings Canyon, Kansas was not required to undertake any remedial measures because, as the order noted, the state had already adopted new disclosure policies and procedures, including (i) designating responsible parties, (ii) mandating closer communication between state agencies, (iii) requiring annual training of key personnel, (iv) establishing a state disclosure committee, and (v) improving disclosure with respect to the state's pension funding progress.

Because the deadlines for underwriters and issuers to report violations has already passed (the deadlines were September 10, 2014, and December 1, 2014, respectively), the coming year should see more settlements pursuant to this MCDC Initiative. To the extent violations are reported or discovered after these deadlines, the SEC has recognized that, given the difficulties that issuers and underwriters have experienced in attempting to identify potential violations during the period before the SEC had implemented the Electronic Municipal Market Access system, it will "consider reasonable, good faith, and documented efforts in deciding whether to recommend enforcement action and, to the extent enforcement action is recommended, in determining relief."[137]

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[136] *In the Matter of the State of Kansas*, Securities Act Rel. No. 9269, 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 (Aug. 11, 2014), https://www.sec.gov/litigation/admin/2014/33-9629.pdf.

[137] Release, United States Securities and Exchange Commission, SEC Enforcement Division Modifies Municipalities Disclosure Initiative, Rel. No. 2014-156 (July 31, 2014), http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370542578459#.VMHlpqQo4y8.

FCPA Settlements

Based on the SEC's recent programmatic focus on FCPA enforcement and the admitted "difficulties in gathering specific testimony and documents from overseas that will be admissible at trial,"[138] it is not surprising that defendants have received significant credit for their cooperation in these cases. In a speech last year, SEC Enforcement Director Andrew Ceresney emphasized the importance of cooperation in FCPA cases, noting "I think any company that does the calculus will realize that self-reporting is always in the company's best interest." Director Ceresney explained that the SEC credits companies for "aggressively policing their own conduct and reporting misconduct" through a "wide spectrum of tools to facilitate and reward meaningful cooperation," including non-prosecution agreements like the one the SEC provided Ralph Lauren Corporation in April 2013 (as discussed in our 2013 Mid-Year Report) or "[m]ore commonly" through reduced penalties as discussed in the following cases.

Layne Christensen Company Administrative Order[139]

In October 2014, the SEC entered a settled administrative order charging Layne Christensen Company with violating the anti-bribery, recordkeeping, and internal controls provisions of the FCPA. According to the order, in which Layne Christensen neither admitted nor denied the findings, Layne Christensen made more than $1 million in illegal payments to foreign government officials in Africa and Australia through the company's wholly owned subsidiaries to obtain favorable tax treatment, customs approvals, and work permits from 2005 to 2010 that resulted in approximately $3.9 million in realized benefits. Pursuant to the settlement, Layne Christensen was ordered (i) to cease and desist from future FCPA violations; (ii) to pay disgorgement of approximately $3.9 million, prejudgment interest of approximately $900,000, and a civil penalty of $375,000; and (iii) to undertake to update the SEC with the status of its FCPA and anti-corruption-related remediation

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[138] Speech, Remarks at 31st International Conference on the Foreign Corrupt Practices Act, Delivered by SEC Enforcement Director Andrew Ceresney (Nov. 19, 2014) (Ceresney FCPA speech), http://www.sec.gov/News/Speech/Detail/Speech/1370543493598#.VMGt2aQo4y8.

[139] *In the Matter of Layne Christensen Company*, Exchange Act Rel. No. 73437, 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 (Oct. 27, 2014), http://www.sec.gov/litigation/admin/2014/34-73437.pdf.

and implementation of compliance measures over a two-year period from the date of the settlement.

The order also expressly indicated that the SEC "is not imposing a civil penalty in excess of $375,000 based upon [Layne Christensen's] cooperation." Director Ceresney reinforced this point, noting that, based on Layne Christensen's "extensive remediation, cooperation and self-reporting steps, we agreed to accept a significantly lower penalty from [Layne Christensen] than we otherwise might have sought."[140] Director Ceresney explained that the civil penalty was "around 10 percent of the disgorgement amount, whereas penalties have typically been closer to 100 percent of the disgorgement amount."

As described in the order, Layne Christensen's cooperation was indeed substantial. After learning of the alleged misconduct in 2010, Layne Christensen (i) initiated an internal investigation by outside counsel and forensic accounting experts; (ii) self-reported its findings to the SEC; (iii) publicly disclosed the potential FCPA violations; (iv) terminated four senior employees involved in the alleged misconduct; (v) conducted a comprehensive risk assessment of its worldwide operations, including strengthening internal compliance, policies, procedures, and controls; and (vi) cooperated significantly with the SEC's investigation, including providing real-time reports of its findings, producing translations of documents, and making foreign witnesses available in the United States.

Bio-Rad Laboratories, Inc. Administrative Order[141]

In November 2014, the SEC entered a settled administrative order charging Bio-Rad Laboratories, Inc. with violating anti-bribery, recordkeeping, and internal controls provisions of the FCPA. According to the order, subsidiaries of Bio-Rad made illegal payments to government officials through third-party agents to obtain government contracts in Russia, Vietnam, and Thailand from 2005 to 2010 that made Bio-Rad approximately $35.1 million in illegal profits. During this time, Bio-Rad's subsidiaries allegedly "demonstrated conscious disregard for the high probability" that these payments were improper,

[140] Ceresney FCPA speech.

[141] *In the Matter of Bio-Rad Laboratories, Inc.*, Exchange Act Rel. No. 73496, 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 (Nov. 3, 2014), http://www.sec.gov/litigation/admin/2014/34-73496.pdf.

and one of its general managers “ignored red flags, which permitted the scheme to continue for years.” Bio-Rad allegedly fostered an atmosphere of secrecy that led to this misconduct by, among other things, allowing country managers to communicate through many different personal email addresses with aliases and by referring to commissions through code words. Pursuant to the settlement, Bio-Rad was ordered (i) to cease and desist from future FCPA violations, (ii) to pay disgorgement of $35.1 million and prejudgment interest of $5.6 million, and (iii) to undertake to update the SEC with the status of its FCPA and anti-corruption-related remediation and implementation of compliance measures over a two-year period from the date of the settlement. The order also recognized that Bio-Rad contemporaneously agreed to enter into a non-prosecution agreement with the DOJ, which required a criminal penalty of $14.35 million.

Although the Bio-Rad order did not contain language (like that found in the Layne Christensen order), indicating that the penalty factored in Bio-Rad’s cooperation Director Ceresney stated that, based on its extensive cooperation, Bio-Rad only paid a criminal penalty of only 40 percent of the disgorgement amount, which is “a large reduction from the typical ratio.”[142]

As described in the order, Bio-Rad’s cooperation was significant and quite similar to the cooperation of Layne Christensen. The only material difference was that Bio-Rad self-reported the potential FCPA violations to both the SEC and the DOJ ***before*** conducting an internal investigation, which, by all accounts, was a risky move that appeared to ultimately pay off in a criminal non-prosecution agreement and reduced criminal penalty.

Bruker Corporation Administrative Order[143]

In December 2014, the SEC entered a settled administrative order charging Bruker Corporation with violating the recordkeeping and internal controls provisions of the FCPA. According to the order, in which Bruker neither admitted nor denied the findings, employees of Bruker’s subsidiaries made illegal payments of approximately

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[142] Ceresney FCPA speech.

[143] *In the Matter of Bruker Corporation*, Exchange Act Rel. No. 7385, 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 (Dec. 15, 2014), http://www.sec.gov/litigation/admin/2014/34-73835.pdf.

$230,000 to Chinese government officials in the form of non-business-related travel from 2005 to 2011 that made Bruker approximately $1.7 million in illegal profits. Pursuant to the settlement, Bruker was ordered (i) to cease and desist from future FCPA violations and (ii) to pay disgorgement of approximately $1.7 million, prejudgment of approximately $310,000, and a civil money penalty of $375,000.

Like Layne Christensen's, Bruker's order expressly indicated that the SEC "is not imposing a civil penalty in excess of $375,000 based upon [Bruker's] cooperation." Although this civil penalty is a greater percentage of the disgorgement amount than the civil penalty levied on Layne Christensen, Bruker was not required to undertake any further remedial measures pursuant to the order (unlike Layne Christensen and Bio-Rad, which each was required to report to the SEC on their compliance programs for a two-year period).

While the order noted that Bruker's cooperation and remedial measures (which were similar to those of Layne Christensen and Bio-Rad) helped it obtain reduced sanctions, it also appeared to suggest that the reduced sanctions were appropriate because the alleged misconduct was not as pervasive and widespread as Layne Christensen's or the result of the corporate culture like Bio-Rad's in light of Bruker's compliance program at the time of the violations. Instead, the order indicated that the alleged misconduct was allowed to occur as a result of Bruker's failure to implement adequate internal controls, including the failure to translate its training presentations on the FCPA, ethics, and compliance issues into local languages.

Bank of America Administrative Order[144]

In September 2014, the SEC entered a settled administrative order charging Bank of America Corporation with internal accounting control deficiencies and books and records violations for allegedly overstating its regulatory capital by $3.714 billion in its SEC filings from 2009 to 2013. According to the order, in which Bank of America neither admitted nor denied the findings, Bank of America failed to deduct certain realized losses on $52.5 billion of structured

[144] *In the Matter of Bank of America Corporation*, Exchange Act Rel. No. 73243, 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 (Sept. 29, 2014), http://www.sec.gov/litigation/admin/2014/34-73243.pdf.

notes and other financial instruments it assumed through its acquisition of Merrill Lynch & Co., Inc. in 2009. Pursuant to the settlement, Bank of America was ordered (i) to cease and desist from future violations of Section 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and (ii) to pay a civil penalty of $7,650,000. The order indicated that the SEC credited Bank of America for its substantial cooperation and remedial measures, including self-reporting and "improved documentation and spreadsheet controls, as well as enhanced internal controls around automation of processes, relating to its calculation and reporting of regulatory capital amounts and ratios." Significantly, the order did not require any additional undertakings.

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